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Buy, Sell, Hold (Tight) From Trading Rooms to Living Rooms, A Frenzied Eight Days

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and PETER LATTMAN

ONE of the most harrowing stretches in Wall Street history began with the loss of the AAA credit rating of the United States and ended with fears of a new recession. In between, the wild swings in the financial markets captivated the nation, and the world.

Even financial professionals were grasping for answers. Many were selling — and many were buying as fast as they could. Each was making a bet on whether last week was a hiccup, or the start of something worse.

9:45 p.m. Friday, Aug. 5: Waterbury Center, Vt.

As she watched her beloved Red Sox battle the Yankees, Karissa McDonough opened her laptop to check e-mail.

Jumping off the screen was a subject line from a news alert at 9:03 p.m.: “U.S. Long-Term Debt Downgraded by Standard & Poor’s.”

She stared at her screen in disbelief. Ms. McDonough, the chief bond strategist at People’s United Bank in Connecticut, had spent her working life analyzing the debt of companies and governments. This news, however, was surreal. This happened in other countries. Not here.

“We were just downgraded!” she exclaimed to her husband.

“Who’s we?”

“The United States!”

She had to react swiftly. Clients might panic. Money managers at People’s United would need to know what to say. She began tapping on her laptop. At 11:02 p.m. she sent an e-mail to more than 100 colleagues. The downgrade, she told them, was “historic but not catastrophic.”

Ms. McDonough went on: “The U.S. Treasury market remains the safest, largest, most liquid investable asset class in the world.” Governments like China’s, she said, would be hard-pressed to find a better alternative.



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Michael Warlan, left, of Third Avenue, a Manhattan fund company, with David Barse. Mr. Warlan pulled something close to an all-nighter on Sunday and barely slept the rest of the week. “It was adrenaline,” he said.

She collapsed into bed. She had a sinking feeling that her vacation on Cape Cod, scheduled for the coming week, was about to be downgraded, too.

Noon Saturday, Aug. 6: Pasadena, Calif.

Stephen Walsh, the chief investment officer of Western Asset, had been expecting the e-mail all day.

“How do you think the markets will respond on Monday?” a worried official from the United States Treasury asked him.

A few weeks earlier, Western Asset, one of the nation’s largest bond fund managers, had asked Standard & Poor’s for a private briefing about America’s credit rating. S&P had already announced that there was an even chance that the nation’s AAA rating might be lowered.

The S&P analysts were prohibited from saying more. But when they met with Western Asset, it was clear that the odds had worsened. “You could tell a lot by their body language, how carefully they answered certain questions,” said one of the people in those meetings. The analysts didn’t say anything specific, but they didn’t have to. Afterward, Mr. Walsh took his top lieutenants into his office, one by one. A downgrade is inevitable, he told them. We need a plan.

Now, it had happened. The previous night, the once unthinkable had occurred. The Treasury official from Washington wanted to know how Mr. Walsh — a man who indirectly controls half a trillion dollars in assets — thought the markets would respond. The Treasury was planning to sell billions of dollars of new

bonds in the coming week. If buyers didn't materialize at the auctions, it could be disastrous for the government, the financial markets and the entire global economy.

"I think investors understand it's not that big a deal," Mr. Walsh told the Treasury official.

It was the same thing he had been saying all day to colleagues, hedge funds and investment banks seeking his advice. "U.S. Treasuries are still the most high-quality instrument out there," he told them. People need a safe place to put their money, and if the downgrade unsettled the stock market, as he suspected it would, investors would flock to safe investments like Treasuries, regardless of S. & P.'s opinions.

"World investors didn't downgrade U.S. debt; S. & P. did," he told one caller. "It's just one opinion."

When he hung up, his wife turned to him. "What if you're wrong?" she asked.

"That's the great thing about Wall Street," he replied. "We'll know Monday morning if I'm a genius or an idiot."

11:30 p.m. Sunday, Aug. 7: East 66th Street, Manhattan

It looked like a sell-off. Not a panic like the one that had struck in 2008, but something different.

Michael Warlan, who heads equity trading for Third Avenue, a mutual fund company in Manhattan, sat in his home office on the Upper East Side, fielding calls and sending instant messages to brokers around the globe.

Amid the turbulence, he smelled opportunity.

Third Avenue, with \$15 billion in assets under management, had in recent months moved about 12 percent of its money into cash. Its strategy is to invest in undervalued stocks — and in May, June and July, there had been precious few good deals to be found. Now, Mr. Warlan sat with a list of stocks he had been eyeing for months. Many were dropping close to the target prices that Third Avenue had been seeking. His colleagues were calling.

The consensus: it was time to buy.

Mr. Warlan started executing trades in foreign markets, pausing for a nap around 2 a.m., then waking at 4 a.m. for the opening of European markets. Without stopping to sleep any more, he went to his office that morning, at the corner of Third Avenue and 41st Street, a few blocks from Grand Central Station. By close of business on Monday, he had spent \$110 million to buy stocks around the world.

"It was adrenaline," he would later say. "Pure adrenaline."

4:30 a.m. Monday, Aug. 8: Pasadena

Working in California, Mr. Walsh started his day before sunrise — to be ready for the opening bell in New York. It was

the first day of United States trading after the debt downgrade.

The stock market opened down, and then grew worse. The sell-off had actually started the day before. Mideast markets had nosedived on Sunday. Futures contracts in Chicago had tumbled. As stocks and corporate bonds fell, Mr. Walsh walked over to one of his traders, a young man with a shaved head, facial scruff and the posture of a man who spends a lot of time sitting in front of a Bloomberg terminal.

They had worked up a list of companies that they suspected would suffer from a spooked market. Ford. HCA. Energy stocks. As the trader watched his screens, he saw that those companies' bond prices were trading 8 percent to 10 percent below their expected range. It didn't make any sense: Ford's finances hadn't changed over the weekend. HCA — a large hospital chain — hadn't stopped admitting patients. It was as if investors were dumping anything with a hint of risk, and, paradoxically, rushing to Treasuries, the very securities that S. & P. had just downgraded.

"You see opportunities?" Mr. Walsh asked.

"Yup," said the trader, Walter Kilcullen. "Stuff is being offered, and no one wants to bid."

Western Asset had set aside \$700 million for just such an opportunity. It was a one-time fire sale — as long as their instincts were right. And no one would know for at least a month, maybe longer. "Let's do it," Mr. Walsh said.

Mr. Kilcullen punched a button on his keyboard, picked up the phone and started bidding on bonds that, seemingly, no one else wanted to touch.

Even as the market panicked, Western Asset wasn't selling. Mr. Walsh was convinced that the future of the American economy was as strong as it had been on Friday.

4 p.m. Tuesday, Aug. 9: Broad and Wall Street

As the closing bell sounded on the New York Stock Exchange, traders glanced at the Dow: after plunging 635 points the day before, it closed up 430 points, one of the wildest swings in recent memory. At Third Avenue and Western Asset, traders bided their time, waiting for the panic to strike again.

10 a.m. Wednesday, Aug. 10 Bridgeport, Conn.

On the wall of the People's United in downtown Bridgeport, the flat-screen television broadcasts CNBC. The news is that the Dow had plummeted more than 300 points in less than an hour.

Thirteen floors above, in a spare corner office overlooking the Connecticut Turnpike, John Traynor, the bank's chief investment strategist, prepared for an

hourlong call with his team. A bronze sculpture of a bull and bear wrestling sat on his desk.

"There are seven participants on the call, including you," said the computerized operator.

Ms. McDonough, the strategist, had dialed in from Cape Cod, where she had sent her husband outside to chase around their children.

Mr. Traynor told his colleagues that by Friday he wanted a memo sent to clients detailing the bank's thoughts on the market turmoil. He peppered them with questions. Was there a risk that the other two big ratings agencies might strip the United States of its AAA status? What would prompt People's to reduce its exposure to equities? Are financial stocks a buy at these prices? Should the money managers adjust their bond allocations after the Federal Reserve said on Tuesday that it would keep interest rates until mid-2013?

"We're in the preservation-of-capital business, and I don't want to make a quick trade," Mr. Traynor said.

Forty-five minutes into the call, Albert Brenner, a senior portfolio manager, brought up Europe. During the discussion, concerns about French and Italian banks had set off a fresh wave of selling, driving the market down 420 points.

"I'm worried about Europe, and worried about the way that the market is worried about Europe," Mr. Brenner said. Another portfolio manager agreed and suggested that the problems overseas were of even greater concern than the issues facing the United States.

"We've seen a flight to quality rearing its head as money has come out of weaker sovereigns and into U.S. treasuries," this manager said.

Mr. Traynor looked up from his notes. It wasn't just Greece, Portugal, Italy and Spain that were in trouble, he said. Maybe big European banks were exposed to all that debt.

"That's a situation no financial institution wants to be in and could have serious consequences."

Noon Wednesday, Aug. 10 Midtown Manhattan

Third Avenue spent another \$110 million on Tuesday, and the pace of buying then slowed a bit. At a series of meetings, analysts had the chance to present their "pound-your-fist ideas," trades so appealing that you're willing to pound the table to convince the company to buy.

In the oval conference room, Jakub Rehor, a senior research analyst, was extolling Allianz, the huge German insurer and owner of the bond giant Pimco. A handful of colleagues were ready to challenge him, mostly to test the strength of his convictions.

Deflation would be toxic for Allianz, argued Amit Wadhwaney, who leads the

group. Could Europe handle deflation as stoically as the Japanese? he asked.

"It happened in Switzerland," Mr. Rehor answered. "Switzerland has been living with it. Twice in the last decade."

"But Switzerland is one country. Germany, France, Italy, Spain — there are these divergent interest groups," Mr. Wadhwaney said. The European economy, bound by a currency but not much else, seemed to be fraying. Wealthy countries like Germany were beginning to chafe at demands that they bail out their poorer neighbors.

"Yes, so it's not even clear who has their hands on the steering wheel," Mr. Rehor said. "This is a car with 15 steering wheels."

Which led to another question: Will the Europeans start printing money, as an alternative to further bailouts? The consequence of that could be rampant inflation. On the other hand, it would be almost impossible for some nations to reclaim their former prosperity without turning on their printing presses.

"They probably will print the money," Mr. Rehor said. "Once it looks like one of the big guys — Italy, France, Spain — is in trouble, they'll look at the size of the problem and say, 'We can't fix it with the bailout fund.'"

8 p.m. Wednesday, Aug. 10 Pasadena

That night, Mr. Walsh watched the news with his daughter, who had just received her first paycheck as a kindergarten teacher. Scenes of rioting in England flashed on the screen. The two had been talking about the week's financial upheavals. The United States, Mr. Walsh told her, was fundamentally secure.

But Europe was a different matter. The stability of some European banks was unclear, he worried. As much as Congress was bickering in the United States, the politics were even worse in Greece, Italy and Britain. It was hard for Mr. Walsh to get his arms around European politics, to understand who was ultimately in charge. It wasn't clear that anyone had a plan for how to react if another crisis took hold.

"Could that ever happen here?" his daughter asked, pointing to the images of Britons setting cars on fire and looting stores.

"I don't think anything like that could happen here anytime soon," Mr. Walsh replied. But there were reasons for concern. Social services were likely to be cut further in many states as governments grappled with a slow recovery and declining tax revenue, he said.

"If we can't get our act together, it could come here," he told her. "I worry that what we're seeing in Europe is coming to a theater near us."

11:43 a.m. Thursday, Aug. 11 Pasadena

As President Obama's face appeared on the giant TV screens at the front of the room, traders stood up from their desks to watch. The president was speaking at a battery company in Holland, Mich., his words intended to calm jittery investors.

His voice came from small speakers on each trader's desk. Except for the television and the cricket chirps of ringing phones, the room was quiet. Someone had installed a large smiley face along one of the rafters.

"There's nothing wrong with our country," the president said. "There's something wrong with our politics."

Walter Kilcullen, the trader who was buying up bonds for Western Asset during the fire sale, glanced at his neighbor. Mr. Kilcullen hadn't shaved that morning. He looked exhausted. He had been getting up at 3:30 a.m. every day, buying everything he could find at the right price — deploying hundreds of millions of dollars — and then hitting the gym to blow off steam, then staying up late at home to re-analyze his trades.

His girlfriend kept telling him to come to bed. He was too tired to explain why this was not the week to catch up on his sleep.

Back at the office, he thought to himself that he had made some good purchases. He had bought one class of bonds when they were 10 percent below normal prices, and then watched them climb 5 percent, a multimillion-dollar profit in a few days.

But it didn't matter. His overall portfolio was down for the week, battered by the downgrade. Over time, it would probably climb again. But he would end the week at a loss.

He rubbed his eyes and pointed to the president on the screen. "At least he

didn't say the bond market is oversold," he told his neighbor. They laughed.

"Blah blah blah blah," someone at the back of the room said to Mr. Obama's image.

Mr. Kilcullen switched off his speaker and turned back to his screen. There were more bonds to buy.

12:30 p.m. Thursday, Aug. 11 Midtown Manhattan

With the market lurching both up and down, David Barse, the chief executive of Third Avenue, asked about conversations that one of his investment groups, called the credit and distressed team, had been having with clients concerned enough to call and check in.

"They really want to hear the inside story," said Tom Lapointe, a member of the team. "Because they read the paper and everyone's drawing graphs that say: 'My God, it's just the beginning of 2008. Look at how this correlates. If that's the case don't we have 80 percent more downside?'"

"What are you telling them?" Mr. Barse asked.

"If risk reprices, risk reprices across the board," Mr. Lapointe answered. "I can't give them the surety of knowing because I don't know. I know it's different this time, and I also tell them, 'By the way, every time someone tells me something is different this time, I always hold my wallet.'"

3:50 p.m. Friday, Aug. 12 Midtown Manhattan

Michael Warlan, the Third Avenue trader, sat in front of a half-dozen computer monitors and watched the market drift to a quiet close — a modest gain for the day. As the minutes ticked away, he was still shopping, having spent close to \$400 million on stocks in the span of five days.

He scoured his screens one last time. Nothing. The closing bell rang through a television that was tuned to CNBC. He slapped a palm on his desk. Time to head home.

Looking back on the hundreds of trades he made this week, was he happy?

"I'm happy we had a plan in place for these very circumstances," he said.

And the trades themselves? "Talk to me in 6 to 12 months."