2008: How Did a Housing Crisis Bring Down the Entire Planet?

In 2008, the collapse of Lehman Brothers triggered the worst financial crisis since 1929. But the real problem wasn't a single building or a single bank — it was an entire system built on repackaged debt sold as gold. Here is the anatomy of the disaster, explained simply.

The Analysis: A Time Bomb Built Brick by Brick

On September 15, 2008, Lehman Brothers, the fourth-largest US investment bank with $639 billion in assets, filed for bankruptcy. Within hours, global markets collapsed. Within weeks, the crisis spread to Europe, Asia, and Brazil. Millions of people lost their jobs, their homes, their savings — without ever having heard of "subprimes" or "CDOs".

How did an American real estate crisis manage to bring down the entire planet? The answer lies in one word: **interconnection**. But behind that word lies a fascinating and terrifying mechanism.

It all started in the 2000s, with very low interest rates set by the Fed. Banks had cheap money to deploy and turned to the booming US real estate market. Prices rose, confidence soared, and lending standards gradually loosened. Banks began lending to low-income, often unstable households at variable rates — the infamous **subprimes** (literally "below standard").

At this stage, the situation was risky but contained. What turned a local risk into a global bomb was **securitisation**. Banks didn't keep these loans on their balance sheets. They sliced them up, bundled them with other assets, and resold these packages as sophisticated bonds called **CDOs** (Collateralised Debt Obligations). Rating agencies, ill-equipped to analyse these complex structures, awarded them AAA ratings — the highest level of trust, reserved for the most solid governments.

These "triple-A" CDOs found their way into European pension funds, Asian banks, and American insurance companies. Everyone believed they held a safe asset. In reality, everyone held a piece of the same shaky American mortgage loans.

The Historical Fact: The Fall of Lehman Brothers

In 2006, US property prices began to fall. Subprime borrowers, whose monthly payments were indexed to variable rates, saw their repayments explode. Defaults piled up. The value of CDOs collapsed.

Bear Stearns, a major Wall Street player, was saved at the last minute by JPMorgan Chase in March 2008, with Fed support. But when Lehman Brothers found itself in the same situation six months later, the US government decided not to intervene. The signalling effect was devastating: if Lehman could fall, who was really safe?

Within 72 hours, the global interbank market froze. Banks stopped lending to each other, because no one knew who held what toxic assets. Credit stopped. Companies could no longer finance themselves. A global recession became inevitable.

> KEY FIGURES — THE 2008 CRISIS IN NUMBERS
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> **Lehman Brothers**: $639bn in assets, bankruptcy on September 15, 2008 — the largest in US history
>
> **Global losses**: estimated between $2,000 and $4,000 billion in destroyed value
>
> **US unemployment**: from 4.7% in 2007 to 10% in October 2009
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> **US public aid (TARP)**: $700 billion committed to save the banking system
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> **Return to pre-crisis levels**: the S&P 500 recovered its 2007 levels in 2013 — six years later

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The Anecdote: "The Big Short" and the Few Who Saw It Coming

In 2005, a doctor turned fund manager, **Michael Burry**, pored over thousands of pages of subprime loan contracts. He spotted what no one else had seen: these loans were built on sand. His models showed that defaults would explode as soon as variable rates began to rise.

He decided to **short** these CDOs — by buying insurance instruments called CDS (Credit Default Swaps) against their default. Problem: no one on Wall Street believed you could short this market. Banks created bespoke instruments for him, while mocking him.

When the crisis hit, Burry pocketed **more than one billion dollars** for his investors and $100 million for himself. His clients, who had threatened to sue him during the two years his position was losing value, were now writing him thank-you letters.

Burry's story illustrates a fundamental truth about investing: **the crowd is often wrong at extremes**. When everyone is convinced that an asset can only go up, that is precisely the

moment when risk is at its maximum.

The Concept: Moral Hazard and "Too Big to Fail"

The 2008 crisis revealed a concept economists had long understood but the public largely ignored: **moral hazard**. When actors know they will be bailed out by public authorities if they take too much risk, they are incentivised to take even more risk. This is the "**too big to fail**" problem.

Several large banks survived thanks to public money not because they didn't deserve to fall, but because their collapse would have brought down the real economy. Their executives were almost never prosecuted. This asymmetry — gains privatised, losses socialised — remains one of the most legitimate criticisms of the current financial system.

The Lesson for Your Portfolio

The 2008 crisis isn't just a page of history. It's a risk manual every investor should have read.

First lesson: complexity hides risk. When a financial product is too difficult to understand, it's a warning sign — not a badge of sophistication.

Second lesson: correlations rise in a crisis. Assets that are "uncorrelated" in normal times tend to collapse together in a panic. Diversification protects against normal crises, not systemic ones.

Third lesson: the market can be wrong for a very long time. Burry waited two years for his thesis to play out. Patience and conviction — grounded in analysis, not ego — are rare and precious skills.

At Axone Capital, we regularly revisit these historical crises not to instil fear, but to build a realistic risk culture. Understanding how the system can break is the best way to avoid being on the wrong side when it does.

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