Propositions

belonging to the thesis

Risks of Leveraged Products

Antonio Di Cesare

Erasmus University Rotterdam

20 December 2012

I

Leverage is almost everywhere in modern finance. When correctly understood and used, it can greatly expand the investment and hedging opportunities — and thus the welfare — of economic agents. If you cannot beat it, join it.

II

The consequences of extreme negative macroeconomic shocks for the banking system are broadly independent of the quality of bank assets. Hence, to survive the shock banks should focus on strengthening their capital base rather than trying to limit the shock impact by looking for investments and management practices deemed to be safer.
(Chapter 3)

III

The contribution of the balance sheet leverage to the explanation of CDS spread changes of non-financial companies is much higher after July 2007 as investors appear to have become more aware of individual risk factors. Overall, the fundamental risk factors identified by the literature as relevant for the pricing of CDSs have maintained their explanatory power even after July 2007, in a period of remarkable stress for the CDS market.
(Chapter 4)

IV

Risk measures that do not take into account the serial correlation of returns tend to understate the true level of risk of hedge funds.
(Chapter 5)

V

When the return distribution exhibits heavy tails, the impact of smoothing returns on risk measures is usually larger than in the normal case.
(Chapter 5)

VI

Having closed-form solutions for several economic problems is a great human achievement. Having whatever kind of solutions for many other economic problems will be a further achievement (although less elegant).

VII

We have learned from consumer testing that not even the best disclosures are always adequate. According to our testing, some aspects of increasingly complex products simply cannot be adequately understood or evaluated by most consumers, no matter how clear the disclosure. In those cases, direct regulation, including the prohibition of certain practices, may be the only way to provide appropriate protections.
(Bernanke, "Financial innovation and consumer protection", 17 April 2009)

VIII

If a CEO says his company is in good health and the company goes bankrupt a few weeks later, he goes to jail for market manipulation, unless the company is a bank. If a policy maker says a country will never default, and it does, he goes to a conference to give a talk on shaping expectations and market irrationality.

IX

If even a small part of the time spent on trying to protect us from a crisis that has already happened were devoted to finding a way to out of it, then we might actually be getting somewhere.

X

Policy makers in the eurozone should have learned that they cannot punish private investors for lending their money to a country and expect the same investors keep lending to the other countries as if nothing happened. However, they seem to be glad to repeat the same mistakes as they insist on granting a senior status to ESM loans.

XI

Leges sine moribus vanae. (Laws without morals are useless.)
(Orazio)