Unfortunately people are not donkeys

I was editor-in-chief of VBA Journaal from 2001 until 2008. We had just emerged from a period when most of the articles that we received were written by academics. Quite often, this meant that the content of the magazine and the requirements and interests of our readers were not properly aligned. From 2001 onwards it was mainly authors who actually worked in the financial sector that provided us with articles. In the beginning, this took some effort on our part, but the process became easier as time went on – especially because as editors we actively tried to come up with interesting themes and looked for authors to match.

The dominant theme in the 2001 – 2008 period was pensions. Articles were written about subjects such as performance measurement at pension funds, the introduction of the Financial Assessment Framework and the investment policies of pension funds. In that respect, not much has changed yet in the financial sector. Pension funds are still very much in the spotlight, although currently the focus is on the introduction of a new pension system. The strong focus on pension investing is not just a reflection of the substantial size of pension assets in the Netherlands (around € 1,500 billion), but also of the amount of knowledge regarding pension policies that is available in the Netherlands. Another subject that was much discussed during this period is alternative investments, including hedge funds, infrastructure, commodities and private equity. During those years, many institutional investors in the Netherlands made room in their investment portfolios for alternative investments. That has not changed over time, although the composition of these investments has. Most institutional investors in the Netherlands do not (any longer) own hedge funds or commodities.

Interestingly, around 2008 the first articles about factor investing and socially responsible investing began to appear. We had no idea then that these forms of investment were destined to become so prevalent. They also remained important themes in VBA Journaal after 2008.

When I joined as editor-in-chief, we were still dealing with the aftermath of the TNT crisis. The value of the S&P 500 had almost halved and the economy was in the throes of a recession. At the end of the 1990s all of us briefly believed that this time everything would be different, that a new era had begun, characterised by strong economic growth owing to presumed productivity gains that would be realised due to all sorts of new technological applications. In 2000 we came to the conclusion that we had been wrong. Again, we had let ourselves get carried away by unbridled optimism. And yes, if you are optimistic you are also prepared to take more risk. And that is exactly what happened. Of course we would never let this happen again. Because, as a Dutch saying goes, a donkey generally does not trip over the same stone twice! But unfortunately, people are not donkeys

When I retired as editor-in-chief in 2008, we were once again in midst of a crisis. This time it was a credit crisis linked to the US housing market. The factors that contributed to this crisis are diverse. For a start, there were the aggressive interest rate cuts by the Fed, which responded to the economic contraction by cutting its official rate from 6.5% to 1% in the space of one year. The accommodative monetary policy caused lending the soar. This was also reflected in house prices, as between

2002 and 2006 house prices rose at an average annual rate of 13% – 14%. And there was another problem. The quality of mortgagors deteriorated over time. These mortgagors not only included house buyers with a precarious financial position, but also financially healthy but excessively leveraged house buyers. Normally you would expect banks, as gatekeepers, to ensure that the risks remain limited, but unfortunately that is not how it works. Because they neatly repackaged those mortgages as structured products, had S&P and Moody's give them attractive ratings and subsequently sold those mortgages on to institutional investors. These transactions generally made the banks money. In order to arrive at their ratings, the rating agencies only used their rearview mirrors and as a result, many subprime mortgages had high ratings. For institutional investors a high rating was sufficient guarantee that all was in order. In the end, the whole house of cards collapsed, causing sharp price falls on the equity and bond markets, as well as another economic recession.

The common ground between the crisis of 2000/2001 and the 2008 crisis is human behaviour. In the years that preceded the credit crisis we also saw unbridled optimism. Taking on a huge amount of debt to buy a house was not a problem, because house prices would continue to go up. And on top of that, interest rates were very low, so that also meant that being highly leveraged was not a problem. Banks also had no problem with this. Of course there are always doomsayers who tell us that things cannot go on as they are, but you always get those. Things were fine in recent years, weren't they? Why would everything suddenly change. Right? The collapse of Lehman was the event that set off a financial avalanche and thus put paid to all the fantasies about eternal prosperity and good things never coming to an end. The most important lesson that 2001/2002 and 2008 have taught us is that people are incorrigible and have a flat learning curve and short memories. The longing for a positive narrative is so great that this blots out negative memories from the past. The positive take on this, is that it produces an interesting and dynamic market environment. A more important conclusion that we must draw, is that for financial market participants, effective behavioural supervision is essential, backed up by effective nudges and incentives. I doubt that this will prevent financial crises in the future, but let's hope that it will contribute to some damage limitation.

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