

Tipping Point Commentaries

Financial Markets that Tip Heavily (while stiffing the bill)

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It has been like watching a train wreck in slow motion, but when did it actually happen? The article I reference lays out the progression of events, again, very familiar stuff by now beginning with the Bear Stearns bailout to the recent dressing out of WaMu like a jointed moose. Mr. Buchanan, a physicist, notes that those professions called sciences employ modeling software to predict behavior. I use a lot of those modelers myself, but you can do the same by buying SimCity and building your own economy with a sophisticated program which is going on 20 years old.

from:

This Economy Does Not Compute

By MARK BUCHANAN

Published: October 1, 2008

the model also shows something that is not at all obvious. The instability doesn't grow in the market gradually, but arrives suddenly. Beyond a certain threshold the virtual market abruptly loses its stability in a "phase transition" akin to the way ice abruptly melts into liquid water. Beyond this point, collective financial meltdown becomes effectively certain. This is the kind of possibility that equilibrium thinking cannot even entertain.

...

So far they've found tentative evidence that a transaction tax may stabilize currency markets, but also that the outcome has a surprising sensitivity to seemingly small details of market mechanics — on precisely how, for example, the market matches buyers and sellers. The model is helping to bring some solid evidence to a debate of extreme importance.

Returning to the topic of tipping points, this last paragraph quoted from Mr. Buchanan is quite telling. The statement leaves us with the prospect that buried within the *crisis* is the metaphorical straw that broke the financial camel's back.

There are a lot of milestones that can be seen from 20-20 hindsight. Perhaps it was the rogue trader of French bank Societe Generale where \$7 Billion evaporated over the weekend. There's a 1% solution. Unfortunately, that doesn't exactly conform to Mr. Buchanan's observation of seeming small details of market mechanics. That is, unless you consider the rogue trader's seeming small role in the scheme of the vast enterprise of Societe Generale.

If I were to extend that new observation, I would recommend the September issue of ***Scientific American*** which devotes its coverage to secrecy and security. The overriding theme there is that many of the security systems coming online, like smart ID cards, in fact lend themselves to less security. Why? And where does this tie into Societe Generale and the financial market meltdown? Because it centralizes valuable data (or money, same thing) behind a permeable wall — a wall only the *experts* would guarantee as safe (and has been penetrated before the roll-out). It pays to scrutinize the *bona fides* of experts who pale at testing and that leads us back to Wall Street.