MARKET MAYHEM · RESEARCH SHEET · EPISODE 15

The Big Short

How Wall Street Burned the World — the 2008 Financial Crisis

United States / Global · 2008 · v1.0 · July 2026

On 15 September 2008, Lehman Brothers, 158 years old, filed the largest bankruptcy in American history, and the global credit system very nearly stopped. Underneath a mountain of jargon, mortgage-backed securities, CDOs, credit default swaps, sat a single simple bet that American house prices could not fall everywhere at once. They did.

Key Facts

Event	The Global Financial Crisis of 2008
Location	United States, then the entire global financial system
The Collapse	15 September 2008 — Lehman Brothers files the largest bankruptcy in US history
The Machinery	Subprime mortgages packaged into securities, CDOs and credit default swaps
The Fuel	Extreme leverage — major banks running at roughly 30-to-1
The Response	The $700 billion TARP bailout and unprecedented central-bank intervention

By the Numbers

Lehman Brothers filed with around $639 billion in assets — the largest US bankruptcy ever

The S&P 500 fell roughly 57% from its 2007 peak to its March 2009 low

The $700 billion TARP programme, plus an ~$182 billion rescue of AIG

Major banks operated at leverage near 30 to 1 — a 3% price move could wipe out equity

AAA on Garbage

The alchemy at the heart of 2008 was the credit rating. Thousands of risky subprime mortgages were bundled together, sliced into tranches, and the top slices stamped AAA, the same rating as government debt, on the theory that they could not all default at once. The models assumed US house prices had never fallen nationwide and never would. That single assumption, embedded in trillions of dollars of securities, was the fault line under the whole system.

> *“ When the model says it cannot happen, the model is the risk. ”*

How It Happened

Years of low interest rates and a belief that house prices only rose fuelled a subprime mortgage boom. Loans were made to borrowers who could not repay, because the loans were not meant to be held.

Wall Street bundled these mortgages into securities and complex CDOs, and rating agencies blessed the senior slices as AAA. Investors worldwide bought them as safe. Credit default swaps then let others bet on, or insure against, their failure, multiplying the exposure far beyond the underlying loans.

Banks financed all this at roughly 30-to-1 leverage. The entire structure rested on the assumption that American house prices would not fall across the whole country at the same time.

The Collapse

House prices did fall, nationwide. Subprime borrowers defaulted, the AAA securities proved worthless, and because the exposures were leveraged and interlinked through swaps, losses ricocheted through the system.

Bear Stearns was rescued in March 2008. Then, on 15 September, the government let Lehman Brothers fail. The shock froze credit markets worldwide; banks stopped trusting each other, and the financial system's plumbing seized.

Governments and central banks intervened on a scale never seen before, the $700 billion TARP, the AIG rescue, emergency lending, to stop a second Great Depression. Markets bottomed in March 2009 after the S&P had fallen about 57%.

Timeline

2004–06	A low-rate subprime boom; risky mortgages packaged into AAA-rated securities
Jun 2007	Two Bear Stearns subprime funds collapse — the first crack
Mar 2008	Bear Stearns is rescued and sold in a fire sale
15 Sep 2008	Lehman Brothers files for bankruptcy; credit markets freeze
Oct 2008	The $700bn TARP is enacted; AIG is rescued
Mar 2009	The S&P 500 bottoms, down ~57% from its 2007 peak

Mind · Method · Money — What This Means for You

MONEY · Leverage plus hidden linkages equals systemic fragility
At 30-to-1, a small drop in asset values wipes out a bank's equity, and credit default swaps linked every institution to every other. Leverage amplifies losses; interconnection spreads them. Know not just your own leverage but the leverage of everyone you are tied to.

METHOD · A model is only as good as its worst assumption
The whole edifice rested on the belief that national house prices could not fall. Everything downstream, the AAA ratings, the risk models, the capital buffers, inherited that single flaw. Interrogate the assumption a structure cannot survive being wrong about.

MIND · "It has never happened" is not "it cannot happen"
Because US home prices had not fallen nationwide in living memory, an entire industry treated it as impossible. Complacency dressed up as data is still complacency. The most dangerous risks are the ones consensus has decided are off the table.

Modern Parallels

2008 is the modern archetype of a leverage-and-complexity crisis: a real asset, mortgaged homes, turned into instruments so intricate that almost no one could see the risk, financed with borrowed money and validated by models that could not imagine losing. Every cycle since asks whether the next danger is hiding in the same place, inside complexity everyone has agreed to trust.

Read & Listen

Read the full write-up and listen to the episode: The 2008 Financial Crisis (EP15)

Related Research

Previous episode: EP14 · Argentina's Corralito (2001)
Next episode: EP16 · The Flash Crash (2010)
The next one forming: The Next Market Crash — 5 Scenarios

Sources & Further Reading

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Andrew Ross Sorkin, Too Big to Fail (2009)
Charles P. Kindleberger, Manias, Panics, and Crashes: A History of Financial Crises
Market Mayhem: When Greed Meets Gravity, The Complete Trader's Edge

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