UNIT 5 Money & Investment

Quotation 1:

"Money is one of the greatest instruments of freedom ever invented by man."

—Friedrich Hayek

Quotation 2:

"Money means more to us than any other object of possession because it obeys us without reservation."

—Georg Simmel

Lead-in

1. Researching and Retelling

Refer to *www.sunflower.ch/en/moneymuseum/picture-tours* and learn the history of money. Then tell the history briefly to your partner. See if you can find other interesting information about money on this website and share the information with your partner.

2. Discussion

In William Shakespeare's *The Merchant of Venice*, the most notorious moneylender Shylock demands literally "a pound of flesh" if Antonio can't fulfill his obligation. This act of villainy, however, is an inexorable fiber of today's financial world. Do you know what it is? And who acts as Shylock now?

Text A

The Descent of Money

Notes:

1. beget: to cause something or to make it happen 产生，招致

2. guise: the way someone or something appears to be, which hides the truth or is only temporary 装扮过的外表，伪装

Today's financial world is the result of four millennia of economic evolution. Money—the crystallized relationship between debtor and creditor—begat[1] banks, clearing houses for ever larger aggregations of borrowing and lending. From the 13th century onward, government bonds introduced the securitization of streams of interest payments, while bond markets revealed the benefits of regulated public markets for trading and pricing securities. From the 17th century, equity in corporations could be bought and sold in similar ways. From the 18th century, insurance funds and then pension funds exploited economies of scale and the laws of averages to provide financial protection against calculable risk. From the 19th, futures and options offered more specialized and sophisticated instruments: the first derivatives. And, from the 20th, households were encouraged, for political reasons, to increase leverage and skew their portfolios in favor of real estate.

Economies that combined all these institutional innovations—banks, bond markets, stock markets, insurance, and property-owning democracy—performed better over the long run than those that did not, because financial intermediation generally permits a more efficient allocation of resources than, say, feudalism or central planning. For this reason, it is not wholly surprising that the Western financial model tended to spread around the world, first in the guise[2] of imperialism, then in the guise of globalization. From ancient Mesopotamia to present-day China, in short, the ascent of money has been one of the driving forces behind human progress: a complex process of innovation, intermediation, and integration that has been as vital as the advance of science or the spread of law in mankind's escape from the drudgery of subsistence agriculture and the misery of the Malthusian trap. In the words of former Federal Reserve Governor Frederic Mishkin, "the financial system is the brain of the economy… It acts as a coordinating mechanism that allocates capital, the lifeblood of economic activity, to its most productive uses by businesses and households. If capital goes to the wrong uses or does not flow at all, the economy will operate inefficiently, and ultimately economic growth will be low."

Yet money's ascent has not been, and can never be, a smooth one. On the contrary, financial history is a roller-coaster[3] ride of ups and downs, bubbles and busts, manias and panics, shocks and crashes. One recent study of the available data for gross domestic product and consumption since 1870 has identified 148 crises in which a country experienced a cumulative decline in GDP of at least 10% and 87 crises in which consumption suffered a fall of comparable magnitude, implying a probability of financial disaster of around 3.6% per year. Even today, despite the unprecedented sophistication of our institutions and instruments, Planet Finance remains as vulnerable as ever to crises. It seems that, for all our ingenuity, we are doomed to be "fooled by randomness" and surprised by "black swans[4]". It may even be that we are living through the deflation of a multi-decade "super bubble."

There are three fundamental reasons for this. The first is that so much about the future—or, rather, futures, since there is never a singular future—lies in the realm of uncertainty, as opposed to calculable risk. As Frank Knight[5] argued in 1921, "Uncertainty must be taken in a sense radically distinct from the familiar notion of 'risk,' from which it has never been properly separated… A measurable uncertainty, or 'risk' proper… is so far different from an unmeasurable one that it is not in effect an uncertainty at all." To put it simply, much of what happens in life isn't like a game of dice[6]. Again and again an event will occur that is "so entirely unique that there are no others or not a sufficient number to make it possible to tabulate enough like it to form a basis for any inference of value about any real probability…" The same point was brilliantly expressed by Keynes[7] in 1937. "By 'uncertain' knowledge," he wrote in a response to critics of his *General Theory*,

> … I do not mean merely to distinguish what is known for certain from what is only probable. The game of roulette is not subject, in this sense, to uncertainty… The expectation of life

3. roller coaster: 过山车

4. black swan: a metaphor that describes an event that comes as a surprise and has a major effect "黑天鹅事件"，指难以预测、不寻常的事件

5. Frank Knight: an American economist who is considered the main founder of the Chicago school of economics 富兰克・奈特

6. dice: 骰子

7. Keynes: John Maynard Keynes, a British economist, widely considered to be one of the founders of modern macroeconomics and the most influential economist of the 20th century. His ideas are the basis for the school of thought known as Keynesian economics. 约翰・梅纳德・凯恩斯

> is only slightly uncertain. Even the weather is only moderately uncertain. The sense in which I am using the term is that in which the prospect of a European war is uncertain, or… the rate of interest 20 years hence… About these matters there is no scientific basis on which to form any calculable probability whatever. We simply do not know.

Keynes went on to hypothesize about the ways in which investors "manage in such circumstances to behave in a manner which saves our faces as rational, economic men":

1. We assume that the present is a much more serviceable guide to the future than a candid[8] examination of past experience would show it to have been hitherto. In other words we largely ignore the prospect of future changes about the actual character of which we know nothing.

2. We assume that the existing state of opinion as expressed in prices and the character of existing output is based on a correct summing up of future prospects.

3. Knowing that our own individual judgment is worthless, we endeavor to fall back on the judgment of the rest of the world which is perhaps better informed. That is, we endeavor to conform with the behavior of the majority or the average.

Though it is far from clear that Keynes was correct in his interpretation of investors' behavior, he was certainly thinking along the right lines. For there is no question that the heuristic biases of individuals play a critical role in generating volatility in financial markets.

This brings us to the second reason for the inherent instability of the financial system: human behavior. As we have seen, all financial institutions are at the mercy of our innate inclination to veer[9] from euphoria[10] to despondency[11]; our recurrent inability to protect ourselves against "tail risk"; our perennial failure to learn from history. In a famous article, Daniel Kahneman[12] and Amos Tversky[13] demonstrated with a series of experiments the tendency that people have to miscalculate probabilities when confronted

8. candid: telling the truth, even when the truth may be unpleasant or embarrassing 坦率的，直言不讳的

9. veer: to change direction suddenly 突然改变（方向）

10. euphoria: a feeling of extreme happiness and excitement 极度兴奋，狂喜

11. despondency: a feeling of extreme distress, without hope 沮丧，消沉

12. Daniel Kahneman: a psychologist and co-recipient of the 2002 Nobel Memorial Prize in Economic Sciences. He is notable for his work on the psychology of judgment and decision making, behavioral economics, and hedonic psychology. 丹尼尔·卡尼曼

13. Amos Tversky: a cognitive and mathematical psychologist; a pioneer of cognitive science 阿莫斯·特沃斯基

with simple financial choices. First, they gave their sample group 1,000 Israeli pounds each. Then they offered them a choice between either a) a 50% chance of winning an additional 1,000 pounds or b) a 100% chance of winning an additional 500 pounds. Only 16% of people chose a); everyone else (84%) chose b). Next, they asked the same group to imagine having received 2,000 Israeli pounds each and confronted them with another choice: between either c) a 50% chance of losing 1,000 pounds or d) a 100% chance of losing 500 pounds. This time the majority (69%) chose c); only 31% chose d). Yet, viewed in terms of their payoffs, the two problems are identical. In both cases you have a choice between a 50% chance of ending up with 1,000 pounds and an equal chance of ending up with 2,000 pounds (a and c) or a certainty of ending up with 1,500 pounds (b and d). In this and other experiments, Kahneman and Tversky identify a striking asymmetry: risk aversion for positive prospects, but risk seeking for negative ones. A loss has about two and a half times the impact of a gain of the same magnitude.

This "failure of invariance" is only one of many heuristic biases (skewed modes of thinking or learning) that distinguish real human beings from the homo economicus[14] of neoclassical economic theory, who is supposed to make his decisions rationally, on the basis of all the available information and his expected utility. Other experiments show that we also succumb too readily to such cognitive traps as:

1. Availability bias, which causes us to base decisions on information that is more readily available in our memories, rather than the data we really need;

2. Hindsight bias, which causes us to attach higher probabilities to events after they have happened (*ex post*[15]) than we did before they happened (*ex ante*[16]);

3. The problem of induction, which leads us to formulate general rules on the basis of insufficient information;

4. The fallacy of conjunction (or disjunction), which means we tend to overestimate the probability that seven events of 90% probability will all occur, while underestimating

14. homo economicus: a rational and narrowly self-interested actor who has the ability to make judgments toward his/her subjectively defined ends 理性经济人

15. *ex post*: 事后

16. *ex ante*: 事前

the probability that at least one of seven events of 10% probability will occur;

5. Confirmation bias, which inclines us to look for confirming evidence of an initial hypothesis, rather than falsifying evidence that would disprove it;

6. Contamination effects, whereby we allow irrelevant but proximate information to influence a decision;

7. The affect heuristic, whereby preconceived value-judgments interfere with our assessment of costs and benefits;

8. Scope neglect, which prevents us from proportionately adjusting what we should be willing to sacrifice to avoid harms of different orders of magnitude;

9. Over confidence in calibration, which leads us to underestimate the confidence intervals within which our estimates will be robust (e.g. to conflate the "best case" scenario with the "most probable")

10. Bystander apathy, which inclines us to abdicate individual responsibility when in a crowd.

If you still doubt the hard-wired fallibility of human beings, ask yourself the following question. A bat and ball, together, cost a total of £1.10 and the bat costs £1 more than the ball. How much is the ball? The wrong answer is the one that roughly one in every two people blurts out: 10 pence. The correct answer is 5 pence, since only with a bat worth £1.05 and a ball worth 5 pence are both conditions satisfied.

If any field has the potential to revolutionize our understanding of the way financial markets work, it must surely be the burgeoning discipline of behavioral finance. It is far from clear how much of the body of work derived from the efficient markets hypothesis can survive this challenge. Those who put their faith in the "wisdom of crowds" mean no more than that a large group of people are more likely to make a correct assessment than a small group of supposed experts. But that is not saying much. The old joke that "Macroeconomists have successfully predicted nine of the last five recessions" is not so much a joke as a dispiriting truth about the difficulty of economic forecasting.

Meanwhile, serious students of human psychology will expect as much madness as wisdom from large groups of people. A case in point must be the near-universal delusion among investors in the first half of 2007 that a major liquidity crisis could not occur. To adapt an elegant summation by Eliezer Yudkowsky[17]:

> People may be overconfident and over-optimistic. They may focus on overly specific scenarios for the future, to the exclusion of all others. They may not recall any past [liquidity crises[18]] in memory. They may overestimate the predictability of the past, and hence underestimate the surprise of the future. They may not realize the difficulty of preparing for [liquidity crises] without the benefit of hindsight. They may prefer… gambles with higher payoff probabilities, neglecting the value of the stakes. They may conflate positive information about the benefits of a technology [e.g. bond insurance] and negative information about its risks. They may be contaminated by movies where the [financial system] ends up being saved... Or the extremely unpleasant prospect of [a liquidity crisis] may spur them to seek arguments that [liquidity] will not [dry up], without an equally frantic search for reasons why [it should]. But if the question is, specifically, "Why aren't more people doing something about it?", one possible component is that people are asking that very question—darting their eyes around to see if anyone else is reacting… meanwhile trying to appear poised and unflustered.

Most of our cognitive warping is, of course, the result of evolution. The third reason for the erratic path of financial history is also related to the theory of evolution, though by analogy. It is commonly said that finance has a Darwinian quality. "The survival of the fittest" is a phrase that aggressive traders like to use; as we have seen, investment banks like to hold conferences with titles like "The Evolution of Excellence." But the American crisis of 2007 has increased the frequency of such language. US Assistant Secretary of the Treasury Anthony W. Ryan was not the only person to talk in terms of a wave of financial extinctions in the second half of 2007. Andrew Lo, director of the Massachusetts

17. Eliezer Yudkowsky: an American blogger, writer, and advocate for Friendly Artificial Intelligence 埃利泽・尤德考斯基

18. liquidity crisis: an acute shortage of liquidity 清偿危机，流动性危机

19. Thorstein Veblen: an American economist and social scientist; the author of *The Theory of the Leisure Class* 托斯丹·凡勃伦

20. Joseph Schumpeter: an American economist and sociologist known for his theories of capitalist development and business cycle 约瑟夫·熊彼特

21. Creative Destruction: sometimes known as Schumpeter's gale; a term in economics which basically describes the way in which new systems destroy and reconfigure previous economic orders 创造性破坏理论

Institute of Technology's Laboratory for Financial Engineering, is in the vanguard of an effort to re-conceptualize markets as adaptive systems. A long-run historical analysis of the development of financial services also suggests that evolutionary forces are present in the financial world as much as they are in the natural world.

The notion that Darwinian processes may be at work in the economy is not new, of course. Evolutionary economics is in fact a well-established sub-discipline, which has had its own dedicated journal for the past 16 years. Thorstein Veblen[19] first posed the question "Why is economics not an evolutionary science?" (implying that it really should be) as long ago as 1898. In a famous passage in his *Capitalism, Socialism and Democracy*, which could equally well apply to finance, Joseph Schumpeter[20] characterized industrial capitalism as "an evolutionary process":

> This evolutionary character... is not merely due to the fact that economic life goes on in a social and natural environment which changes and by its change alters the data of economic action; this fact is important and these changes (wars, revolutions, and so on) often condition industrial change, but they are not its prime movers. Nor is this evolutionary character due to quasi-autonomic increase in population and capital or to the vagaries of monetary systems of which exactly the same thing holds true. The fundamental impulse that sets and keeps the capitalist engine in motion comes from the new consumers' goods, the new methods of production or transportation, the new markets, the new forms of industrial organization that capitalist enterprise creates... The opening up of new markets, foreign or domestic, and the organizational development from the craft shop and factory to such concerns as US Steel illustrate the same process of industrial mutation—if I may use the biological term—that incessantly revolutionizes the economic structure from within, incessantly destroying the old one, incessantly creating a new one. This process of Creative Destruction[21] is the essential fact about capitalism.

(Adapted from *The Ascent of Money* written by Niall Ferguson)

Exercises

I. Reading Comprehension

1. Determine whether the following statements are true or false based on the information you get from the text. Write a T for true, an F for false, and an NG for not given.

______ 1) Western financial model tended to spread around the world because of the imperialism.

______ 2) The ascent of money has been one of the driving forces behind human progress.

______ 3) Uncertainty must be taken in a sense that is different from the notion of "risk."

______ 4) The present is a more reliable guide to the future than the past.

______ 5) The collapse of the financial system is perennial as it is within our nature to make mistakes.

______ 6) Kahneman and Tversky's experiment demonstrates that real human beings cannot behave the same as the homo economicus of neoclassical economic theory.

______ 7) Economists could never give a successful economic forecasting due to the enormous difficulty of the task itself.

______ 8) Darwinian idea of evolution is applicable to the wayward development of financial history.

2. Discuss the following questions with your partner.

1) According to the author, how many reasons are there contributing to the turbulent evolution of finance? And what are they?

2) What is "failure of invariance"? Please explain it in your own words with examples.

3) Joseph Schumpeter expounds innovation as the critical dimension of economic change. He seeks to prove that innovation-originated market power could provide better results than the invisible hand and price competition immortalized by Admit Smith. Do you agree with him? Why or why not?

II. Blank-filling

Complete the following sentences with the words or phrases given in the box. Change the form when necessary.

drudgery	ingenuity	tabulate	hypothesize	heuristic
volatility	veer	euphoria	despondency	dispiriting

1. "Food is consumed by people whether the financial markets are ___________ or not," he said. "People need food."
2. The young girl was ___________ over the passing of her father.
3. Psychologists ___________ that his odd behavior was caused by a chemical imbalance in the brain.
4. She hated the domestic ___________ of her marriage life.
5. The car ___________ suddenly to avoid running into the dog.
6. She showed amazing ___________ in finding ways to cut costs. That surprised all her friends.
7. A particularly ___________ outcome of all this is the total absence of a firm, long-term commitment from the government.
8. The drug produces intense feelings of ___________.
9. A machine is used to ___________ an enormous number of the votes.
10. By reviewing examples of ___________, it is possible to focus on this approach to problem solving that takes one's personal experience into account.

III. Paraphrasing

1. Rewrite the following sentences with the words or phrases given in the brackets, keeping the meaning unchanged.

1) And, from the 20th, households were encouraged, for political reasons, to increase leverage and skew their portfolios in favor of real estate. (divert)

____

____

____

2) For this reason, it is not wholly surprising that the Western financial model tended to spread around the world, first in the guise of imperialism, then in the guise of globalization. (form)

3) That is, we endeavor to conform with the behavior of the majority or the average. (comply)

4) If you still doubt the hard-wired fallibility of human beings, ask yourself the following question. (deeply-rooted)

5) If any field has the potential to revolutionize our understanding of the way financial markets work, it must surely be the burgeoning discipline of behavioral finance. (thriving)

2. Rewrite the following sentences in your own words.

1) On the contrary, financial history is a roller-coaster ride of ups and downs, bubbles and busts, manias and panics, shocks and crashes.

2) We assume that the present is a much more serviceable guide to the future than a candid examination of past experience would show it to have been hitherto.

3) Knowing that our own individual judgment is worthless, we endeavor to fall back on the judgment of the rest of the world which is perhaps better informed.

4) As we have seen, all financial institutions are at the mercy of our innate inclination to veer from euphoria to despondency…

5) The fundamental impulse that sets and keeps the capitalist engine in motion comes from the new consumers' goods, the new methods of production or transportation, the new markets, the new forms of industrial organization that capitalist enterprise creates…

IV. Translation

1. Sentence Translation

1) Money—the crystallized relationship between debtor and creditor—begat banks, clearing houses for ever larger aggregations of borrowing and lending.

2) From ancient Mesopotamia to present-day China, in short, the ascent of money has been one of the driving forces behind human progress: a complex process of innovation, intermediation, and integration that has been as vital as the advance of science or the spread of law in mankind's escape from the drudgery of subsistence agriculture and the misery of the Malthusian trap.

3) For there is no question that the heuristic biases of individuals play a critical role in generating volatility in financial markets.

4) The old joke that "Macroeconomists have successfully predicted nine of the last five recessions" is not so much a joke as a dispiriting truth about the difficulty of economic forecasting.

5) A long-run historical analysis of the development of financial services also suggests that evolutionary forces are present in the financial world as much as they are in the natural world.

2. Passage Translation

全球经济衰退的消息本身就够糟糕了，但它还给全球化时代的自由市场带来了最大的威胁。这是近三十年来，全球经济的两大引擎——贸易和资本流动——首次同时反转逆行。世界银行表示，2009年流入新兴市场国家的净私人资本可能只有2007年的一半，2007年的记录是1万亿美元；与此同时，全球贸易量也将自1982年来出现首次缩减。两者同时逆转将催生出一些扭曲的调整措施。从中国到德国，这类依赖出口来拉动经济增长的国家将出现增速下滑，除非它们能快速启动内需。私人资本的逃逸意味着经常账户赤字的新兴市场国家同时面临投资和出口收入的干涸。风险便出现了：痛苦不安的政府向一位虚伪的老朋友——保护主义——求助。

V. Cloze

"Money makes the world go round!" It is a common 1) s___________ we've all heard in our lifetimes. "Benjamins" has become an integral part of our society, and with the things one can 2) a___________ with it, it's no wonder why so much evil has been fostered from it. Since the days of ancient Rome, money has had some 3) n___________ effects on society. It 4) f___________ greed in even the most 5) k___________ individuals, causes them to destroy and obliterate anything that stands in the way of them and their valued prize, gives way to the ability of foul hearted human beings to control and gain power over others for insidious purpose, and leads to the common hardworking citizen to resort to 6) c___________ and thievery. Money, even with all its blessings and holy purposes, is one of the world's greatest evils. The first argument to how currency is evil is the hidden greed and selfishness it brings out in the sweetest of people. The little avarice embedded in us all that only the thought of getting a few coins into our hands can bring out. This 7) d___________ for "cash" can poison the heart and mind of the common man and stem the tide of any pure and 8) s___________ thought that the individual would have. The ordinary man turned to be a drug dealer, and some corporations, for example, whose only 9) c___________ is largely the acquisition of "dough" neither hid the lust they possess for money nor care whether someone gets hurt in their mad 10) q___________ for riches.

VI. Listening

Listen to the recording and complete the following passage with the information you get.

Money is your means of survival. The 1) ___________ you pronounce upon the source of your 2) ___________ is the verdict you pronounce upon your life. If the source is corrupt, you have damned your own existence. Did you get your money by 3) ___________? By 4) ___________ to fools, in the hope of getting more than your ability 5) ___________? By lowering your standards? By doing work you despise for purchasers you 6) ___________? If so, then your money will not give you a moment's or a penny's worth of joy. Then all the things you buy will become, not a 7) ___________ to you, but a reproach; not an achievement, but a reminder of shame. Then you'll scream that money is evil. Evil, because it would not pinch-hit for your self-respect? Evil, because it would not let you enjoy your 8) ___________? Is this the root of your hatred of money?

Money will always remain an 9) ___________ and refuse to replace you as the cause. Money is the product of virtue, but it will not give you virtue and it will not 10) ___________ your vices. Money will not give you the unearned, neither in matter nor in spirit. Is this the root of your hatred of money?

VII. Writing

Perhaps the most controversial topic of all the matters in the world, money remains to be the gravity of our daily lives, and it shapes our fortunes quite literally. But money is a boon-and-bane-in-one. It could empower and corrupt one at the same time. Write a passage of 300-350 words on “Money, a Virtue or a Vice?”

Text B

Investing Nightmares: Protect Your Money Now

Whether it's a bond bubble bursting or the threat of deflation, there's no shortage of nightmare scenarios for investors to be worried about today. And while you can't completely insulate[1] your portfolio from risk, there's plenty you can do, starting with maintaining a diverse collection of assets and rebalancing regularly. In fact, if that's all you do, you'll probably be in pretty good shape: A portfolio with a 60/40 split between stocks and bonds and rebalanced at the end of each year would be only a hair below the all-time high it hit in 2007 before the crash. But if you're particularly worried about specific scenarios, and you want to protect against it, there are ways to hedge.

Just keep in mind that you can't eliminate risk entirely from your portfolio. "If you expect returns, you have to take some risks," says Bob Doll, chief equity strategist for BlackRock, a New York-based investment management firm. "If you hedge all the risk out of your portfolio, you end up with no return. You have to make some bets." And the proverbial mattress isn't an option—over time, you'll get clobbered[2] by inflation.

Like any insurance, portfolio protection costs you—either in cold hard cash or lost return. But that's OK—you shouldn't lament paying for protection that, in retrospect, you didn't need, any more than you would regret buying life insurance if you live to a ripe old age. But to keep the cost reasonable, think carefully about what risks concern you the most and then hedge just enough to take the edge off that risk, says Marty Kearney, a senior instructor at the Chicago Board Options Exchange (CBOE)[3]'s Options Institute.

Here are five common worries and how you can best insure against them.

Notes:

1. insulate: to protect someone from particular influences, especially unpleasant ones 隔离

2. clobber: to affect someone or something badly, especially in a way that involves losing money 严重影响（尤指使其遭受经济损失）

3. Chicago Board Options Exchange (CBOE): 芝加哥期权交易所

4. Federal Reserve: Federal Reserve System; the central banking system of the United States 美国联邦储备系统

5. go short: the practice of selling securities or other financial instruments, with the intention of subsequently repurchasing them at a lower price 卖空

6. Barclays: a British multinational banking and financial services company headquartered in London 巴克莱银行

7. mutual fund: a type of professionally managed collective investment scheme that pools money from many investors to purchase securities 共同基金，互助基金

The Bond Bubble Bursts

When investors soured on stocks in 2008, they started piling into bonds. The combination of huge demand, rate cutting by the Federal Reserve[4] and a slow economy drove interest rates down to historic levels, and bond investors got stellar returns. (Bond prices rise when interest rates fall because the older, higher-yielding bonds become more valuable.) Now it seems as if there's nowhere for interest rates to go but up, and that's bad news for bonds, since the price of old (lower-yielding) bonds will fall as market rates rise. Indeed, the air already seems to be leaking out of the balloon—the price of a ten-year Treasury that matures in November 2020 has dropped 6% in just the past two months.

Strategy: Go short[5]. The longer the maturity on the bond, the more it's affected by rising rates. If you stick with bonds that mature within five to seven years, rising rates will only nick your portfolio by about half as much as they would if you were holding 30-year bonds. For example, rates on ten-year Treasuries jumped 1.3 percentage points in early 2009. What happened to bond prices? The Barclays[6] five-to-ten-year year Treasury index lost 4.8%; the Barclays Long Treasury index fell nearly 13%.

One simple way to invest in medium to short-term bonds is to buy a mutual fund[7] such as Vanguard Intermediate Term US Treasury fund (VFITX), which invests solely in US Treasuries with an average maturity of five to ten years. If you want a touch more yield, you can buy Vanguard Intermediate Term Bond Index Fund (VBIIX), which invests in high-grade corporate and government securities that mature in less than ten years. Or stay even shorter with the Vanguard Short-Term Investment Grade fund (VFSTX).

Price: Risk and reward go hand-in-hand, so the shorter the maturity, the less the return. A five-year Treasury bill, for example, was recently yielding 2%, while 30-year bonds were paying 4.41%.

Inflation Spikes

One scenario that would blow a hole in the bond bubble is a significant spike in inflation. Indeed, many experts are convinced that today's benign price growth and low interest rates can't last.

If inflation soars, so do interest rates and that spells disaster for your bond portfolio. If long term interest rates were to shoot higher by five percentage points, the value of a traditional bond portfolio would plunge 50%, says Paul Jacobs, a certified financial planner at Palisades Hudson Financial Group in Scarsdale, New York.

Strategy: Add commodities and floating-rate securities to your portfolio. Floating-rate bond funds, such as the Fidelity Floating Rate High Income Fund (FFRHX), offer rising yields when market rates rise. A fund or exchange-traded note that tracks a commodities index, such as the Dow Jones-UBS Commodity ETN (DJP), should also increase in value when inflation rises. In the past if you were worried about inflation, experts also advised buying the US Treasury's Inflation Protection Securities, better known as TIPS. In addition to giving investors a (small) yield, TIPS keep up with inflation because your principal increases each year by the amount of the consumer price index. But the prospect of inflation is so baked into the market psyche that TIPS yields actually went negative in October, and have been bumping around zero ever since. A TIPS fund, however, such as Vanguard Inflation-Protected Securities Fund (VIPSX), which yields a sorry 0.38% today can continue buying the bonds as yields move higher.

Price: Floating-rate bond funds typically invest in the debt of highly-leveraged companies, so there's some risk of default in that portfolio especially if rates rise enough to push those companies into bankruptcy. Also, commodity prices are notoriously volatile, so dedicating more than a small amount of your portfolio to commodities creates a whole new risk.

Deflation Rears Its Ugly Head

If you want to see a real horror story, take a look at the performance of Japan's Nikkei index[8], which topped out near 39,000 in late 1989 and has been slipping ever since—today it hovers around 10,500. Japanese stock prices are now at roughly the same level they were in 1983. The culprit is deflation—declining prices that cause consumers to sit on their pocketbooks, depressing prices of everything. Why buy something today when it will be cheaper next month?

8. Nikkei index: a stock market index for the Tokyo Stock Exchange (TSE) 日经指数

9. Financial Finesse: a provider of financial education, counseling, and financial wellness programs for organizations and employees nationwide

10. S&P 500: a stock market index based on the market capitalization of 500 leading companies publicly traded in the US stock market, as determined by Standard & Poor's 标准普尔500指数

Strategy: Cash is king in a deflationary environment, says Linda Robertson, senior financial planner with Financial Finesse[9] in Manhattan Beach, California. Even though you're not likely to earn much interest on your money when it's invested in bank deposits and short-term Treasury bills, having money stashed in cash benefits you because prices decline with each passing day. In a deflationary environment, a portfolio that doesn't grow at all still increases your buying power. Right now there's an unusual anomaly in the market, however, that allows you to get a decent yield by owning long-term bank CDs with limited early withdrawal penalties. As MoneyWatch blogger Allan Roth has explained, you can earn yields in the range of 2.7%, and if you decide to withdraw the money early, pay a penalty of only two months' interests.

Price: If deflation doesn't materialize, the cash in your portfolio is going to slowly lose buying power. Your cost is that loss of buying power plus the "opportunity cost" of not having your money in higher-yielding investments. On the other hand, the high-yield CDs mentioned above will keep you ahead of inflation, and since you can sell without paying much of a penalty and move your cash into higher yielding options, the price of this protection is relatively low. Consider this part of your fixed income portfolio.

The Stock Market Crashes

You know you need to have exposure to the stock market, but you can't stomach the idea of holding an asset that could lose nearly half its value in six months, as stocks did from September 2008 to March 2009.

Strategy: The best protection against a market crash is to have a portfolio that's well-diversified between stocks and bonds, and to rebalance it regularly. This strategy would have resulted in minimal losses even from the 2008 disaster. But there may be cases where you want a more targeted insurance policy—for instance if you own stocks options or restricted stock that you can't sell. You can hedge against losses by buying "puts" on the security. You can even buy puts on an entire index, such as the S&P 500[10]. Puts give you the right to sell shares at a specific price in the future. So, for instance, you could buy puts that give you the right to sell at a price that's 10% below today's price. You wouldn't exercise your puts if the security drops less than that, but if it drops more, you can sell at your strike price and pocket the difference.

Price: A put on the S&P 500 that would allow you to sell 100 shares at a 1,100-point level (the index is at about 1280 now) in 90 days recently cost between $690 and $890. A typical option contract ("puts" are options to sell; "calls" are options to buy) expires in three months. If you want protection that lasts longer, it costs more. Never bought or sold options and don't know how they work? The Chicago Board Options Exchange offers free tutorials on its website. Keep in mind that this is a very pricey strategy. Renew that option every three months, and you're spending around $3,000 a year on an index that, recent history notwithstanding, tends to rise more than fall.

The Voldemort[11] Market

You can't name the disaster. You don't know exactly what it is, how powerful it might be or when it might strike. But you're pretty sure there's a huge risk lurking in the financial markets somewhere and it's dangerous and frightening. The biggest danger is that your fear will lead you to do exactly the wrong thing, such as selling at the bottom or buying "safe" bonds at their peak.

Strategy: Diversify—widely. Because different markets rise and fall at different times, the only way to protect your portfolio from the disaster-that-cannot-be-named is to divvy your assets up[12] among many different types of investments, including stocks, bonds, cash, commodities, and real estate, says Jerry Miccolis, chief investment officer at Brinton Eaton, a boutique investment firm in Madison, New Jersey.

But the 2008 market rout that savaged virtually all markets in 2008 led some to believe that traditional diversification is not enough. Investors need some assets in emerging stock markets in Asia and South America; commodities such as timber (not just gold); and investments in commercial real estate, which you can buy through real estate investment trusts[13] and real estate-focused mutual funds. Of course, even those asset classes declined in 2008, but at least Treasuries and gold held up. And some asset classes bounced back

11. Voldemort: a fictional character and the main antagonist of J. K. Rowling's *Harry Potter* series 伏地魔

12. divvy up: to share something between several people 分配，分摊

13. real estate investment trust: a company that owns, and typically operates income-producing real estate or real estate related assets 不动产投资信托公司

faster than others. Miccolis also likes exchange-traded funds that bet on market volatility by mimicking volatility indexes, such as Deutsche Bank's EMERALD index, which aims to capture the variance in S&P 500 prices.

Price: When you're widely diversified, there's a good chance that some part of your portfolio is always going to be performing badly. On the other hand, some investments also should be performing well at all times, which reduces the chances that a market disaster will savage your financial future. And by rebalancing—selling winners and buying more of the losers—you are automatically buying low and selling high.

(Adapted from *www.cbsnews.com*)

Exercises

I. Discussion

1. According to the text, what major methods of investment do people usually have?
2. How would inflation influence people's investment? What investment strategies have been mentioned in the text to tackle investment's side effects?

II. Leaderless Group Discussion (LGD)

Theory

The concept of leaderless groups has been important in the development of theories about personal leadership traits and group leadership patterns. A review of how leaderless groups have functioned in practice indicates that the primary value of the concept may be more as the setting for researchers to discover how leaders emerge in groups and what individual behavior, attributes, and characteristics are correlated with the recognition of leadership than it has been in helping us understand the dynamics of how leaderless groups actually function. This may be because in the absence of clear leadership roles or in a leadership vacuum, participants will invariably insert leadership behavior. In some way, the concept of LGD has influenced the development of popular concepts such as self-directed and self-managed teams.

Compared with individual interviews, the LGD, as an assessment tool, has the following advantages:

- More candidates can be observed for much longer periods of time at the same time.
- The observer is completely free to observe and doesn't bother to prepare and present questions.
- All candidates have the same interview situation at the same time and with the same interviewers.
- The candidates are more stimulated by the group discussion than they would be during an individual interview.
- Self-awareness is enhanced when behavioral feedback is given by other participants.
- It can cultivate the participant's skills to structure a situation that is initially ambiguous, help the group solve problems, and earn esteem among other group members.
- It provides information concerning the attitude of each candidate toward other members of the group.
- It presents a specific evidence concerning the ability of each candidate to be a leader in a group.

However, some people have criticized the use of the LGD as an assessment tool as there are also problems with it:

- It requires professional design of the tasks as well as assessment criteria for the group discussion, which may be time-consuming.
- It is not feasible for selecting candidates from a large pool of candidates because of the time and cost involved with training the individuals who rate the applicants.
- It may not be fair to the participants as there might be differences among the various roles and tasks randomly assigned within a single group.
- The process is hard to be standardized as judgments made by the observers can vary owing to their individual personality, skills, experience, etc.

Practice

Divide the whole class into groups of six and conduct a leaderless group discussion based on the following information. Each group has 30 minutes for the discussion. Then choose one group to present their conclusion in front of the class.

◆ **Background**

Xanadu is a regional banking firm headquartered in Hong Kong and Shanghai. Its services include investment, merchant, retail, and private banking, with the bulk of its revenue generated by its retail banking service. Xanadu's current marketing strategy and unique selling point are to cater exclusively to customers in the region of Asia-Pacific. However, due to increased competition from big names in international banking, Xanadu is losing its grip.

You have recently joined Xanadu as a graduate management trainee. As part of your development, you are asked to participate in a meeting to address current and strategic issues alongside senior management. In preparation for this meeting, you and your colleagues are attending a committee meeting to discuss the way forward and to provide practical recommendations. You will discuss the following management issues and have to come to a mutual agreement on the most suitable course of action for this case.

◆ **Management Issues**

Due to the global financial crisis, this year's projections predict a significant drop in profits from Xanadu's flagship retail banking service. Introducing a new online services division may allow Xanadu to continue providing banking services to customers regardless of their geographical position. This solution was met with mixed results by the board, with traditionalists favoring the conventional brick-and-mortar style and modernists wanting to catch up with big high street banks. Senior management has asked for the input of junior management regarding the implementation of this service and its potential implications.

◆ **Task**

As a group, identify the pros and cons of implementing an online banking service at Xanadu and decide on a way forward.

Topic-related Vocabulary

1.	excess reserve	备付金（超额准备金）
2.	committed amount of foreign investment	协议外资金额
3.	credit rating	信用评级
4.	registered capital	注册资本
5.	insolvency	资不抵债
6.	return on assets (ROA)	资产收益率
7.	lender of last resort	最后贷款人