Life After Lehman

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A year ago today, US investment bank giant Lehman Brothers filed for bankruptcy, sending shock waves reverberating through global financial markets. Whether the US Treasury was right to let this happen still remains open to much debate. Either way, at the time, the news, despite being highly depressing, played up the key view of my colleagues and I that another US financial institution would go to the wall after the Bear Stearns fiasco. In fact, we had even put forward the idea of a Lehman Brothers collapse way back in March 2008. More importantly, our extremely bearish view of US equities, which we had held since November 2007, when the Dow was trading at 13,200, really started to bear fruit, big time.

Aside from accelerating our bearish view of global equities, the Lehman Brothers event played another important role in our analysis, this time in March of this year. At that time, the Dow was exhibiting a strong reversal pattern on the monthly chart. However, the fact that the macro environment was so dire made us wary of going long. Yet, when we looked back to the severe market dislocations and extreme political ill-feeling caused by the collapse of Lehmans, we realised that the new Obama administration was not going to let another major financial institution go to the wall, thereby putting a floor under bank stocks. This highly important assumption, along with the monthly reversal pattern, and added to the fact that nobody we knew, or read, shared our view that bank stocks would rally, allowed us to promote a bullish stance on US financial stocks, which we are delighted to say has returned over 40.0%.

Anyway, enough of the past, what about the future? The Dow is trading close to key resistance at 9,660. If it can break above this level, which we think likely at some point soon, it can trade all the way back to 10,000, with the next major resistance level coming in at 10,200 on the monthly chart. It would almost be like Lehman's bankruptcy never happened, right? Wrong. Such a move would not be the start of a bull run back to the pre-crisis highs. Although the fundamentals have improved, which we said they would back in March, as bank stocks rallied and fiscal stimuli took effect, they are still not good. Yes, the US exited recession in Q309, but the deteriorating employment situation coupled with a highly reticent consumer will keep US growth below trend for several years to come. Disappointment on the growth front will lead to disappointment on the earnings front, which in time will cap this rally. For the time being, so long as the Dow holds key support at 9,300 we will continue to be stock friendly.