

*"... full of intriguing and controversial ideas. Bernice Cohen highlights the early warning signals of the big bear market all investors fear ... I commend her book to you."*  
Jim Slater

# THE EDGE OF CHAOS

*Financial  
Booms,  
Bubbles,  
Crashes  
and Chaos*

 WILEY

Bernice Cohen

# CONTENTS

<b>Acknowledgements</b>		xi
<b>Preface</b>		xiii
<b>Introduction</b>	<b>Crashes in Context</b>	xv
	Consistent patterns of behaviour in crashes. The purpose of this book. Study the past. An era of rapid financial and monetary freedom.	
<b>Part I</b>	<b>Setting the Scene</b>	<b>1</b>
<b>Chapter 1</b>	<b>A Cascade of Crashes</b>	<b>3</b>
	Evocative terminology for crashes. A model for stock market extremes. Do rational markets boom? Chaos in our universe. After the boom, the crash. Anatomy of a crash. A brief historical overview of some major crashes. Dutch Tulipomania, the 1720 bubbles in the Mississippi and South Sea Companies. Twentieth-century crashes; 1929, 1987 and tempestuous weather. The chain reaction crash. The Japanese bubble (1982–92). A Chinese footnote. The global bond market bubble of 1993–4. The crash mentality.	
<b>Chapter 2</b>	<b>The Search for the Irrational Investor</b>	<b>35</b>
	Investor types. Introducing the irrational investor. Jekyll and Hyde investors. They got it right: they got it wrong. The basis for rational behaviour. The	

	real stress factor. People don't change, but circumstances do.	
Chapter 3	<b>Chaos Rules</b> So what is chaos? The science of complexity. At the edge of chaos. Confronting the chaos world. The logic of applying chaos theory to crashes. The randomness red herring. Nature's rule book. Linear and nonlinear systems. Holism in stock markets. The order/disorder mixture. Positive feedback. The Butterfly Effect. Financial butterflies. Irregular cycles.	63
Chapter 4	<b>Profitable Chaos</b> Secret structures. Fractals tell the story. The technical route. The fundamental route. Financial fractals (charts). Self-similarity. Triple links in the crash scenario. Moving averages. Identifying major turning points. Financial markets as damped, driven systems. Beneficial trends. Profiting from structure. Gains on the edge of chaos. Financial pumps. Patterns that fail. Using the charts.	94
Chapter 5	<b>The Chaos Route to Profits</b> Phase transitions in chaos. Sand piles and chaos in human societies. Phase transitions for investors. Criticality. Is there a market strange attractor? Behavioural changes in the index. Anti-chaos after the crash. Capitalise on chaos.	125
<b>Part II</b>	<b>The Bubbles of 1720</b>	<b>145</b>
Chapter 6	<b>The Build-up to the Bubbles</b> The political dimension. Special conditions in France. The origins of the 1720 bubbles. Links between the two bubbles. Special conditions in England. The concepts behind Law's System. Unique aspects of the South Sea scheme. Differences between the South Sea and Mississippi bubbles.	147

Chapter 7	Mississippi Madness Law's legacy. The scheme is launched. The boom takes off. The System at its peak. The objectives of Law's System. The beginning of the end. The knock-out blow. Reconstruction begins. Mississippi chaos.	169
Chapter 8	The South Sea Fiasco Founding the company. The conversion scheme is hatched. The scheme takes off. Fuelling the boom. Rising expectations. The bubble companies explosion. The mania spreads. The South Sea Bubble at the peak. Accolades for fraudsters. The beginning of the end. The trigger for collapse. South Sea chaos.	201
Chapter 9	The Aftermath Dog days for both bubble companies. Mississippi winners and losers. Mississippi downfall and debt deflation. South Sea Company's struggle to survive and debt deflation – depression follows the boom. Chaos in the collapse. Self-organisation for the reconstruction.	232
<b>Part III Modern Bubbles and Crashes</b>		<b>251</b>
Chapter 10	1929 And All That Optimism in 1922. The trigger. The easy credit lure. The boom accelerates. Nonlinearity, the geared route to super-profits. The leverage pyramid. Wall Street at the peak. Early nagging doubts. Wall Street butterflies. The downturn arrives. The great collapse. Debt deflation – Wall Street fall-out. The slow reconstruction begins.	253
Chapter 11	1987 – The Global Crash Background to the crash. Recession precedes the boom. The Japanese export miracle. The trigger. American liberalisation. Low oil prices fuel the boom. Ignoring the warning signs. The boom accelerates. The property bubble. The financial pump.	280

	The speculation mania. Imaginative new trading ideas. Fraudsters galore. The pinnacle in sight. The world economy at the peak. The technical view at the peak. Nagging doubts. The flood of selling. The aftermath.	
Chapter 12	Japanese Bubbles	311
	Rising from the ashes. Build-up to the boom. The Japanese financial pump. The boom accelerates. Innovative investment instruments. Japanese fraudsters aplenty. Property price madness. The boom leads to the bust. Dog days for Japan. Fall-out from the bubble. Reorganisation attempts – Japanese style. A savage case of debt deflation. Time to knuckle down to national recovery.	
Chapter 13	Bonds, Bears and Butterflies	335
	The devastation of the bubble. Build-up to the 1993 bond bubble. A trigger ignites the boom. Easy credit and the financial pump. Innovative new techniques. Mass participation at the peak. Early nagging doubts. The Greenspan Butterfly Effect. The selling stampede. Unwinding the bubble. A batch of bubbles. Spotting the bubble-building signals.	
Chapter 14	An Alphabet Alert	352
	Profit from the boom. Recognise the turning point. How to recognise a coming collapse. Important advance indicators. The bond relationships. The symptoms of economic distress. Checklist for emerging bubbles. Missing pieces of the jig-saw. Early nagging doubts. The crash of crashes scenario. Vital clues from past mistakes. A summary of signals – an alphabet alert.	
	<b>Bibliography</b>	<b>379</b>
	<b>Index</b>	<b>383</b>