The Latest Thinking

Fear, Greed and Fairy Tales

How the markets and society at large are losing touch with reality.

August is always a squirrely month in the markets, but in 2011 it went full-tilt manic-depressive. After U.S. stocks had risen by more than 21 percent in the previous 12 months, they gave back 16 percent in a two-week span from July 25 to August 8. Standard & Poor's downgrade of U.S. debt, as well as renewed concerns over the financial survival of Greece, Ireland and Portugal and the resulting exposure of German and French banks, had sparked fears of another global financial meltdown and had many economists lowering their outlooks for global economic growth and warning of another recession.

Although that state of affairs changed little as August wore on, the world's markets whipsawed up and down, driven by huge and often inexplicable daily reversals in investor sentiment. In late September, the markets once again went into free fall, losing six percent in one week — due, in large part, to Fed Chairman Ben Bernanke's thinly veiled and not particularly new warnings of double-dip recession — only to come roaring back the next week, clinging to vague reports of Europe's plan to resolve its fiscal crisis and essentially ignoring negative news about U.S. home sales and corporate earnings.

These wild convulsions, often based upon no real news and frequently flying in the face of the day's developments, would make anyone wonder if the market had become completely untethered from any supportable vision of reality. "Even rational, seasoned investors feel like they've been raked over the emotional coals," said James B. Stack, editor of the *InvesTech Market Analyst* newsletter.

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Psychoanalyst David Tuckett, a professor at University College London, would agree with Stack's pointed juxtaposition of reason and emotion. Tuckett is on the leading edge of a relatively new school of thought called "emotional finance," which acknowledges that markets are complex systems defined by the emergent aggregate behavior of individual actors, but suggests that those systems are best understood not by trying to account for rationality or irrationality per se, but for their emotional underpinnings. "Decision making is a combination of reason and emotion. Few things that people do are, as such, irrational," said Tuckett.

In *Minding the Markets*, his new book with co-author Richard Taffler, a professor at the University of Edinburgh School of Management, Tuckett argues that financial assets have become so complex and the forces acting on them so numerous and unknowable, that they are nearly impossible to value objectively. Therefore, investors seek to make sense of them by creating a narrative — about an individual investment or a market trend — that conforms to their powerful emotions and unconscious fears and desires. For an illustration, one need look no further than how September's rumors of an inchoate plan to solve the European debt crisis — a plan about which even many European leaders were unclear and dubious — were seized upon by world markets that seemed to have simply grown tired of negative news.

Tuckett's thesis would seem to apply beyond the markets. In politics, in government, in day-to-day busi-

Jacob Thomas

ness and social dealings, it is hard not to notice people's increasing tendency to fashion self-serving narratives that are ever more fantastic, divorced from reality and very often destructive. It has been suggested that this is a form of whistling in the dark. German sociologist Ulrich Beck has argued that in the face of amorphous global specters such as environmental disaster, stock-market meltdowns and international terrorism, individuals are more likely to attempt to manufacture their own certainties.

In fact, many scholars contend that modern global society has descended into a permanent state of free-floating fear. This is not, they say, because people are personally experiencing an increase in direct threats to their well-being, but rather it is an abstract, pervasive sense — reinforced by communication technologies and the media — that problems are everywhere, enormous, inextricable and unsolvable. New York University professor of law and sociology David Garland has noted the startling growth of risk-related conversation and literature, pointing out that the word "risk" is used to describe a wide variety of otherwise unconnected experiences and phenomena. In effect, every conceivable aspect of life is now considered some form of risk to be managed. Sociologist Stanley Cohen also commented in "Folk Devils and Moral Panics" that "reflections on risk are now absorbed into a wider culture of insecurity, victimization and fear." Anthropologist David Parkin has observed that "today fear can migrate freely from one problem to the next without any causal or logical connection."

The transference of fear from one context to another was in evidence this past year as protesters from Wisconsin to Greece to Spain seemed to transmogrify worries about debt and austerity into more elemental, diffuse and darker impulses. "If people are afraid and feel powerless, the act of destruction becomes an act of agency, and they seek out a segment of society to blame," said Pamela Rutledge, who studies how emerging technologies affect cognitive psychology. "Fear hampers our cognitive and moral capacities. It makes us worry about 'not enough' and about 'losing what's ours.' It creates a divisive, us-versus-them environment that influences our behavior."

The starkest example of that was provided by the riots that ignited across Britain in August, for which no clear reason was evinced other than a vague, smoldering sense of class warfare. Social anthropologist Gabriele Marranci found those riots "unusual in many aspects, such as the heterogeneity of those involved, the dynamic of how they started, a lack of apparent common strategy and a lack of shared reasons for rioting. [The riots] appeared more to be a collective case of violent hysteria than an actual riot in the traditional sense."

Perhaps the lesson of the volatile and violent summer of 2011 is not only that our global society has become inordinately fearful, but also that it is becoming dangerously, maybe irretrievably, derivative. As technology has made us obsessed with tracking and "trending" one another's every action, utterance and data point, we have become caught in a vortex of derivative thinking and derivative action. As we wonder "what it all means for me," we are inexorably drawn to the dominant narrative, real or imagined, that offers some sense of solidity and solace. And in the process, we put our originality, morality, resistance and good sense at great risk.

Can China Continue to Grow?

With direct investment underperforming, inflation flaring and a real estate bubble looming, the world's second largest economy must find a new model for sustainable growth.

China, most experts agree, is at a crossroads. Over the past 20 years its mercurial growth, which has increasingly shaped the global economy, has been based upon massive fixed investment — roads, bridges, buildings and machinery — as well as low-cost exports, inexpensive labor and artificially cheap money. Many believe this has been a recipe for a "hard landing" — a sharp slowdown in capital spending and precipitously slower growth overall.

Among the most pessimistic is Michael Pettis, a senior associate at the Carnegie Endowment for International Peace's Asia Program, who recently summarized his view in *The Wall Street Journal*: "China's growth was based on large increases in government-directed investment. As a consequence, it had to run large trade surpluses to absorb the resulting