

Michael Lewitt on the Key Issues in the Credit Crisis

By Robert Huebscher

September 23, 2008



Michael Lewitt is the President and co-founder of Harch Capital Management (HCM) based in Boca Raton, FL. Mr. Lewitt authors The HCM Market Letter, a monthly review of the financial markets and political world. His work is cited widely in the financial press, and he is scheduled to appear on *60 Minutes* in connection with the current crisis. Mr. Lewitt's op-ed piece, [Wall Street's Next Big Problem](#), appeared in the *New York Times* on September 16 and Mr. Lewitt's article, [The Fall of Lehman – How to Fix It – Part II](#), also appears in this issue.

Mr. Lewitt spoke with us on September 19, 2008.

What are the near-term events investors can expect from the market? What do you expect will be the fate of Citibank, Morgan Stanley, Goldman Sachs, and Wachovia? Do you expect to eventually see large-scale bank failures similar to what occurred during the S&L crisis?

In the near term, we can expect more volatility. I expect Morgan Stanley to try to stay independent, but it is very likely it will be forced into a merger with a larger depository-taking institution. I expect Goldman and Citigroup to stay independent for the moment. I do expect many smaller banks to merge or go out of business because of bad mortgages or bad real estate loans.



In your article “The Fall of Lehman – How to Fix It – Part II” you make a number of recommendations to “correct the excesses” that led to the crisis. Which of these should take the highest priority now in light of current events?

First should be limiting financial institutions' leverage. Second should be regulating the derivatives market and creating a central clearing house for the credit derivatives market. Leverage limitations should be placed on credit default swap (CDS) trades. After that, there is a long line of things that must be done, but those would be my top two priorities.

You have written that the major credit rating agencies still inexplicably retain an enormous amount of power. How would you address this problem?

Credit agencies may need to be changed into not-for-profit institutions or government agencies in order to be relieved of the conflicts of interest that compromise their intellectual independence. In the meantime, investors should ignore what they say because they have destroyed their credibility.

When will the economy begin to feel the inflationary impact of the bailout measures, and how severe do you expect that inflation to be?

It will take a couple of years for the inflationary impact to be felt, but it will be severe and long-lasting once it begins.

You have written that the only safe investments now are “Gold, short-term U.S. Treasuries, short-term Swiss and German government paper, the Swiss franc, and certain Asian currencies like the Singapore dollar.” Would you completely avoid the global equities markets?

I would urge individual investors to completely avoid equities right now. The market is trading like a casino. Institutional investors are behaving like a bunch of nervous Nellies and would do better to think before they act for a while. My answer is the same for investors with a two year time line. I think stock market risk will remain high for at least that long.

Is there a nightmare scenario that scares you and, if so, what is that scenario and how likely is it?

I think we saw the nightmare scenario, the failure of AIG. The only other nightmare scenario out there is the collapse of General Electric Credit, and I have no reason to believe that would happen. If we haven't seen Armageddon, we better hope we never see it because we came as close as possible to a complete collapse of the global financial system this week.



www.advisorperspectives.com

For a free subscription to the Advisor Perspectives newsletter, visit:
<http://www.advisorperspectives.com/subscribers/subscribe.php>