Financial Contracts and the Lying Liars Who Create Them

By The Mogambo Guru

02/17/09 Tampa Bay, Florida The Economist magazine innocently asks, “Why is finance so unstable?”

Immediately, I jump to my feet to scream my guts out that, “It’s because the amount of corruption is, like it always is at the end of long booms, completely off the freaking charts, and nothing is as it seems; everybody is lying to you; everybody is trying to steal your identity and you are being ripped off every freaking day, in countless ways, by corrupt thieving morons in government who are so, so desperate at this point that they are resorting to insanity!”

Apparently, that was not the winning answer, and my powerful entry was tossed aside in favor of, “Financial services are different from other industries, if only because so much of the business is writing bets. One side pays the other for a claim that comes good if, say, oil prices fall, or a company defaults on its bonds, or householders make the mortgage payments on time.”

So, stung at not having my answer selected as the winning entry, I think to myself, “Insurance policies don’t explain why the financial markets are unstable! So my answer is better! Where’s my damned prize?”

Perhaps in response to my anticipated objection, I could tell by long experience that they started to say something like, “You’re a moron, so why don’t you shut up?” But instead they took the “high road” and put me in my place by saying that “Expansion in most businesses is held in check by the need to build assembly lines, rent retail space or hire workers. All that takes time and money. By contrast, financial contracts can be written almost instantaneously and without limit.”

Instantaneously and without limit! Wow! Now I see!

The problem arose when people found out that everybody lied about the money or the collateral that they were putting up as their halves of the bets! Hahaha!

And then they lied about those bets to use as collateral for other bets, around and around until everybody owned, and owes, lots and lots of these derivative bets until one day – surprise! – they are all found out to be a Big Load Of Lying Crap (BLOLC)! Like now! Hahahaha!

They don’t call it BLOLC, of course. They call it “counterparty risk”! Hahahaha!

The interesting thing to me is that The Economist magazine explains that the market for derivatives has gotten so huge because (and this is the important point) they are useful to people signing contracts, as “After America came off of the gold standard in 1971, businesses wanted a way of protecting themselves against the movements in exchange rates", by which they mean that nobody wants to experience a loss of the buying power of their stupid fiat money!

So, figuratively climbing upon my soapbox to thunder at passersby, once again we have one more damning piece of evidence, to add to the mountain of other evidence, that the dollar being tethered to gold, as per the Constitution, was a Good, Good Thing (GGT), and that any other arrangement was a Bad, Bad Thing (BBT), especially the fiat dollar thing, which was the worst thing of all things, and now the Worst Of The Worst Things (WOTWT) is going to happen to us!

And the reason for the calamity is stupidity, pure and simple, as The Economist magazine notes that the infamous Black-Scholes option-pricing model "showed how to work out an option price from the known price-behaviour of a share and a bond. It is as if you had a formula for working out the price of a fruit salad from the prices of the apples and oranges that went into it", while at the same time price movements in the option prices come from "the equation in physics that describe the diffusion of heat." Hahahaha!

The Economist doesn't go so far as to agree with me that this stupid theory that "all probabilities are always normally distributed, even over the long-term" is ridiculous, and which is even stupider than thinking that "investing in the stock market is the same as saving", which, along with the tragic concept of "everlasting love", are the three stupidest things I have ever heard of in all my years on this planet you call Earth.

Well, let's not forget the other stupidity that brought Black, Scholes and Long Term Capital Management to ruin; assuming that there would always be somebody out there who was so stupid as to take the other side of their bets, no matter what was happening, at predicted prices! Hahaha! Morons!

Apparently, since I see that I am the only one laughing, I assume that I am missing the point, because The Economist magazine keeps insisting that "The idea behind quantitative finance is to manage risk. You make money by taking known risks and hedging the rest" which doesn't make much sense to me because if the risks are known to everybody, then the option is priced as a 50-50 bet, and I am here to tell you that I laugh at anybody who says that they can make money on a 50-50 bet! Hahaha!

Of course, nobody at the offices of The Economist will answer the phone when I call to argue the point, but they imply that my theory, my ignorance and my sheer stupidity notwithstanding, problems soon arose because "the idea behind modeling got garbled when pools of mortgages were bundled up into collateralized-debt obligations (CDOs)", resulting in a "baffling complexity" of assets where "each one contained a unique combination of underlying assets", thus making them "impossible to model in all but the most rudimentary way".

By this, I assume they mean that if it weren't for that One Tiny Thing (OTT), everything would be fine, and we would be prospering and laughing, having a wonderful time, perhaps sharing a pizza el supremo mucho grande extravaganza, a princely cholesterol-bomb topped with every pork product known to man, instead of hunkering down in our filthy, stinking bunkers waiting for the world to collapse in flames and the fiat dollar to collapse, as have all other fiat currencies in all of history and all the stupid economies that depended upon them.

Of course, there is still time to buy a pizza, and a little more gold and silver before the prices explode! Whee! This investing stuff is easy!