The Gambling Economy

Finance Everywhere, But Not a Dollar to Reap

Once upon a time, banks were in the business of taking and lending money. They were housed in stately temples, mostly inhabited by boring people, all dressed alike and convinced of their supreme importance as minders of the cash entrusted to them by assorted simpletons, aka accountholders.

To broaden their reach, banks maintained vast networks of satellite branches where said accountholders could meet the local manager whose demeanour inspired both confidence in those leaving their money behind and fear in other seeking to take money out.

Traditional retail banking still exists although in a much slimmed-down form. Local branches have been replaced by convenient online banking and their managers made way for chatbots that invariably seem unresponsive and clueless by design.

The withdrawal of banks from the high streets and neighbourhood corners is unsurprising. Today, most banks derive no more than three percent of their turnover from 'traditional' business operations such as fees and lending depositors' cash to companies wishing to expand or families looking to buy a home.

In 2022, the total assets of the financial sector in the UK amounted to a truly staggering $16.88 trillion - well over five time the aggregate output of the country's entire economy. Those assets comprise mostly claims on other banks.

Shuffling Trillions

Globally, the financial sector shuffles some $667 trillion around in the form of financial instruments. This compares to a global GDP - the total output of the world economy - of an estimated $105 trillion. Whereas GDP is a measure of the value of everything produced from hairpins and hammers to supercomputers and space rockets, the turnover of the financial industry is a measure of speculation - an activity that adds no value whatsoever.

By definition, there are two sides to every financial trade: a winner and a loser. Every dollar in profit is matched by a dollar in loss. The financial transactions that enable betting on the movements of whatever commodity or instrument, do not actually produce an output. The entire scheme represents a zero-sum game. The banks so engaged - essentially all of them - create no value whatsoever.

Take, for example, the practice of arbitrage - but one of a bewildering array of bets available to cash chasers. In its most basic form, arbitrage seeks to capitalise on price differences between markets. Arbitrage can take many forms and generate huge profits, especially when fast computers, proprietary algorithms, and artificial intelligence are deployed to spot and exploit minuscule price discrepancies between two or more similar assets.

This is what the 'flash boys' at most hedge funds do. It is called statistical arbitrage and involves vast volumes of money that move around in milliseconds to buy cheap in one market and sell at a profit in another one - all in a split second.

Essentially, arbitrage equals to scalping, a form of speculation as old and universal as it despised. Earlier this month, fast-movers were able to secure tickets to the 2025 Oasis reunion concerts at official box office prices for instant resale to less astute or savvy fans, generating a cool profit albeit at the expense of the slow-movers. Most people would agree that scalping is not a very ethical business. Bands such as the Rolling Stones have been known to shoehorn extra concerts into their touring schedule just to deprive scalpers of their profit by flooding the market with tickets.

Yet, in finance nobody seems overly troubled by arbitrage - or scalping on steroids.

Paths to Riches

Traditionally, there existed just a few narrow paths to riches: a fortune could be inherited, married, or stolen. However, for working stiffs, unable or too decent to tap into these opportunities, a fourth option beckoned: finance or, as it was known prior to becoming a respectable if not fashionable pursuit and 'industry', gambling.

High rollers and other risk takers no longer needed to head to Las Vegas or Monaco, but could get their fix online at an untold number of (often shady) websites that promise easy access to vast riches with exotic 'products' and testimonials from winners showcasing their palatial mansions and stables of fast cars and voluptuous women.

All that, and more, could be yours if you only follow a short course on trading in forex, crypto, or some other imagined asset that may easily be leveraged. Since the input is cash - your cash - banks are involved in the facilitation of your bets. The course that unlocks this wonderland - only $49.99! - is usually light on the downsides and only provides the bare legal minimum of warnings hidden in small print only accessible by the eagle-eyed.

On a macro-economic and societal level, gambling adds absolutely nothing to the economy. At a casino, gambling may be construed as a pastime or entertainment, but institutionalised gambling is less innocent. The lure of infinite riches based on a zero-sum financial play cannot sustain an economy or, indeed, a society: the play lacks value even though it moves up to seven times more money than activities that produce an measurable output and add wealth.

Illusory Hedges

Take, for example, Ray Dalio and Bridgewater Associates, the hedge fund he set up in 1975. Hedge funds represent the ultimate contradiction in terms. They promise positive returns regardless the direction of the overall market. Come rain or shine, hedge funds want to do well by placing a balanced mix of bets that, in conjunction, should produce a profit under any and all circumstances.

By definition, a hedge is not supposed to turn a profit. It's more traditional use is merely to protect against volatility. It is employed routinely in cross border trade by both exporters and importers as an insurance against fluctuations in the value of currencies that could cause disappointments and losses at both ends of a trade deal.

Curiously enough, as the hedge funds turned into an industry sometime in the 1970s, nobody spotted the contradiction in their business model. The grandiloquence of their managers and savvy marketing techniques convinced most big institutional investors - such as sovereign wealth funds and pension funds - that hedge funds had discovered a novel and profitable way to tap into the proverbial pot of gold at the end of the rainbow.

Mr Dalio claimed, rather shamelessly, that he had found the holy grail of investing. The World Bank pension fund, one of Mr Dalio's earliest clients, thought otherwise and left Bridgewater after the fund proved unable to make good on its promises.

Just like all others, Bridgewater enjoys good years and bad years. The fund was found on the profitable side of the 1987 Black Monday market crash and milked that lucky break for all it was worth - and more. Mr Dalio was duly sanctified after his Pure Alpha Fund gained a most respectable nine percent in 2008, the year of the credit crunch when the overall market plummeted.

However, in most years Mr Dalio's magic touch was absent. In fact, between 2012 and 2022 that same acclaimed Pure Alpha Fund rose just 17.8% whilst any boring index fund tracking the S&P 500 would have seen its value rise by 272%. An investigation by the Wall Street Journal concluded that any run-of-the-mill investment portfolio with a 60/40 split between equities and bonds easily outpaces any of Bridgewater's funds. So much for that holy grail.

The Megalomanic

However, Mr Dalio makes a lot of noise, as indeed do most captains of the hedge fund industry. He has become a fixture on television where he invariably foresees the imminent arrival of a market-busting recession requiring a 'hedge'. If he feels particularly depressed, Mr Dalio predicts, well, a depression. The industry insider joke is that Ray Dalio "called fifteen of the zero last recessions."

Perhaps there is just more than a little envy at play here. Love him or hate him, Mr Dalio has turned Bridgewater into the world's biggest hedge fund. However, most people who work at Bridgewater detest the man.

Having outgrown his proverbial britches, Ray Dalio morphed into a omniscient and omnipresent deity-like creep who is convinced that he, and he alone, holds they key to the ultimate truth. That truth is derived from constant feedback - and self-flagellation.

Bridgewater staff members are required to bombard and assail each other constantly with feedback, especially of the negative sort. Everybody must speak up and confront perceived laggards face-to-face with criticism which, moreover, must be delivered bluntly and with no regard for common courtesy.

Bridgewater offices were transformed into dystopian dens of surveillance with cameras and microphones recording every conversation and gesture.

Private phones or laptops have been banned and every keystroke entered into a computer is logged and tracked. Sifted with the help of artificial intelligence, the data so gathered is sent to the company's 'Transparency Library' which serves to identify the failings of individual staffers.

Why do Bridgewater staff put up with Mr Dalio's idiocy? Well, why not read *The Miser,* the comedy by French playwright Molière that shows what greed can do the people.

Lessons from Mao

The unfortunates caught by the Transparency Library must confront their peers during probes and interrogations modelled on the 'struggling sessions' used in Maoist China to find, humiliate, and eliminate perceived enemies of the state.

At Bridgewater, employees are forced to denounce their colleagues just like the Chinese Red Guards of the Cultural Revolution used their victims' family and friends to extract confessions of imaginary crimes against the collective.

The pomposity, vanity, and delusion of Ray Dalio, a mediocre fund manager by any measure, have become epic in their own right. Emulating the Little Red Book of Maoist China, Mr Dalio had his ideology condensed into *The Principles* with implementation monitored by the company's very own 'politburo'. Distilled to their vacuous core, *The Principles* contained a simplistic yet enigmatic formula: 'Pain + Reflection = Progress'.

With it institutionalised culture of bullying, Bridgewater became a monument to a single person's vanity and delusion - erected to make money out of money without the expenditure of effort. For all of Mr Dalio's bravado, the net contribution to society his outsized hedge fund, and all the others, is exactly zero.

Instead of peddling his rather silly ‘principles’, Mr Dalio would be wise to recognise that to be successful in gambling you only have to be right 51% of the time.

Tossing Coins for Profit

As it happens, hedge funds have no need for holy grails, guiding principles, arrogant gurus, or other props.

Science offers definitive proof that a coin flipped with gusto and caught midair is about two percent more likely to land on the side facing upwards before the toss. Now, that’s interesting.

The science involved includes aerodynamics and a string of other complex factors, but is beyond reproach. There is no need to terrorise staff, formulate principles, track down and humiliate under-performers, or boast about your genius: just toss a coin and take it from there. It beats taking investment advice from a monkey with a keyboard. By the way, that has been tried as well and the monkey reportedly beat a number of reputable fund managers.

The curious behaviour of the tossed coin has been used as a foundational principle in the design of an investment strategy - and with great success too. It is part of the ‘secret sauce’ of a rather obscure and hermetically closed outfit called Renaissance Technologies. The firm’s likewise secretive Medallion fund is run by geniuses who know next to nothing about investment fundamentals but all the more about mathematical and algebraic models, and statistical analysis.

Now listen up, Dalio’s of this world: over the last thirty years, Medallion has produced average annual returns of 71.2% before fees - 39% after - beating the world’s most celebrated investors including Warren Buffett and George Soros.

Regrettably, the fund has been closed to outside investors since 1993 and is accessible only to select current and former employees and their immediate family members. So, for the rest of us, it’s back to inheriting, marrying, or stealing any riches craved.