

More

Create Blog Sign In

Viable Opposition

Subscribe To

 Posts 

 Comments 

About Me

A Political Junkie

I have been an avid follower of the world's political and economic scene since the great gold rush of 1979 - 1980 when it seemed that the world's economic system was on the verge of collapse. I am most concerned about the mounting level of government debt and the lack of political will to solve the problem. Actions need to be taken sooner rather than later when demographic issues will make solutions far more difficult. As a geoscientist, I am also concerned about the world's energy future; as we reach peak cheap oil, we need to find viable long-term solutions to what will ultimately become a supply-demand imbalance.

[View my complete profile](#)

Total Pageviews



5,333,402

Popular Posts - Last 30 Days

THURSDAY, MAY 1, 2014

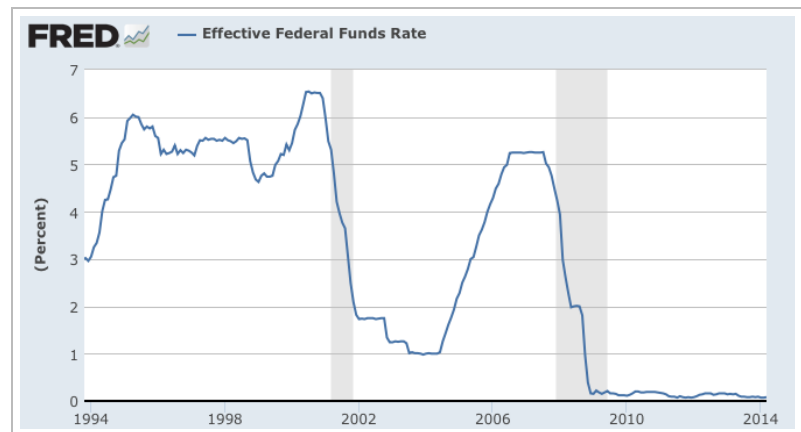
Collateralized Debt Obligations - An Unlearned Lesson

Updated August 2014

Back in October 2013, I posted a [brief](#) on the return of collateralized debt obligations or CDOs, those toxic little gems that helped bring the financial world to its knees in 2008 - 2009.

I thought that it was time for an update to see what the great minds of Wall Street are selling to their discerning clientele and how much they are selling.

Let's take a quick lesson in exactly what CDOs are, remembering that [this](#) is what happened to interest rates over the past two decades:



Back in the early 2000s, as investors began to get more than a little perturbed about the dropping returns on their fixed income investments, Wall Streeters creatively began to bundle together assets of widely varying types, including loans, mortgages and leases that served as collateral for the CDO. The idea was that these "no risk", high grade investments would generate a stream of cash flow to investors and a massive stream of cash flow to the issuing investment banks and their employees.

These bundled assets were sold to individual investors, pension funds and governments who desperately needed higher returns in what was then thought to be a low interest rate environment, not unlike today. Unfortunately, as investors

Barbara is a Chemical Engineering graduate with a Masters in Management Science. She has been a member of the Board of Directors of the International Association of Chemical Engineers (IACHEC) for over 10 years. She is also a member of the American Chemical Society (ACS) and the American Nuclear Society (ANS). She is currently a Senior Lecturer in the Department of Chemical Engineering at the University of Toronto.

[The World Economic Forum - Board of Trustees and Canada's Ego-In-Chief](#)

The World Economic Forum, the international non-governmental organization that believes that it has the answers for everything that ails the...



[The People Behind the World Economic Forum's Great Reset](#)

If you haven't been paying attention, it may surprise you to find out that the Great Pandemic of 2020 is being used by one of the world's...



[The Bank of Canada - How Canadians Feel about a Canadian Dollar CBDC](#)

There is little doubt that the world is heading towards a central bank digital currency-dominated future, thanks to the efforts of organizat...

[Blogs I Like](#)

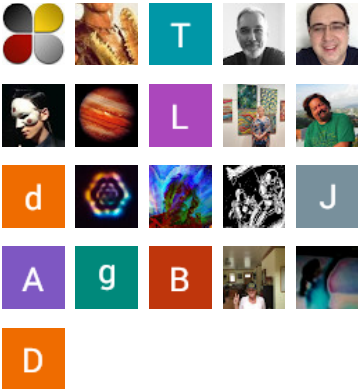
[Off Guardian](#)

[Moderate Poli](#)

[Financial Sense](#)

[My Followers](#)

Followers (489) [Next](#)

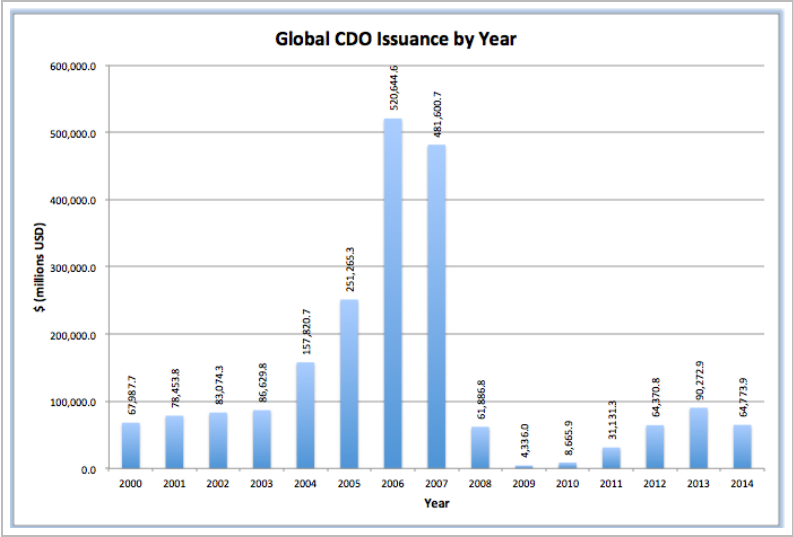


[Follow](#)

found out the hard way, many of these collateralized debt obligations contained a substantial measure of toxic debt, particularly subprime mortgages which were accompanied by very high default rates. So much for the "assets" and "collateral". Despite their AAA rating, many of these CDOs plunged in value, taking the aforementioned investors on a long and painful downhill ride. **According to estimates made in 2012 by the [Federal Reserve Bank of Philadelphia](#), of the \$641 billion worth of structured finance asset-backed securities collateralized debt obligations (that's a mouthful!) or SF ABS CDOs that traded at the desks of the major investment banks in the United States, a total of \$420 billion or 65 percent of the total will be written down!**

Now, a sane person would think that investment bankers and investors learned from their mistakes and would refrain from making the same error in judgement again. Perhaps not, as we will see.

From SIFMA, here is a graph showing the global volume of CDOs by year issued since 2000:



You'll notice the very sharp drop off in issuance of CDOs when the bottom fell out in 2008. Both Wall Street and investors got wise and dropped the idea of issuing and purchasing CDOs. By 2009, only \$4.3 billion worth of CDOs were issued, down 99 percent from the peak year.

Now, let's look at the recent past. Looking at 2013, while we haven't yet reached the heady year of 2006 when \$520 billion worth of CDOs was issued, the volume is definitely moving upward, hitting \$90.3 billion for the year, up from 28.7 percent from 2012. In the first and second quarters of 2014, \$64.774 billion worth of CDOs were issued, the second highest two quarter total since the first half of 2007 and the \$38.775 billion

Blog Archive

- 2023 (114)
- 2022 (162)
- 2021 (218)
- 2020 (225)
- 2019 (197)
- 2018 (227)
- 2017 (241)
- 2016 (249)
- 2015 (250)
- ▼ 2014 (272)
 - December (26)
 - November (20)
 - October (22)
 - September (24)
 - August (23)
 - July (27)
 - June (17)
 - ▼ May (13)
 - [You Are What You Eat](#)
 - [The Decline of Entrepreneurship In America](#)
 - [The Amazon Factor and America's Changing Retail En...](#)
 - [The Death Penalty and the United States](#)
 - [Crushing America's Economic Potential](#)
 - [Young American Workers](#)
 - [Hooked on Cheap Credit in America](#)
 - [The Relatively Jobless Recovery](#)
 - [The Trade Links Between Europe and Russia](#)
 - [Declining Homeownership in America](#)
 - [What Southeast Ukraine Wants](#)
 - [The Low-Wage Employment Recovery - The Illusion Co...](#)
 - [Collateralized Debt Obligations - An Unlearned Lesson](#)
- April (21)

in Q2 2014 is, by a wide margin, the highest quarter total since 2007 as well. Wall Street and their overseas counterparts could well be setting us up for the first \$100 billion CDO year since 2007 if the issuance rate seen in Q1 and Q2 2014 continues.

So, have the world's investment banks and investors learned a lesson from the Great Depression? Apparently not. The "too big to fail" mantra of 2008 - 2009 is alive and well and living in the hallowed executive suites of the world's largest banks.

Posted by A Political Junkie at [7:30 AM](#) 

Labels: [CDO](#), [Wall Street](#)

3 comments:

Anonymous [May 1, 2014 at 2:24 PM](#)

Why would they learn anything, none of them went to jail, and the government bailed them out with US tax payer money. They have nothing to lose, everything to gain.

[Reply](#)



Bruce Wilds [May 7, 2014 at 8:39 AM](#)

The more and more I study derivatives it now appears the main goal of QE may have been to hold up the underlying value of assets that feed into and support the massive derivative market more than help the economy. QE has up to now stopped an implosion of derivatives and the resulting contagion and shock that would have spread throughout the financial system.

Paul Wilmott from Oxford University estimates the derivatives market at \$1.2 quadrillion, to put that in perspective it is about 20 times the size of the world economy. The point of the article below is to call attention to the insanity of derivatives as an instrument or tool to add stability to our financial system. By stacking risk upon risk and transferring it off to another party who may not be able to preform you do not increase stability.

<http://brucewilds.blogspot.com/2014/03/derivatives-house-of-cards.html>

[Reply](#)



The Business Student [September 30, 2015 at 7:27 PM](#)

It is interesting to see that so many individuals who take the time to understand CDOs and their part in the recession in 2008 have the same

- ▶ [March](#) (25)
- ▶ [February](#) (25)
- ▶ [January](#) (29)
- ▶ [2013](#) (255)
- ▶ [2012](#) (232)
- ▶ [2011](#) (153)
- ▶ [2010](#) (186)

take on the issue.

While I do think that these financial instruments do have a place in the finance world and can help us make borrowing cheaper, there needs to be a stronger understanding by the finance community.

Check out this article for a similar take on it:
www.businessasusualblogs.wordpress.com

[Reply](#)



Enter Comment

[Newer Post](#)

[Home](#)

[Older Post](#)

Subscribe to: [Post Comments \(Atom\)](#)