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Real Market Economics

The Fundamental Framework
for Finance Practitioners

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Preface

Economics is about the allocation of resources, so it is at the heart of markets. And yet to many, economics is a field that feels far removed from the realities of what they see trading. Common sense, some entrepreneurial intuition and a decent dose of luck might seem like the only tools one needs to navigate a profitable path, especially when approaching a new financial market. However, this would be a weak framework. It is one where inconsistencies can thrive, cancelling out the rewards of erstwhile successful views or leaving no protection when risks crystallise. Of course, luck is always welcome, but there is no accounting for it. Relying on that for returns is to make those returns ultimately un-replicable and thus unstable—a recipe for an unintentionally short relationship with real markets. A robust framework is needed instead, which this book provides.

Unfortunately, there is a chasm between most economic research and what is fundamentally driving real markets. At the academic end, economists insist on talking to themselves and pursuing niche research over addressing the needs of those allocating resources. It is almost another language, so it should not be surprising when people struggle to realise the relevance of economics. City economists bridge some of the gaps, but only for select clients. The business relies on dependence to justify hefty fees. It is like fishers fetching a higher price from those who cannot catch fish themselves. Those who lack understanding in our product or the willingness to pay will also find many in this smelly business passing goldfish off as an excellent tuna steak. Most people must make do with superficial portions. Readers of this book should learn to tell the difference and how to start catching metaphorical fish for themselves.

This book's originality is mainly its existence, rather than most of the ideas within it. Numerous other books address select issues of relevance to real markets, but they are narrow and deep. Reading them will not provide the robust framework needed. Meanwhile, the general and lengthy books from academia might have tremendous breadth, but even "applied" ones are poorly suited to practitioners, who are not the target audience. If you want a book that will abstractly teach you mainstream economic thought and its workhorse model as gospel, there are lots of books of that ilk. Mastering their mainstream models will open up many well-paid jobs re-teaching the same skills or applying them for places not subject to normal market pressures, i.e. government payrolls in all their guises, including central banks. However, if you want to make serious money instead, you need to be where the profits are. That means participating in real markets where many conventional assumptions are simply wrong. Properly placed, the realism of models that relax such assumptions brings their rewards. And a working knowledge can be attained relatively quickly.

Before we can start massaging out theoretical tensions, we need to make sure the framework is forming on strong foundations. It cannot be robust without that. Challenges to even the basic economic concepts will nonetheless be tackled here as promptly as it is possible to do so without causing unnecessary confusion. Correcting the theoretical foundations after they've set is an unnecessarily difficult task that also leaves inappropriate foundations in the interim. The first part of this book builds up the core framework of economic concepts, starting with real levels of activity before turning to growth in it and then prices, amid the dynamics of business cycles. Part two adds on the stabilising crossbeams, including macroprudential policies next to the more conventional monetary and fiscal ones. It naturally addresses how we might watch and anticipate changes in these policies. Finally, part three liberally coats the framework with financial markets, thereby making the completed framework's robust structure useful for investing in real markets.

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