Bear Stearns from 20 Billion to 236 Million and Beyond

What a difference a year makes. Last year at this time Bear Stearns had a high flying stock price of $150 a share and a market valuation of 20 Billion. Having been founded in 1923 they were considered one of Wall Streets most venerable investment houses.

Going back to 2005 Bear Stearns was selected as "Most Admired" securities company in Fortunes annual survey a distinction they retained until 2007. During this time period many of the decisions that would lead to their eventual downfall were being made. In the middle of 2007 the armor of Bear Stearns started to crack. The subprime problems were beginning to explode. Basically it was becoming clear to the financial industry that many of the subprime loans that had been given out over the last few years were not going to be repaid.

One of Bear Stearns funds, the "High-Grade Structured Credit Fund", started to falter. In a sign of things to come when Merrill Lynch acquired 850 million of the collateral for the fund they were only able to auction it off for 100 million.

A problem started to develop with two of Bear Stearns funds that operated as hedge funds. The interesting word here is hedge fund. Hedge funds basically operate under the philosophy that by investing in a large number of loans that are somewhat risky you minimize the risk. While a few individuals might go into foreclosure the investor is protected because they have invested in a high number of loans. The problem the financial industry started to realize in mid 2007 was that a large number of these were going into foreclosure. In July these two hedge funds had lost nearly all of their value.

By August lawsuits had started flying as angry investors started to sue over their losses alleging that Bear Stearns had not property disclosed their exposure to hedge funds. A few months later Bear Stearns declared write down of 1.2 billion on their securities.

2008 brought more problems for Bear Stearns. Rumors started to circulate that Bear Stearns was having cash problems. JP Morgan started to provide emergency funding to Bear Stearns but it did not seem to stop Bear Stearns slide into financial chaos. This led to the final offer of 240 million for Bear Stearns. Not only was this substantially less than the 20 billion Bear Stearns was worth a year ago, but it was less than the value of Bear Stearns headquarters in New York which is valued at 1.2 billion. The fact that the purchase price is lower than the value of the real estate owned by Bear Stearns is seen as a sign that many of the financial assets Bear Stearns owns have a negative value.

Another interesting point is comparing Bear Stearns to Countrywide. Both were large institutions with exposure to the subprime real estate market. But Countrywide was seen as a free wheeling company that almost ignored risk and rose fast and feel fast. In contrast Bear Stearns was seen as an older company that had weathered through multiple recessions. But in the end the same market brought both these companies to their knees. Basically spreading out risk among many subprime borrowers does not help if the real estate market weakens resulting in a large percentage of borrowers going into default. Hopefully the collapse of Bear Stearns will serve as a warning lesson for future companies. And the warning lesson hopefully will not only be remembered only in bad times, when it is frequently too late, but in good times when the seeds are sown for future financial turmoil.

About the Author

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Source: http://www.spivo.com