



SuperModels 9/16/2008 2:15 PM ET

## Poof! There go Americans' dreams

So much for the fairy tale about the little guy buying stocks for a sweet life and a safe retirement. Now that vision is crumbling along with some of Wall Street's giants.

By [Jon Markman](#)

As one major financial institution after another succumbs to crushing losses this year, it is mourning in America for the hopes of average working people who believed in the myth of stock ownership as a sure path to a better life now and a safe retirement later.

It may sound like a gross exaggeration to say that the dreams of Main Street are dying on Wall Street this week, but it is a fair interpretation of recent events. For the capital that is required to fund businesses, schools, streets, farms, vacations, homes and cars is quite literally evaporating like dew at the start of a summer day with the untimely death of every bank, brokerage and insurance company.

Where did the money come from, and where has it gone? It's an interesting saga, and it will take just a few minutes to tell. Let me warn you first that it starts out like a fairy tale but quickly becomes a horror story, so I'll be sure to tell you when to cover your eyes.

### The times that Wall Street forgot

For years, banks, brokers and insurance companies have besieged us with marketing claims that the regular purchase of shares in public companies would effortlessly grow in value forever.

Never mind that there have been long periods in the past century -- such as, roughly, 1929 to 1932, 1937 to 1949 and 1965 to 1982 -- when this simply wasn't true. It has been valid enough in the recent consciousness, from 1982 to 2000, and with that hopeful seed planted, the same ad whizzes who depend on our natural human optimism to buy all manner of fluff took it from there.

This hasn't always been the case -- far from it. During the first 90% of the industrial age, companies that wanted to grow their businesses were required to convince committees of stingy men at banks that their projects were worth investing in. Those committees were loath to put their firms' capital at risk, so they demanded both collateral and personal-liability agreements from supplicants. Except for brief and disastrous interludes of public participation in Europe -- each of which ended with 100 years of citizens' abstinence from capital markets -- only people of great means financed industry.

**Talk back:** [Do you see the American Dream slipping away?](#)

But in the middle of the 20th century, an unchecked ambition to build big projects across the United States and Asia was married to the development of mass-market advertising techniques, and the practice of persuading average moms and dads to put hard-earned money to work in big business with little fear as to its safety was born.

Railroad and shipping barons of earlier times would be shocked to discover how little concern most people have exercised in the past few decades when plunking their salaries into mutual funds or individual stocks. The idea of risk-free investing, to people who really take the risks and thus understand them, is laughable.

It is only now, during this period of acute crisis, that individuals who won't go on a bicycle without a plastic-foam helmet are coming to grips with what business risk really means. And that is why a childlike innocence is dying along with the stock market this week, making people feel as sad, helpless and angry as when they first discovered the truth about other realities of adulthood.

Unfortunately, it is not just working people who are learning these lessons. It is investment-industry workers, too, and supposedly sophisticated hedge fund managers and bank executives, not to mention government officials and regulators. For virtually all have succumbed to the falsehood that risk is just a four-letter synonym for opportunity to some degree or another. They have stumbled into making bets at a casino whose rules they don't really understand and that are not, in any case, written down.

### Neither a borrower . . .

At this moment, at trading-desk workstations and brokerage back offices around the globe, there is a process of creative destruction taking place -- not just of capital but of beliefs. Every financial institution is trying to come to grips with how much exposure it has to **Lehman Bros.** ([LEH](#), [news](#), [msgs](#)), the 158-year-old investment bank that has just declared itself insolvent with almost \$650 billion in liabilities.

These institutions are likewise trying to figure out how much exposure they have to thrift **Washington Mutual** ([WMM](#), [news](#),

[msgs](#)), which may find itself in bankruptcy court before the week is out. (Insurance titan **American International Group** ([AIG](#), [news](#), [msgs](#)) has also been a worry, but a government rescue announced Tuesday evening will likely keep it out of bankruptcy.)

### Video on MSN Money



#### ▶ [Does market hinge on AIG?](#)

If American International Group can find the capital it needs, it will end the current panic. If it can't, look for more selling -- especially in Asia, says MSN Money's Jim Jubak.

You might think it would be a simple matter for businesses to figure out how much money they have at risk in their relationships with these troubled companies, but that's not the case. I'm told by insiders that even in this digital age, billions of dollars in liabilities are toted up each day on paper and must be hand-counted, double-checked and cross-referenced by branch managers who are much more accustomed to long golfing weekends than tedious back-office work.

As one example, consider that Lehman was one of the 10 largest dealers in the world of a type of widely popular bond-insurance instrument called credit default swaps, or CDSs, which meant they were the middlemen between two parties -- a buyer and a seller -- that didn't know each other. CDSs allow bondholders to hedge against the possibility that their security will default and allow speculators to bet on the possibility of bond defaults. It's one of the largest types of instruments in the world, with a total of about \$60 trillion in nominal value, but also the least regulated.

#### [Continued: Raising cash -- and fear](#)

It will take days for owners of CDSs bought through Lehman to determine how much they have, much less to create a paper trail to present at bankruptcy court and to possibly find the counterparty to which they either owe money or by which they are owed. By some estimates, Lehman had 2 million CDS contracts outstanding.

Meanwhile, these trading operations are not doing anything productive to earn their companies money -- and the ones that were using CDSs as a hedge, rather than as a speculation, are frantically trying to find new counterparties with which to trade even though they don't know exactly how much money they have to work with. I'm told it's literally been chaos at big companies for three days, with people making mistakes and freaking out as they work 20 hours a day.

#### **Raising cash -- and fear**

Now, don't think anxiety has descended just in the back office. All day long, both regulators and stock analysts have been calling security dealers' chief executives to ask them about their liabilities, assets and collateral. When reports are published later in the week, you can bet that any reports listing companies with more liabilities than collateralized assets will lead to major equity and credit downgrades, and further serious stock losses.

When credit and equity are downgraded, contracts demand that companies come up with additional collateral to backstop their own liabilities. That means assets ranging from common stocks to U.S. Treasuries to equipment to asset-backed securities will flood the market over the next couple of weeks as companies speed to meet their obligations.

OK, now here's the place where you may need to cover your eyes.

Satyjit Das, a credit derivatives expert based in Australia, told me in a phone interview Monday from Singapore that these events have "essentially destroyed the capacity of the banking system to provide funding to businesses." He added: "Investment banks have destroyed their capital by making foolish loans on a massive scale, and the chance that they will get new capital, as they did back in the spring, is low. If you are a sovereign wealth fund and give new money to Wall Street now, you look like a chump. They won't be sugar daddies anymore. It won't fly politically at home. It isn't going to happen."

So who's going to refill the capital well? You may have heard that money does not grow on trees, and neither can countries actually "print" money, since that actually involves the sale of new bonds at a time when the market is flooded with them.

Well, U.S. Treasury and Federal Reserve officials have urged American banks to pool together a \$70 billion fund to bail out weaker members of their tribe. But Das scoffed at the effort as a nonstarter, considering they are all equally desperate to hold on to their capital: "It's like the deaf . . . volunteering to help the blind," he said.

So you can see why stock markets are suffering. The credit engine that has fueled the planet's economic growth is now kaput, as banks and governments have downshifted from risk-taking mode into survival mode. The only hope now is that the unraveling will not accelerate and become an uncontrolled spiral into the ground.

"The European Central Bank and U.S. Federal Reserve have held international financing together with chicken wire and hope, and only now are people seeing how fragile it has been for years," Das said. "As the contraction of credit feeds out into the real economy, business expansion will grind to a halt, unemployment will soar, and consumer spending will falter -- all of which leads, in turn, to lower production and more unemployment."

## 2 games in 1

Almost a year ago to the day, as **Bear Stearns'** hedge funds were first unraveling and banks were about to start announcing billion-dollar write-downs, Das told me in [this column](#) that the credit crisis had not even reached the first inning and that the deleveraging process would be a prolonged event.

Now he thinks the financial part of the game is in the fifth inning, as it has raced toward the inevitable conclusion of large-company bankruptcies faster than he expected. There are only so many major institutions that can go under, after all, and already two are dead, and two more are on the brink.

### Video on MSN Money

---



#### [▶ Does market hinge on AIG?](#)

If American International Group can find the capital it needs, it will end the current panic. If it can't, look for more selling -- especially in Asia, says MSN Money's Jim Jubak.

Yet it turns out we're in a double-header, and the nightcap involving the crushing of the "real economy," which is where all of us live and work, is only in the first inning -- as companies are just starting to cut back jobs in a serious way to match diminished business and the loss of borrowing power. On Monday, **Hewlett-Packard** ([HPQ](#), [news](#), [msgs](#)) and Lehman Bros. announced plans to lay off 25,000 people each.

Now we just have to hope this game isn't called because of darkness.

*At the time of publication, Jon Markman did not own or control shares of any company mentioned in this column.*