

Being right too early in the market: why did Michael Burry nearly lose everything before he won?

Michael Burry saw the subprime crisis coming as early as 2005. Yet for almost two years his bet cost him money and his clients' trust. Here is why being right too early can be as expensive as being wrong.

The analysis: being right is not enough

Many investors believe that having the right idea is all it takes. It isn't. A correct idea has three enemies: **time**, **the cost of waiting** and **other people's patience**.

If you bet against a market, every month it keeps rising costs you something: fees, paper losses, or the confidence of the people who trusted you with their money. And if the wait lasts longer than your resources, you are forced out. Usually at the worst possible moment, just before your scenario plays out.

That is the whole difference between **being right** and **making money**. The first depends on your analysis. The second also depends on your timing, your position size and your ability to hold on.

A line often attributed to the economist John Maynard Keynes sums it up:

The market can stay irrational longer than you can stay solvent.

Michael Burry's story is the most famous illustration of it.

The historical fact: a market that "never goes down"

In the early 2000s, US housing takes off. Between 2000 and 2006, home prices almost double, according to the Case-Shiller index. One belief spreads everywhere: house prices never fall.

Michael Burry, a doctor by training who became the manager of Scion Capital, does what almost nobody else does. He reads the prospectuses of mortgage-backed securities, line by line. Inside, he finds subprime loans built around a trap: a low teaser rate for two years (around 4%), then a rate that jumps sharply (around 10%).

His conclusion: once those rates reset, millions of borrowers will be unable to pay. In 2005, he decides to bet against those loans.

The story: two years of paying to be right

To bet on defaults, Burry buys **CDS** (credit default swaps). Think of it as fire insurance on a house you don't own. You pay a small premium every year. If the house burns down, you collect almost its full insured value.

On paper, the bet is asymmetric: a loss limited to the premiums, a potentially huge payoff. But this is where timing comes in.

The carrying cost

Insurance has to be paid for as long as the fire doesn't happen. In 2006, house prices are still rising. Burry keeps paying his premiums, and his fund falls behind. This is the **carrying cost**: what you pay every month to keep a position open while you wait for it to work.

Pressure from clients

His investors see only one thing: a manager losing money while the market goes up. They are furious, and some want their money back. Burry makes a deeply unpopular decision: he **restricts part of the withdrawals**. Without that, he would have had to sell his CDS before the crisis proved him right.

The payoff

In 2007, defaults surge and subprime collapses. Burry's CDS are suddenly worth a fortune. His story was later told by Michael Lewis in the book *The Big Short*, made into a film in 2015.

KEY FIGURES — MICHAEL BURRY'S BET

Almost 2x : rise in US home prices between 2000 and 2006 (Case-Shiller index, rough order of magnitude)

4% then 10% : typical subprime loan rate, before and after the two-year teaser period (order of magnitude)

2 per 100 : rough annual CDS premium, to collect close to 100 in case of default

+489% : Scion Capital's performance, net of fees, from November 2000 to June 2008

About +3% : S&P 500 performance over the same period

The lesson for your portfolio

Burry won, but only just. With less control over withdrawals, or a position too large for his fund, he could have been forced to give up before 2007. History would then remember a manager who was wrong.

Three practical takeaways for individual investors:

- **Position size matters as much as the idea.** Strong conviction does not justify betting everything. The right size is the one that lets you survive a long wait.
- **Leverage shortens your clock.** With leverage, every move against you weighs more, and the market can force you out before your thesis plays out.
- **Measure the cost of waiting.** Fees, premiums, missed opportunities: a position that costs you every month must be sized with that cost in mind, not just the expected gain.

This story is also told on video in the "Anecdote de marché" (Market Anecdote) series on the Axone-Capital YouTube channel.

At Axone Capital, we often say that good analysis is only half the job. The other half is building a position that can last until the market proves you right.

Frequently asked questions

What does being right too early mean in investing?

It means correctly predicting a market move, but long before it happens. While you wait, the position can lose money or rack up costs. If you have to exit before the outcome, your correct analysis earns you nothing.

How did Michael Burry bet against subprime mortgages?

He bought CDS, contracts that work like insurance against mortgage defaults. He paid a regular premium, and those contracts soared in value when defaults exploded in 2007.

Why did Burry's investors want to leave?

Because in 2006 the housing market was still rising and the fund was losing money on the premiums it paid. From the outside, the bet looked bad. Burry had to restrict part of the withdrawals to keep his positions.

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