INDEX

Accidents/organizations, 159–161
Accountants, failure (reasons), 135
Accounting conventions, problems, 138
Accounting orientation, 137–138
Adaptation, best measure, 232–233
Adverse selection, 191–192
American depositary receipts (ADRs), 68
America Online (AOL), 139
Amex Major Market Index (XMI) futures, 12
Analytically driven funds, 248
Analytical Proprietary Trading (APT), 44–45
initiation, 189
remnant, form, 190
A Programming Language (APL), 43–47
Asset, problem, 45
Armstrong, Michael, 130
Arthur Andersen, failure, 135
Artificial markets, 229
Asia Crisis (1997), 3, 115
Asian currency crisis, 114
Asian economies, 118
Asia-Pacific Economic Cooperation (APEC), 63
Assets
class, hedge fund classification, 245
direction, hedge fund classification, 246
Asynchronous pricing, 225
AT&T Wireless Services IPO, SSB underwriting, 130
Back-office functions, 39
Bacon, Louis, 165
Bamberger, Gerry, 185–187, 251
Bankers Trust
lawsuit, 38
purchase announcement, 75
Bank exposure, 146–147
Bank failures, 146
Bank of Japan, objectives/strategies, 166
Baptist Foundation, restatements/liability, 135
Barings (bank)
bankruptcy, 39
clerical trading error, 38–39
derivatives cross-trading, 143
Beard, Anson, 13
Beder, Tanya, 204
Behavior, economic theory, 231
Berens, Rod, 75
Bernard, Lewis, 42, 52
Biggs, Barton, 11
Black, Fischer, 9
Black Monday (1929), 17
Black-Scholes formula, 9, 252
Block desk, 184–185
Trading positions, 186
Bond positions, hedging, 30
Booth, David, 29
Breakdowns, explanation, 5–6
Broker-dealer
block-trading desk, usage, 184
price setting role, 213–214
Bucket shop era, 177
Buffett, Warren, 62, 99, 181, 198
arb unit closure, 87–88
Bushnell, Dave, 129–131
Butterfly effect, essence, 227
Capital cushions, 106
Capitalism, 250
Cash futures, 251
arbitrageurs, 19, 23
spread, 19
trade, 19
Cerullo, Ed, 41
Cheapest-to-deliver bond, 251
Chicago Board Options Exchange (CBOE), 252
Black-Scholes formula, impact, 9–10
Citigroup
Associates First Capital Corporation, 128
consolidation, impact, 132–134
Japanese private banking arm, 133
management change, Fed reaction, 133
organizational complexity/structural
uncertainty, 126
Citron, Robert, 38
Coarse behavior
benefits, 232–233
consistency, 236–237
Coarse behavior (Continued)
  decision rules, 233
  in humans, 235–237
  measurement of, 238–239
  response based on, 236
  rules, optimality, 238
Cockroach example, 232–233, 235
Collateral, usage, 218
Collateralized mortgage obligations (CMOs), 71–75, 250
Commercial Credit, Primerica purchase, 126
Competitive prices, 36
Complexity
  by-product, 143
  implications, 156
  importance, 144–146
Consumer lending violations, Federal Reserve fine, 132
Control-oriented risk management, 200
Convergence Capital, 80
Convergence trades, 122
Convertible bond (CB) strategy, 57–58
Cooke, Bill, 185–187
Corporate defaults, possibility, 29–30
Corporate political risk, 140
Corrigan, Gerald, 196–198
Countervailing trades, 213
Credit Suisse First Boston, 72–73
Crises, causes, 240
da Vinci, Leonardo, 136
Denham, Bob, 62–63, 99, 195
Derivatives customization, 143
  trading strategy, 30
Deterministic nonperiodic flow, 228
Detroit Edison, Fermi-1 experimental breeder reactor, 161–164
Deutsche Bank, investment banking (problems), 72–73
Dimon, Jamie, 77–78, 91, 97–98, 126
Distressed debenture, event risk, 248–249
Dow Jones Industrial Average (DJIA), 2, 12
Dynamic hedge, 12, 161
Dynamic system, 228–229
Ebbers, Bernard, 70
Economic catastrophe, 257
Efficient markets hypothesis, 211
Einste, Albert, 224–226
Emerging market bonds, 71
Enron
  restatements/liability, 135
  U.S. Senate hearings, 129–130
Epstein, Sheldon, 46–47, 49
  index-amortizing swap, 116
Equity trading
  profitability, 71–75
  proprietary reliance, 73–74
European Monetary System currency crisis (1992), 3
Event risk, 248–249
Factor exposures, 202
Fair value basis, 29
Federal Deposit Insurance Corporation (FDIC), 113
Federal Reserve
  policy shifts, 85
  rate hike, impact, 53
Feduniak, Bob, 42, 52
Feuerstein, Donald, 196
Financial instability, aspects, 3–4
Financial markets, 224–225
Financial risk, 256–257
Fisher, Andy, 59, 80
Fixed income focus, 251–252
Fixed income research (FIR), 8–9, 43–44
Flood, Gene, 190
Franklin, Mark, 97
FREQ-floating anxiety, 235
Friclionless markets, 209
FrontPoint Partners, 204, 205
FTSE Index, 117
Fundamental data, 166
Furu, example, 233–235
Future market, 17–19
Futures shock (1635), 175–177
Galbraith, John Kenneth, 16
Gamma, problems, 24–25
General Electric (GE), 41–42
Generally accepted accounting principles (GAAP), 135
Geographic regions, classification, 246
Global Crossing, restatements/liability, 135
Godel, Kurt, 222–224, 227–228
Gold, Jeremy, 8–9
Goldman Sachs acquisition, 75
  public offering, delay, 109
Goldstein, Ramy, 116–118
Gracie family, 258–259
Gracie, Gastao, 258
Greenhill, Bob, 73
Greenmail, taxation, 13–14
Gross Domestic Product (GDP), 5–4
Growth bias, 202
Grubman, Jack, 128–130, 134
MCI/BT involvement, 69–71
  nursery school admissions, 131–132
Gutfreund, John, 62–63, 105, 195–197
  resignation, 199
Haghani, Victor, 102–104, 110, 112
Hall, Andy, 63–67
Hawkins, Greg, 51
Hedgefundedness, 243–244
Hedge funds, 165, 207, 214–215, 243
  classification, problem, 245
  classification, 245–246
  control, 252–253
  defining, 245
  economic service, 219
  existence, question, 244
  regulation, 247–250
Heisenberg, Werner, 223–228
Hilibrand, Larry, 79, 110, 113
Human error, 149
Market (Continued)
failures, safeguards, 239–240
illiquidity, portfolio insurance by-product, 14
innovation, 11–12
makers, problem, 191–192
regulation, 146–154
risk, paradox, 1
volatility, 5, 25
vulnerability, 224–225
Market bubbles, 168–174
Market-to-book ratio, 138
Marx, Karl, 250
Marxist backward market, exploitation, 250
Material adverse change clause, 65
Maughan, Deryck, 59, 73–77
MCI Communications
British Telecom (BT), merger/trade, 63–64, 67, 128
conclusion, 74
EPS, decline, 70
renegotiation, willingness, 67–68
stock, decline, 64
Mean-reversion analysis, 190
Mechanical failure, 149
Mercury Asset Management, 196
Mergers and acquisitions (M&A) advice/underwriting, 33
Meriwether, John, 52, 100, 197
renegotiation, 199
Merrill Lynch, 42
Merton, Robert, 9, 207
Metallgesellschaft Refining and Marketing (MGRM), oil price risk (offloading), 37–38
Mexican Brady bond/Eurobond spread, 107
Mexican peso crisis (1994), 3
Miller, Heidi, 78–80, 140
Modigliani, Franco, 208–209
Money flows, 167
Morgan Stanley
APL, usage, 44–45
Dean Witter, merger, 75
IT department, 43
portfolio insurance, 10–12
risk arbitrage department, 15
risk manager, 42
Morgan Stanley Asset Management (MSAM), 11
Morgan Stanley Investment Management (MSIM), 205
Mortgage-backed securities (MBSs), 54–56, 213
Mortgage market, 35, 54–55, 102
Mortgages, opportunities, 35
Mozer, Paul, 195–198
Myojin, Sugar, 59, 63, 78–79
Natural catastrophe, 257
New York Stock Exchange (NYSE) specialists, impact, 20–21
stock sale, 13
Noncash exchanges, 40
Norman Conquest, 215
Norris, Floyd (editorial), 91–92
O’Brien, John, 10
One-off events, 249
Opportunistic strategies birth/death cycle, 252
history, 251
Optimal behavior, mathematical framework, 237–240
Options, stripping, 117
Option theory, 24
Orange County, bankruptcy, 38
Organizational dysfunction, 134–136
Pacioli, Luca, 136–137
Fairwise stock trades, 187
Palmedo, Peter, 17, 28–29
Faloma Partners Management Company, 42
Pandit, Vikram, 12
Parets, Andy, 63–69
Parkhurst, Charlie, 85
Partnership model, 37
Perfect market paradigm, 209–210
imperfections, 210–212
liquidity, degree, 212–213
Phibro, Salomon acquisition, 66
Physical processes, modeling, 229
Platt, Bob, 7–8
Portfolio insurance, 10–15
market crash, 22
Portfolio managers, loss (risk), 204–205
Position disclosure, problems, 225
transparency, increase (financial market regulator advocacy), 225
Preference shares, illiquidity, 115
Price convergence, 121–122
Primal risk, 235–237
knowledge, limits, 230–232
Primogeniture, 215–220
implications, 216–217
Objective, impact, 216
Principal only (PO), 34–55
Principia Mathematica (Russell), 221–223
Procter & Gamble, losses, 38
Program trading, absence, 24–25
Protest bids, 195–196
Quants, 8–9, 82–84
Quantum Fund, 180–181
Quattrone, Frank, 72
Rational man approach, 231
Real assets, valuation, 137–138
Real-world risk, 237–238
Reed, John, 127
Relative strength index (RSI), 190
Relative value trades, 101–102
Rhoades, Loeb, 125
RISC workstations, 191
Risk control, 220
knowledge, absence, 231–232
management, 36
nature, variation, 249
reduction, 185
progress/refinement, impact, 4
tactical usage, 200
276
INDEX

Risk arbitrage, 15–16, 65, 71
Risk Architecture, 126
Risk-controlled relative value trading, 102–103
Risk-management structure, 238
Robertson, Julian, 165, 179–182
Rosenbluth, Jeff, 59, 83
Rosenfeld, Eric, 51, 79, 86
Rothschild, Nathan, 88–89
trading strategy, 90–93
Waterloo, relationship, 89–90
Rubinstein, Mark, 10
Russell, Bertrand, 221–223
Russia default, 103–104
Russian short-term bonds, 103
Salomon Brothers
arbitrage units, 73–74, 80–82
convergence trades, 120–124
proprietary trading, reduction, 92
risk management committee, 98–101
risk measuring/monitoring, 126
U.S. fixed income arbitrage group, 91–93
U.S. Treasury spread position, on-the-run/off-the-run trade, 120–124
Salomon North, 81, 100, 199
Salomon Smith Barney
convergence trades, 120–124
proprietary trading, reduction, 92
risk management committee, 98–101
risk measuring/monitoring, 126
U.S. fixed income arbitrage group, 91–93
U.S. Treasury spread position, on-the-run/off-the-run trade, 120–124
Samuelson, Paul, 208–209
Santa Fe Institute, 229
Scharf, Charlie, 123–124
Scholes, Myron, 9, 119
Scrib Reports, 201–202
Securities
price behavior, 36
volatility calculation, 14
Self-referentiality, 222
Shaw, David E., 165, 189, 243
Shiller, Robert, 179
Shopkorn, Stan, 181
Shuttle disasters, 159–161
Simon, Jim, 165
Singapore International Monetary Exchange (SIMEX), Osaka Exchange (matched positions), 39
Smith Barney, 75
Solow, Robert, 208–209
Soros, George, 179–180
Speculative traders, economic service, 219
Spread trades, holding periods, 83
Standard & Poor’s (S&P) futures contracts, sale, 20
Statistical arbitrage
concept, 194
emergence, 182–188
origination, 184
traders, 191–192
Statistics, objective, 134–135
Stavis, Rob, 53, 59, 70–80, 84
Stock clearance/finance, 27–28
StockGeneration, web site, 168
Stock market crash (1929), 137
Stock market crash (1987), 1–2
demons, 7
impact/meditation, 18–20
mechanism, understanding, 28
meltdown, physics, 25–30
postmortem, 13–14
warning signs, 16–18
Strauss, Thomas, 196
resignation, 199
STRIPs, 40–41
Sunbeam, restatements/liability, 135
SuperDOT, linkage, 189
Swap maturity/rate level, interaction, 47
Systems, interactive complexity, 155
Takeovers, impact, 15–16
Tartaglia, Nunzio, 187–189
Thorp, Ed, 188
Three Mile Island, 159
safety systems, dangers, 147–150
Tight coupling, 143
accidents, 154–157
complexity, combination, 256
failure, cascade, 145–146
interactive complexity, relationship, 157–159
origination, 144–145
reduction, 260
Tilley, Jim, 8–9, 46
Time disintermediation, 21
Touevs, Alden, 9
Too big to fail doctrine, 113
Top-down approach, 167
Travelers
brokerage unit, 75
Citigroup merger, 125, 140
Shearson American Express, merger, 78
Tribeca Investments, 204
Tulip mania, 174–177
Turnover, demand satisfaction, 173
Two-plus model, 85–86
U.K. tax code, change (1997), 117, 118
Ukraine Radiological Institute, 163
Unanticipated events, 239
Uncertainty, implications, 257
Uncertainty Principle, 223–227
behavioral analogue, 226
Undecidability Theorem, 223–224
Underwriting, profitability, 33–34
Union Bank of Switzerland (UBS), 48
Epstein, impact, 48–49
Goldstein, impact, 116–118
LTCM impact, 118–120
LTCM losses, 115–116, 120
monetary loss, 49
Swiss Bank Corporation, merger, 49
Unwind/unrealized losses, 68
INDEX

U.S. arbitrage, losses, 100
U.S. swap market, 92
U.S. Treasuries
  auction, false bid, 198–199
  stripping/reconstitution, 40
U.S. government issues, 123
U.S. yield curve trades, tracking error, 84–86

Valuation model, 60
ValuJet, 151–154, 159
Virtual stocks, investment, 168–169
Vranos, Michael, 81

Warrants, 57–59
Waste Management, restatements/liability, 135

Wealth
  change, market appreciation (relationship), 178
  dilution, prevention, 216
Weill, Sandy, 75–80, 125–129
Whitehead, Alfred North, 221–223
Whitney, Arthur, 45
Window dressing adjustments, 202–203
Workforce, diversification, 4
WorldCom, 70
  SEC inquiry, 128
World Trade Organization (WTO) accord (1999), 171

ZBI, 203–204