

# One Guy Who Has Seen It All Doesn't Like What He Sees Now

By E.S. BROWNING  
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Peter Bernstein has witnessed just about every financial crisis of the past century.

As a boy, he watched his father, a money manager, navigate the Depression. As a financial manager, consultant and financial historian, he personally dealt with the recession of 1958, the bear markets of the 1970s, the 1987 crash, the savings-and-loan crisis of the late 1980s and the 2000-2002 bear market that followed the tech-stock bubble.

Today's trouble, the 89-year-old Mr. Bernstein says, is worse than he has seen since the Depression and threatens to roil markets into 2009 and beyond -- longer than many people expect.

Mr. Bernstein, whose books include "Against the Gods: The Remarkable Story of Risk," sees two culprits. One is the abuse of securitization -- the trend for banks to hold fewer loans on their books and instead turn them into securities that were sold to other investors. The other is simply years of overborrowing by financial institutions and consumers alike.

Mr. Bernstein is hopeful that Federal Reserve intervention will prevent deflation and depression, but he says there is no guarantee.

Excerpts of a recent interview:

**WSJ:** Aside from securitization, what were the main causes of the problem?

**Mr. Bernstein:** You don't get into a mess without too much borrowing. It was sparked primarily by the hedge funds, which were both unregulated by government and in many ways unregulated by their owners, who gave their managers a very broad set of marching orders. It was a real delusion. It was like [former New York Gov. Eliot] Spitzer: "I am doing something dangerous, but because of who I am, and how smart I am, it is not going to come back to haunt me."

When you think about how all of this will work out in the long run, we are going to have an extremely risk-averse economy for a long time. The lesson has painfully been learned. That's part of the problem going forward. You don't have a high-growth exit from this, as you've had from other kinds of crises. We won't have a powerful start, where the business cycle looks like a V. Here, the shape of the business cycle is like an L, where it goes down and doesn't turn up. Or like a U, a flat U. The reason for that is that people aren't going to get caught in this bind again. They will tell themselves, "I'm too smart to do that

again." And everyone else is going to be saying the same thing. It is, in fact, going to be a wonderful environment in which to take risk, because there aren't going to be any excesses.

I'm a child of the Depression, and I am thinking about what the early years were like after World War II. It took a very long time to get the memory of the Depression out of business decisions, and certainly banking decisions. I think this is going to be the same. The Fed, too, is going to be less decisive and is going to feel that what it should do is less clear. One of the things that gave people a sense that they could afford to take risks was the sense that the central bankers more or less know what they are doing. But I don't think we are going to feel that way going forward.

**WSJ:** You said that it could turn out that the smart thing to do is to take more risk, because everyone will be so risk-averse. What kinds of investments do you see as the big winners coming out of this?

**Mr. Bernstein:** You could say: the things that have been beaten down the most, which would be real estate. But I think real estate is going to be under a cloud for so long, and you can't buy real estate with cash, it is too much money. I think you should go with the stock market. If things are better, the stock market will go up, and if things are awful, the stock market is going to be way down. But it is a place where, if you want to take risks, you've got a wide range of choices. This is why I own stocks [in addition to other investments], because I don't know where the bottom is going to come, and I want to be exposed to every kind of possibility I can think of. And, at least, if you pick the stock market and you are wrong, you can change your mind. There is some liquidity there. Stocks never became cheap, but they didn't become crazy, the way other assets were.

**WSJ:** How long do you think this whole process will take, before we get back to normal?

**Mr. Bernstein:** Longer than people think. The people who think we will have turned in 2009 are wrong. There has to be a respite along the way. Nothing goes in one direction forever. But it will take longer than people think. If that weren't the case, I would be talking entirely differently. I would be saying, "What an opportunity we have got." And I just can't believe that the opportunity is here yet. There is too much to unwind.

**WSJ:** Can you explain the reason you think it will take a long time?

**Mr. Bernstein:** We have to go back to a moment when people have the courage to borrow and lenders have the courage to lend. Until credit is going up instead of down, you can't have growth. Housing has got to be a very important part of that; it always has been. You have to reach a point where somebody says, "This house is cheap, I am going to buy it," or where some businessman says, "This is a great opportunity for us to expand our business. Everything is available to us."

If China goes into a recession, God knows. The Iraq war and the whole situation with terrorism, we really don't know where that is going to come out. There are so many

things that have got to get buttoned down before you say that the future looks good enough to take a risk.

**WSJ:** What kind of indications are you looking for as signs that the economy is about to get better and that the stock market and the investment world are about to turn the corner?

**Mr. Bernstein:** Somehow, the housing trouble has to at least flatten out. As long as that is going on, I think the pressure on the credit system is going to persist. It is kind of the leading indicator. It is where the trouble started. We have to underpin the consumer. That is why this is different. That is why this is like nothing we have had before.

Before, it was investment that made the V at the bottom of the business cycle. I don't see real investment turning enough without some sign from the consumer side. Maybe the foreign countries will do it for us. That is a substitute for consumption here. Maybe. But I think that they won't do enough for us, and maybe will be too infected by us to do it. But maybe growth in Asia will help us. The Asian thing is tremendously exciting.

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