



# Black Swan Capital Currency Snapshot

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## A little history:

### The way our financial system is and has to be ...

Jim Grant said a few months back in one of his Interest Rate Observer bi-weekly missives: “Humans are simply incapable of handling credit,” or something close to that. We have seen the deleterious impact of easy money before. And no matter the regulatory environment conjured up to keep it from happening again—it will.

In perusing an excellent book titled, *The Panic of 1907*, penned by Robert Bruner and Sean Carr, I ran across this mini-postmortem on why it happened:

“The recounting of events of 1907 suggests that the storm gathers as follows. It begins with a highly complex financial system, whose very complexity makes it difficult for anyone to know what might be going wrong; by definition, the multiple parts of the financial system are linked, which means that trouble in one institution, city, or region can travel easily and quickly to others. Buoyant growth in the economy makes the financial system more fragile, in part due to the demand for capital and in part due to the tendency of some institutions to take on more risk than is prudent. Leaders in government and the financial sector implement policies that advertently or inadvertently elevate the exposure to risk of crisis. An economic shock hits the financial system. The mood of the market swings from optimism to pessimism, creating a self-reinforcing downward spiral. Collective action by leaders can arrest the spiral, though the speed and effectiveness with which they act ultimately determines the length and severity of the crisis.”

Does any or all of that sound vaguely familiar? Heck, if you exchange 1907 with 2008, the postmortem on the current crisis is complete!

“The only thing new in the world is the history we don’t know,” said Harry Truman.

And our lack of historical perspective seems a direct function of our hubris. We continue to make the same mistakes with credit (and every other major area of our

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existence for that matter) as those who have gone before us...again...again...and again. Each generation thinks they know more than the one before.

And once the generation with true enlightenment (which comes from being kicked in the teeth a time or two) is gone—it presents the current generation with all kinds of new opportunities to stumble and create silly things such as VAR and stress-testing of portfolios in order to rationalize taking on ridiculous levels of risk. And those august experienced businessmen on those highly elevated risk committees' who should know better focus more in fees than prudence. This won't change. Ugghhh....

By the way! 1908 proved a tough year. According to Brunt and Carr: “Gross earnings by railroads fell by 6 percent in December [1907], production fell 11 percent from May 1907 to June 1908, wholesale prices fell 5 percent and imports shrank 26 percent. Unemployment rose from 2.8 percent to 8 percent, a dramatic increase in a short space of time.”

Of course the economy did recover. Industrial production rebounded in 1909. The Dow Jones Index actually bottomed in late 1907 despite the severe recession in 1908 i.e. bad news already in the price. Nothing has changed there either. Markets discount. And it's why we haven't jumped on the “inevitable dollar ride to banana republic land” just yet.

And one more interesting historical anecdote: To the chagrin of many, the panic of 1907 was the catalyst for the establishment of the Federal Reserve Banking system. Now there's a glorious legislative achievement if ever there was one.

Regards,

Black Swan Capital