The Financial System and Risk Management

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Bloomberg presented quite a few articles the week marking the ten year anniversary of the Lehman collapse describing and evaluating the historic financial event. All of them, of course, included information on changes made to prevent a recurrence with each author providing their opinion on effectiveness.

The best was the last. *Maybe This Financial System Can't Be Fixed* by Cathy O'Neil states boldly in the first paragraph that while officials have said risks have been reduced, there is, *just one problem. We need a different financial system, not just better risk management.*

At the time of the crash she was a quantitative analyst for a firm partly owned by Lehman's and their mathematical models regarding the chance that what did happen would happen were at the forget about it level.

The problem with models used in finance is that companies only care about the ones that make money. The risk models are about losing it, but since some risk is necessary to make money, and if something really bad happens they will with few exceptions be bailed out. They exist only to provide a veneer of balance.

O'Neil doubts if an effective risk model is possible because of bad data, and the fact that it can only look back in time for what might happen in the future. It's wrong to think that computers can solve problems that people can't.

She then provides some answers for the question: *what is the financial system's proper role as a public good?* She doesn't say how long it took her to stop laughing and begin a search for the impossible. One of the few honest aspects of capitalism in action is that it makes it obvious for all to see that it doesn't give a damn about the public good. But she has already given us the answer -- we need a new financial system. I'd only change the wording to a new political and economic system.

Some portentous signs may have been revealed in Markit's composite PMI readings for both Europe and the US. Composite means that it includes both manufacturing and services. The rate began falling in February and stayed in decline since. In the US it began falling in May and has continued a decline since then. Interestingly both began at about a 59 high and are now about 54.

Besides the fools who describe China as communist because that’s what the rulers say they are there those who base that claim on a fundamental difference between a capitalist society and a communist society; that the latter effectively controls and manages its economy. The Peoples Bank Of China can shape the nation’s economic condition simply be issuing appropriate commands. Meanwhile the Fed pulls a string the nation watches and waits to see if it had an effect on the hoped for change.

With the recent appointment of Yi Gang as the new head of the PBOC it will become more difficult to people in the myth. Yi received much of his advanced education in the US. He has shown an interest in Milton Friedman and quantitative analysis. He thinks just like any bourgeois economist. Just the person China needs to make the best decisions with respect to the full development of a capitalist system.

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