Traders, Guns and Money

Knowns and unknowns in the dazzling world of derivatives

Revised edition

SATYAJIT DAS
Publisher’s acknowledgements  xiii
List of figures and tables  xiv
About the author  xvi
Introduction to the paperback edition  xvii

PROLOGUE  1
Miracles and mirages  3
Serial crimes  6
Beginning of the end/end of the beginning  11
Knowns and unknowns  14
Unreliable recollections  16
Summary judgment  21

1  FINANCIAL WMDS – DERIVATIVES
DEMAGOGUERY  23
School days  26
It’s all Chinese to me  27
A derivative idea  28
Betting shops  30
Secret subtexts  32
Leveraged speculations  34
Under the radar  39
Whole lotta swapping going on  40
The golden age/LIBOR minus  50  44
Warehouses 47
Serial killings 51
Forbidden fruit 53
Derived logic 60

2 BEAUTIFUL LIES – THE ‘SELL’ SIDE 62
Smile and dial 64
Market colour 66
Rough trade 70
Analyse this 73
Class wars 76
Ultra vires 78
Feudal kingdoms 79
Uncivil wars 81
Golden rules 82
Business models 83
The medium is the message 87
Bondage 89
Tabloid cultures 90
Conspicuous currency 91
Ethnic cleansing 93
Foreign affairs 94
FILTH 96
Lost in translation 97
A day in the life 98

3 TRUE LIES – THE ‘BUY’ SIDE 101
Turn of the fork 102
Risky business 103
Magic kingdoms 106
Stripping or stacking/hedging perils, again 110
Me too 113
‘Zaiteku’ or the bride stripped bare 114
The gamble in P & G 118
Tobashi, baby 122
Gnomes of Zermatt and Belgian dentists 125
Death swaps 126
Investment fashions 129
Alpha, beta, zeta 132
Looking after the relatives 135
Agents all 136
Unique selling propositions 137

4 SHOW ME THE MONEY – GREED LOST AND
REGAINED 141
Money uncertainty 142
Toll booths 143
Take a seat 145
Efficient markets 147
On the platform 148
A day at the races 151
Black swans, black sheep 151
Trading places 152
Secret intelligence 155
Overwhelming force 157
Oracle of Delphi 157
Free money 160
The colour of money 162
In reserve 163
A comedy of errors 165
Black holes 166
What’s the number? 171
Nothing like excess 172
Nice work if you can get it 174
Dukes of Hazard 176

5 THE PERFECT STORM – RISK MISMANAGEMENT
BY THE NUMBERS 178
Shock therapy 179
Holy risk! 180
Risk spin 181
Risque matters 184
Placebo effects 186
Among the unbelievers 189
Risk cults 191
In the long run ... 195
Modus operandi 197
Secret trader’s business 198
Let the good times roll 199
The perfect storm 200
Weather forecasts 202
Endgame 204
Mean risk 205
Extreme sports 206

6 SUPER MODELS – DERIVATIVE ALGORITHMS 209
Out of the sheltered workshops 210
Rocket science 212
Culture wars 214
Conveyor belts 216
Trivial pursuits 217
Grand oprey 219
The quest 220
Genesis 223
Gospels 227
Greek tragedies 230
Failing the model test 232
CSI (Crime Scene Investigation) 1987 – ‘Oh LOR-dy!’ 235
CSI 1992 – ERM (extremely risky, man!) 236
CSI 1998 – selling England by the pound 237
CSI 1998 – Asian fever 240
Model envy 241
Omitted variable bias 243

7 GAMES WITHOUT FRONTIERS – THE INVERSE WORLD OF STRUCTURED PRODUCTS 245
Driving over lemons 247
The best of times . . . the worst of times 248
Ghostbusters 250
It wasn’t me, sir 251
Heaven and hell 252
Split personality 256
Golfing holidays 258
The flood 261
Power to the people 263
Recycling junk 267
Six packs 270
Take no prisoners 273
The usual suspects 275

8 SHARE AND SHARE ALIKE – DERIVATIVE INEQUITY 279
Billion dollar baby 280
Self arbitrage 283
Arbitraging others 285
Taking it over 287
Buying back the farm 288
Who’s fooling who? 289
Strippers 293
Pearls of wisdom 295
Own goals 298
Taxing times 301
Fund times 304

9 CREDIT WHERE CREDIT IS DUE – FUN WITH CDS AND CDO 308
Credit wars 309
Credit epiphanies 311
First-to-credit derivatives 312
Remote credit 315
Mistaken identity 318
Heard it on the grapevine 321
Guaranteed delivery 322
Re-re-re-re-re-restructuring – CDS stutters 324
Beyond the push and pull 326
Imitation and flattery 328
Tranche warfare 332
It’s super 334
A capital idea 336
The arbitrage age 337
Hangovers 338
UFOs 339
Geeks with Greeks 340
Never believe your own lies 343
Russian dolls 345
Black holes 347

EPILOGUE 350
The Asian century redux 351
Vexatious litigation 355
The more things change 358
Hot tubbing 361
Rogue trader 364
Bangs and whimpers 368
The China Club 369
BOAT (Best of all time) 370
Knowns and unknowns 371

AFTERWORD: CREDIT CRUNCH – THE NEW KNOWN KNOWN OF FINANCIAL MARKETS 374
Living in the Age of Kali ... 374
Supersize my debt! 375
Would you like debt with that? 377
The new liquidity factory 379
Lying NINJA mortgagors 379
The lines of transmission 382
It’s different this time! 384
The bear comes out of hibernation 385
Waiting for the other shoe to fall ... 387
Financial shell games 389
The short and long of it all 391
Model shock 392
Missing the mark 393
Truth in labelling 396
Regulatory irregularities 398
Reversion to mean 400
Credit crunch 401

Notes 402
Index 408