

Contents

Foreword		ix
1 Introduction		1
1.1 How Helpful Is the Notion of Tail Risk?		10
1.2 Dichotomies and Ambiguities		14
1.3 Trust and Solvency Are All or Nothing Dichotomies		14
1.4 The Asymmetry of Private Gain and Public Losses		18
Endnotes		21
2 Cross-Sectional Asset Correlations		27
2.1 Lessons for Risk Management		35
2.2 Correlations and Volatility		36
2.3 Increased Asset Correlations		42
2.4 Stress Regression Analysis		45
2.5 Heat Maps Illustrate the Binary Nature of Risk On/Risk Off		49
Endnotes		57
3 The Changing Character of Financial Markets		61
3.1 Market Returns Do Exhibit Memory		66
3.2 Hurst Coefficient		70
3.3 Hurst Values Reached Extremes During 2008		72
Endnotes		75
4 The Flash Crash		81
4.1 Market Microstructure		86
4.2 Predator Prey Dynamics		88
4.3 Computer Simulations of Market Behavior		90
Endnotes		92
5 Detecting Mini Bubbles with the VPIN Metric		97
5.1 Adverse Selection as the Basis for the VPIN Method		98
5.2 The Role of the Japanese Yen in the Flash Crash		110
Endnotes		116

6 Foreign Exchange and the Carry Trade	119
6.1 Primer on the Forex Market	120
6.2 The FX Carry Trade	122
6.3 Does the Carry Trade Pose a Risk to the Financial System?	123
Endnotes	129
7 The Enigmatic Performance of the Japanese Yen	133
7.1 The Nikkei 225 and the Yield on the US Treasury Ten-Year Note	137
Endnotes	146
8 The Aussie/Yen Connection	149
8.1 The Role of Aussie/Yen in Inter-Market Strategies	157
Endnotes	162
9 Precursors to Illiquidity	165
9.1 Using Heat Maps for FX and Other Asset Correlations	166
Endnotes	174
10 Mainstream Financial Economics Groping Towards a New Paradigm	175
10.1 Disappearance of Income	176
10.2 Vendor Financing	183
10.3 Global Imbalances and the Martin Wolf Thesis	183
10.4 Project Evaluation and the Cost of Capital	186
10.5 Towards a New Paradigm in Economic Thinking	187
10.6 Rational and Efficient Markets	190
Endnotes	194
11 Could a Eurozone Breakup Trigger Another Systemic Crisis?	201
11.1 The European Stability Mechanism (ESM)	209
11.2 Impact of Monetary Union	211
11.3 The Debt Deflation Trap in the Eurozone	214
11.4 Eurobonds	218
11.5 The Visceral Dimension to the Eurozone's Problems	221
Endnotes	222
12 China, Commodities, and the Global Growth Narrative	227
12.1 Chinese Consumption of Base Metals	235
12.2 The Internationalization of the Renminbi	243
Endnotes	246
13 Drawdowns and Tail Risk Management	251
13.1 Protecting Against Drawdowns	260
13.2 The Tail Risk Protection Business	265
13.3 Raising Cash and Switching to Safe Haven Assets	267
13.4 Implementing Drawdown Protection Strategies	270
13.5 Tail Risk Protection from Outright FX Positions	273
Endnotes	279

	Contents	vii
14 Liquidity and Maturity Transformation		285
14.1 Money Market Spreads		291
14.2 Liquidity		294
14.3 Repo Financing as the Safest Form of Interval Confidence		295
14.4 Towards New Models of Network or Systemic Risk		298
14.5 The Shadow Banking System and Liquidity Risk		299
14.6 Maturity Transformation Is Spanning an Interval		299
Endnotes		302
15 Emotional Finance and Interval Confidence		307
15.1 Constructive Ambiguity		308
15.2 Double Binds and Emotional Finance		311
15.3 Patience and Investment Decision Making		318
Endnotes		320
16 Adjusting to More Correlated Financial Markets		327
16.1 Some Final Musings on Markets and Mayhem		331
Endnotes		334
Appendix		337
Index		343

<http://www.pbookshop.com>

<http://www.pbookshop.com>