Go see the Academy award nominated movie *The. Big Short*

Perhaps one of the biggest surprises to me this year was the nomination of the movie "The Big Short" for several Academy Awards including for Best Picture. This, despite the fact that I went to the movie shortly after it came out and loved it. Perhaps my surprise had to do with the somewhat technical nature of some of the content in the movie.

I am also a big fan of the book by Michael Lewis (http://www.amazon.com/The-Big-Short-Doomsday-Machine/dp/0393338827) upon which the movie is based. When the book first came out I ran (literally, as part of my jog that day) to the bookstore before a flight to an actuarial conference, to buy the book. At the time I was doing a lot of research on the financial crisis and in particular the role of 1) speculative behavior and 2) fraud, in the financial crisis. I was in particular, very eager to get my hands on actual documented examples of corrupt and fraudulent behavior leading up to and during the financial crisis. While there was pretty solid evidence concerning the Madoff Ponzi scheme that not only was evidence readily available that the alleged return to the Madoff funds were highly suspicious (see al professionals such as those at the rating agencies would have indicated that many low-quality mortgages were going into the financial derivative products being sold by Wall Street. However the evidhttp://www.amazon.com/No-One-Would-Listen-Financial/dp/0470919000/ref=sr_1_1?ie=UTF8&qid=1456522932&sr=8-1&keywords=NO+ONe+would+one+would+listen), but many fund managers were aware or at least suspected fraud. However, this fraud was small potatoes compared to the global financial crisis. I suspected that data was readily available, that if reviewed conscientiously by finance professionals would show the mortgage-backed products to be grossly overvalued. I had been unable to find the evidence of what the analysts had actually been using. Then the book *The Big Short* came out. The book was a treasure trove of such examples. It follows the lives of several maverick Wall Street investors who had discovered/figured out that there was a real estate bubble, and even worse that derivatives based on real estate were grossly overvalued and headed for a big fall. From my paper "Banking on Robbery: The Role of Fraud in the Financial Crisis" (http://www.data-mines.com/Resources/Papers/Francis.pdf) :

"Lewis, in *The Big Short* (2010), describes how two Wall Street analysts uncovered major problems with the 1990s subprime companies. In 1997, the analysts, Steve Eisman and Vincent Daniels acquired a Moody's database with information about the subprime industry. While the database did not have loan level details, it contained descriptive statistics about the loan portfolios of the subprime companies. In particular, the database contained default and prepayment statistics. Daniels noticed extremely high prepayment statistics for the manufactured housing category. He determined that the prepayments were really defaults classified as "involuntary prepayments."

One of the other analysts featured in *The Big Short* was Michael Burry, a former physician turned financial market quantitative geek. "Lewis (2010) describes how hedge fund manager Michael Burry witnessed the enormous price increases in San Jose and in 2003 decided that a housing price decline of historic proportions would eventually occur. “You have to watch for the level in where nearly unlimited or unprecedented credit can no longer drive the housing market higher.” Burry analyzed the statistics, such as percent with no documentation, loan-to-value ratio of mortgages, location, etc. before betting against the mortgage pools. He wrote that, “It is ludicrous to believe that asset bubbles can only be recognized in hindsight.”[1]

The Wall Street mavericks bet that markets would decline using such vehicles as credit default swaps. It was not at all clear that these investments were going to pay out because big Wall Street banks that perpetrated the financial crisis also controlled the valuation of the credit default swaps. At any rate, go see the movie. The producers and directors use some clever techniques to educate moviegoers on the somewhat your convoluted techniques used by the Wall Street investors. The movie was produced by Brad Pitt played the starring role in a movie based on one of Lewis’s other books *Moneyball*.

I also recommend the following websites with movie trailers and author interviews:

Movie Trailer:

https://www.youtube.com/watch?v=vgqG3ITMv1Q

Interview with Author were he discusses the future of finance at Berkeley

https://www.youtube.com/watch?v=stnGC9jL8Fk

The Movie Nomination

http://oscar.go.com/nominees/best-picture/the-big-short

Academy Award Nominee

http://www.imdb.com/awards-central/oscars?pf_rd_m=A2FGELUUNOQJNL&pf_rd_p=2413779822&pf_rd_r=0Q87B4TDP1G58DP1KVX0&pf_rd_s=top-1&pf_rd_t=15091&pf_rd_i=video&ref_=ac_ac_nav_i2

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[1] Quote is from “Banking on Robbery: The Role of Fraud in the Financial Crisis

”, Casualty Actuarial Society eforum, 2010, and the book *The Big Short*.

Interview of Michael Burry

https://www.youtube.com/watch?v=II1EAHIeDQc

60 minute interview of Michael Lewis

https://www.youtube.com/watch?v=FMt_ZczGmEU

My essay on Fraud and the Financial Crisis

"Why Won't we use the F(raud) Word?

https://www.soa.org/library/essays/fin-crisis-essay-2011-toc.aspx