Steve Eisman: From The Big Short to the Long Way Home

Disruptive Forces in Investing **June 25, 2024**

Anu Rajakumar: In 2008, the housing market crash sent shockwaves through the financial world and beyond. Yet a select few investors foresaw the impending crisis and sounded the alarm well before the collapse. Their compelling stories were documented in *The New York Times* bestselling book, *The Big Short: Inside the Doomsday Machine*, and later brought to life in its film adaptation, *The Big Short*. With a star-studded cast, including Brad Pitt and Steve Carell, the movie portrayed these investors experiences during that volatile era in finance. Among them was Steve Eisman, who was depicted by Steve Carell under the pseudonym, Mark Baum. But what actually happened behind the scenes? How did the Steve Eisman detect the early signs of the crisis? And what are his views on today's markets? My name is Anu Rajakumar, and joining me today is Steve Eisman, Senior Portfolio Manager at Neuberger Berman to discuss his remarkable career journey, the story behind *The Big Short,* and his outlook going forward. Steve, welcome to the show.

Steve Eisman: Thank you. That was some intro. I'd even want to listen to me.

Anu: I know. Everyone should be very excited about this episode. Now, Steve, as I mentioned, you were at the center of a monumental moment within our industry's history, and you have a prolific story as it relates to that time period. So, let's take a step back in time. What were some of those first signals that you noticed when you first saw the bubble forming?

Steve: You had to lead with the-the big question.

Anu: The big question.

Steve: Well, let's go back for a minute.

Anu: Sure, please.

Steve: So, I was a sell side analyst at Oppenheimer in the 90s. I was the financial services analyst. I covered everything that wasn't a bank or an insurance company. And one of the groups that I covered was what I like to call the first generation of subprime mortgage companies, there were about eight of them. And in 1998, for reasons that we don't need to go into, they all went bankrupt, or almost all of them went bankrupt.

And that, you know, it was very funny because across the hall from me at Oppenheimer was Henry Blodget, he was the first-grade internet analyst, and he was telling people how Amazon was going to go to the moon and here I was covering a sub-sector that literally went to dust. You don't forget when you cover a sub-sector, and it goes to nothing.

So, in 2001, I went to a hedge fund, and eventually in 2004 I became the portfolio manager of the financial services group at FrontPoint, in around 2002, the second generation of subprime mortgage companies went public. And the funny thing was that they were basically run by the same people who ran the first generation they just changed the names. So as early as 2002 and '03, I knew this was going to end into tragedies because I'd already seen the play. The only question was when would there be a tragedy?

So, it lasted a lot longer than I thought it would and by the time it ended, it almost took down planet Earth because the industry, which had been a cottage industry in 1998, by 2006 was originating $500 billion worth of paper every single year. Whereas, $50 billion was a big year in the old days but I was just basically sitting there waiting for it. And so, I was waiting for the canary. So, what was the canary? The canary was that by the summer of 2006, the loans that were securitized in early 2006 started to show very high level of early delinquencies, very early. That was the canary in the coal mine. I started shorting subprime paper in the fall of 2006, because I knew it was already over. It was only a question of time.

By the way, the subprime mortgage sector completely blew up in August of 2007. By then, credit quality had gotten so bad that no investor would buy the paper anymore, and that was the end. So, what I like to say in retrospect is that, in August of 2007, the financial crisis was baked because all the big firms owned all that paper, it took more than a year later for it to actually happen, but in August of 2007, it was done. There was literally nothing anybody could have done to stop it at that point.

Anu: So, during that time, what was the discussion like amongst your peers? Was everybody seeing this?

Steve: Oh, no, not at all. So, the people who invested in this paper, call it the Bond world, they made a lot of money, and they couldn't imagine this would ever end because it was a gravy train for them, and they would constantly come up with excuses as to why credit quality was bad but would get better. They had this burnout thesis, which I loved, which was that "Yeah, the loans are getting bad pretty quickly, but those people will default very quickly, and the rest will be fine." And my response to that, "Well, yeah-yeah-yeah, it'll burn out. It'll burn out when everything goes to zero." So that actually proved to be correct, but nobody believed it until it actually was,

Anu: It's too late.

Steve: It was too late.

Anu: [chuckles]

Anu: Yeah. No, absolutely. Now that's a helpful background. As I highlighted in the introduction, you know, in the movie you're played by Steve Carell. How involved were you in the process of the movie's development, *The Big Short* and then- were there any behind-the-scenes anecdotes or moments that you'd love to share with us?

Steve: The book, which was written by Michael Lewis, I was very involved with. I mean, I think he must have interviewed me at least a dozen times, so that I was very involved with. The movie, I had almost no involvement with whatsoever. They bought the rights to my life. I met the director. I had breakfast with Steve Carell once, at a Diner on 88th Street and Madison Avenue on a Sunday morning and that was really the only time I ever spoke to Steve Carell in any depth.

Anu: What was that breakfast like?

Steve: I barely remember it. You know, he just wanted-

Anu: [chuckles]

Steve: -to know what I was like. It was very casual.

Steve: I only have one contribution to the movie. It's actually confined to a word. So, they came to New York- most of the movie was filmed in New Orleans, and they came to New York, to film, you know, just a couple of outdoor scenes. So, there's a scene in the movie, which my wife and my kids and I were all invited to watch, it was filmed on Houston Street. And Steve Carell is talking on his cell phone to his wife, Marisa Tomei. Which, by the way, my wife actually looks like Marissa Tomei.

Anu: Okay. [laughs] That's great.

Steve: Um, and he's talking to his wife, and he's walking, and he is about to end the conversation and he hails a cab. And this cab pulls up and, he hangs up and he's about to get into the cab and they have this extra like brush past him to try and steal the cab. And so, the first cut was he confronts the extra, and he says to the extra, "Hey, that's my cab, a-hole." Cut. And that's how it was originally written.

Anu: Okay.

Steve: So, Steve Carell then goes over to talk to Adam McKay, who's the director and the author of the script, and they're watching on this little camera the scene that they have just filmed. And I turned to my wife, and I say, "I'm going to say something." And she says, "Please God, don't say anything." And I said, "No, I'm going to say something." She said, "No, please, I'm begging you, don't say anything." It's, "No, I'm going." And I walk over, and I say, "Hey, guys, um, I don't know if this is important, but if it were me, I'd have said schmuck, and Schmuck's in the movie.

Anu: Okay, great. That’s your claim to fame.

Steve: And that's my only contribution to the whole movie. That's it.

Anu: and you got to go to the premiere of the movie?

Steve: I went to the premiere.

Anu: Amazing. Very, very cool.

So, I guess the next question really is about how that era really shaped your investment philosophy going forward. You know, you've been a portfolio manager at Neuberger for a number of years when you look back at that time or even before, from, you know, the 1998 experience, when you think through, you know, the last couple of decades, how have all of those experiences informed how you make investment decisions today?

Steve: Well, I have a bit of a different answer to that question than you might expect. You know, from '92 through 2008, my area of expertise was financials. And in the 2000's, that was the center of the universe, which is hard to imagine since tech is so much the center of the universe now. But in the 2000s, that is the way it was. Financials were the center of the universe. Everybody thought people who ran those firms were geniuses. Well, they were wrong, but that's what they thought. And that's one of the reasons why I was able to see what I could see because it was my area of expertise.

And then it was over. And in 2012, I started another hedge fund that really did the same thing, which was being long-short financials. And it didn't work. And it didn't work because financials were no longer the center of the universe, risk was much lower and the correlation within this sector at one point was almost as high as one. So, you can't extract alpha out of a sector where the correlation is one. So, I shut it down and I joined Neuberger, and I guess the lesson here is to be flexible because I used it as an opportunity to retool myself. I don't really do that nearly as much in financials as I used to. I spent a few years really learning all the other sectors of the S&P. It took me a while and Neuberger was a great place to do it. And one of the reasons why it's such a great place to invest, is that Neuberger, on the equity side, we tend to be very long-term investors, so, managements tend to like to come see us. Companies view Neuberger in a very friendly way and so, every day there are companies walking through Neuberger and you get to see them in a very relaxed setting. You know, just for example, by chance I had was in a meeting with the CEO half an hour ago, you didn't get that opportunity to hedge fund. So that's something very important that I find as part of the learning experience, you get to see these CEOs over and over and over and over-over again.

Anu: Yeah, absolutely. We've discussed a lot about the past, and what's happened in some of these, critical inflection points of your career. What's your outlook on the future of current markets right now?

Steve: I'm very very positive. There's a joke on *CNBC* now, when I go on, they call me happy Steve. So let me backtrack that for a second. You know, what were the things that caused the financial crisis if you want to boil it down to like a couple of sentences. It was that the large financial institutions were way over-levered. You had a very big asset class that blew up. And systemically important firms owned the asset class, those are the three causes. And then there's a fourth, which is derivatives, which, you know, made it all worse. And so if you fast forward to today, large financial institutions are not over-levered. The regulators force the leverage to be cut by more than half. It's an astonishing statement when you think about it. The risks that they hold are much lower. So, the financial system in the United States is probably healthier today than it's been in anyone's lifetime. The consumer is not over levered like he or she used to be.

So, then the only question is, you know, you don't have to worry about calamity. I mean, certainly there could be war, et cetera, there could be a black swan that we don't know about. But in terms of what I can see, there's nothing out there that's going to cause the US economy to blow up. So, then the question is, okay, what are you looking at? Credit quality of the consumer is good and never forget that two-thirds of the US economy is the consumer. And the difference between today versus, let's say, the basic economy in 2008 is that it's a much more dynamic economy, it's much more tech-oriented, it's much more innovative, which is why the US stock market has outperformed every other stock market in the globe for probably a decade now, and in almost every single year.

So, what I think about the markets today is that there are three very very large stories. You know, what I like to say is that in bad times people focus on balance sheets and credit quality, and in good times, they focus on stories. And today there are three, and I believe in the first two, and I really don't believe in the third. The big two are tech and AI and everything having to do with it, which we could certainly get into. And the second one is infrastructure, which is combination of onshoring, improvement of the grid, greenification, and the fact that the United States government is going to spend $1.2 trillion over the next 10 years on those three themes. Those two big themes are going to drive this economy for the next several years, which is probably one of the reasons why to everyone's surprise, we have not had a recession, they've just overpowered it. And the third large theme is crypto, which I'm not a believer in, but obviously, other people are.

Anu: Interesting. Yeah. I feel like crypto has sort of wavered off of a lot of people's, key lists of things that are going to drive it in the future. Well, last question for you, Steve, is, you know, you've had, like I said, a remarkable career. The question is about what advice you'd give young investors who are starting out today. What are some of the big lessons that you've learned that, um--

Steve: Well, let me give career advice first.

Anu: Sure. Go for it.

Steve: Because I get that question a lot, you know, I make speeches a lot of the time and people will ask me, "Can you give me some career advice?" And what I say is that I disagree with Warren Buffett when he says, "pursue your passion." I think that's wrong. And the reason why I think it's wrong is, and I always use this as an example, you can like opera, but if you can't sing, you're not going to be an opera singer. So, what I like to say is find out what your attributes are. And let me explain what I mean by that, attributes are not the same thing as intelligence. Best example I can give is, I remember in high school I had a whole bunch of very smart friends. You know, some of them were really good in math and science, and they couldn't write to save their lives and I had other friends who were great in history and English and they couldn't add. That's what attributes are. And a funny story behind that is when I was a lawyer after graduating law school, I was miserable. And my wife was also a lawyer, and she was miserable. And so, we couldn't figure out why are we so miserable? So, my wife who can get very creative says, let's go to this place called the Johnson O'Connor Institute they test attributes. So, I didn't even really know what that meant, but okay, let's-- we'll take a day because any-any excuse to get out of-

Anu: To not be a lawyer. [laughs]

Steve: -not be a lawyer and be a lawyer for a day, I'm taking it. So, I was a corporate lawyer and, they do a whole battery of tests about, you know, are you good at math, are you good at this? And at the end of the day, they sat down with me, and they said, um, your attributes are pretty clear. You are very, very good at generating ideas and you are not detail-oriented at all. The worst thing you could be is a corporate lawyer. And I'm thinking, okay, now I know why I'm unhappy. So, eventually, I went to Wall Street where you generate ideas. So, what I tell young people is try and figure out what your attributes are. Are you math-oriented, are you story-oriented? You know, if you're math-oriented and you want to go into the business, you know, maybe you should be on the fixed income side. If you're story-oriented and you want to be this, maybe you should be on the equity side. But don't do something that goes against your own attributes because you're going to feel like you're banging your head against the wall all the time.

Anu: Yeah. You know, our team just did a training assessment called Working Genius, which is about understanding where you derive your energy, right, and your joy from.

Steve: Right.

Anu: You spend so much of your time working that if you're in a job which drains you for 80%, 90% of your day, it's probably not the right role for you.

Steve: Correct.

Anu: So, uncovering the areas that you-you get energy from and get joy from that you want to do more of, which I think is really important. Steve, thank you very much for your thoughts today. I can't let you leave without a bonus question.

Steve: Okay. Bonus question.

Anu: Bonus question. You come from a family of professional financial investors.

Steve: Yes.

Anu: And so, I'd love for you to share a little bit about your family's story, how they got into investing, and maybe any just lessons that you learned from observing them as investors.

Steve: So, the original person in the business is my mother, who started out at the Bank of New York in the '50s. And then got to Stevens & Clark in late '50s, early '60s. Then she went to Oppenheimer where she grew a business. And then my father, who like me, went to Harvard Law School, but he had been a prosecutor and then a defense attorney, joined her probably in 1967. And they grew that business for years. And then, in mid-90s my brother-in-law, my sister's husband, Michael, joined them and they all came to Neuberger. And in 2009, my sister, who was also a pretty big sales side analyst covering consumer, joined them in 2009 at Neuberger, and I joined in 2014. So, it's a family business. So, I'll just relay one humorous story. So, this is a true story. This took place, you know, as the crisis was unfolding, probably September, October. Now I, of course, was short everything, so I felt fine, but-- so I'm going to tell this story and the words that I'm going to say, the dialogue, is literally word for word as it was said, it's just that good. So, it was one of those days during the crisis when the market was like down a thousand points in the afternoon. So, listen, I'm short, I'm fine, but you know, my parents and brother-in-law at Neuberger, they're long only, they can't possibly be happy. I'll be a good son and I'll call and see how they're doing. So, I called, my mother picks up, I go, this is the dialogue verbatim: "Ma, how you doing?" "Steven, your mother is not good." My mother can be a bit of a drama queen. I said, "Ma, is there anything I can do to help you?" She says, "Yes, Steven, promise me, promise me you will let me die in my bed." And I said, "Mom, I promise you, I will let you die in your bed. Where that bed will be, I make no promises." She hung up on me. So, then the next morning the market opened down like a sewer again, it's around 10 o'clock. I call her office and her assistant picks up and I say let me talk to my mother and her assistant says, "She's not here." I go, "What do you mean she's not, where is she?" "She's home." I said, "Okay." So, I hung up, I called home, she picked up. I go, "Ma, what are you doing?" She says, "I'm nailing the bed to the floor." True story…

Anu: Oh my goodness. That is, that is terrific. Well, first of all, it's really impressive to hear that your mother was an investor. I'm sure one of the only female investors.

Steve: Oh, for sure.

Anu: Because there were only like a handful, I'm sure in the 1950s like you said. So very cool to hear that. Did you get any, life lessons about finance when you were younger or any kind of lessons that they shared with you?

Steve: Well, yeah, we used to talk stocks all the time.

Anu: Yeah.

Steve: So, I kind of grew up in the business.

Steve: I don't know if that's a life lesson.

Anu: It's funny, actually, that your dad was a lawyer, and then left being a lawyer but then-

Steve: To join her.

Anu: But yeah, but then you also-

Steve: Then I became a lawyer and then left to eventually join them.

Anu: Well, Steve, I just want to thank you again so much for your time today and for sharing some of those excellent stories about your career journey, it's been great having you on the show.

Steve: Anytime.

Anu: And to our listeners, if you've enjoyed today's episodes, we invite you to visit our website, www.nb.com/disruptiveforces where you can find previous episodes as well as more information about our firm and offerings.

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