

Bruner, Robert F. & Carr, Sean D. – The Panic of 1907

John Wiley & Sons, 2007, [Equity Investing] Grade ★★★★★

When historic financial crashes are discussed the US Wall Street crisis of 1929 to 1932 often springs to mind. The less well-publicized crisis of 1907 might not have been just as brutal but it was still severe. The stock market declined by 37%, 42 banks and financial institutions went under and in 1908 the US and many other areas around the world saw an “intense” depression. It was a crisis with classic bank runs that had a long lasting effect on the organization of the American financial system. Robert Bruner and Sean Carr of the University of Virginia set out to explore what we can learn from the 1907 events.

In the introduction the authors propose a loosely held framework for how financial crises can be understood and explained. They offer a model with multiple factors that influence the development, instead of succumbing to the one-trick-pony rationalizations of many pundits – “it was the greedy bankers” or “it was the stupid politicians” etc. The major part of the book describes the historical events but in a concluding analytical chapter Bruner and Carr return to their model.

It is obviously a good thing to bring these perhaps too forgotten events into the spotlight. The historical account is despite its sometimes-complex content very readable. The main character of the book is undoubtedly John Pierpont Morgan. Even if the details, companies and persons of this crisis are specific to 1907 the chain of events are easily recognizable from other late day crashes. One thing is however different, the US had no central bank in today’s meaning. J.P. Morgan accompanied by George Baker at the First National Bank and James Stillman at the National City Bank instead shouldered the role as the lender-of-last-resort, in the end - and after many late night sessions - bringing calm to the markets.

The public reactions to the rescue endeavors were however mixed. Some hailed Morgan as a hero. In an increasingly radicalized US where the public

opinion often was against Big Finance others accused the “money trust” to have exploited the crisis to their own gain. Morgan had to appear in a number of hostile congressional hearings. In 1913 the Federal Reserve System was formed to take on the role that Morgan and his partners had had previously. Ironically the FED was formed from a blueprint drawn up by much the same investment bankers the bank was set to replace.

So what are the components of the authors’ model of financial crises? They start with the statement that the financial market must be seen as a system where the actors interact with each other by decisions taken on imperfect information. This opens up for contagion where trouble will travel and the chain of events are more often than not non-linear and thus impossible to predict. Some pre-conditions for a bust is a preceding economic boom with increasingly voluminous and loosely controlled credit growth and add to this political decisions within financial and monetary policies that too often affect the market pro-cyclically. An economic shock that manages to reverse the psychological climate then triggers the crisis and greed turns into fear. When collateral values and trust disappear, liquidity quickly does the same. Collectively beneficial calmness is tossed aside as everyone runs for the exit simultaneously.

This book is published pretty much on the top of the 2002 - 2007 bull market. Yet, even if the authors in my opinion identify the components of a crisis correctly the forward looking part that rounds up the concluding section is completely devoid of the factors that only a few months later will create an even worse crisis than the one in 1907. This is no critique but only serves to show how hard it is to foresee financial calamities in advance. For anyone that wants to understand the coming financial crisis – whenever it arrives – it will be beneficial to read this well written account of the events that helped to shape the world we live in today.

Mats Larsson, October 19, 2017