book review

The ascent of money: a financial history of the world

by Niall Ferguson

(2008, Penguin, New York)

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WITH THE STATE of the financial markets continuing to be a pressing concern around the world, Niall Ferguson's book, *The ascent of money*, helps us to understand how we got to where we are today. The most interesting part of the book, is the last third, which outlines the spectacular growth of credit, derivatives, credit default swaps and collateralised mortgages. The last of these, introduced in 1983, grew to over $4 trillion by 2008, and the outstanding nominal value of derivatives is over 10 times as much as that.

Ferguson's discussion of the history of finance should be mandatory reading for anyone entering the world of finance. The book was completed in May 2008, and subsequent drastic and exceptional events, which are obviously not covered, leave the reader wondering what happened next and why and what does it all mean for the future.

The key messages in the book are that all bubbles burst and financial markets don't lend themselves to reliable analysis and forecasting. With tens of millions of investors driven by fear and greed, and billions of consumers influenced by current trends and expectations, scientific calculations cannot say much about the future. Financial intermediaries make money by generating transactions whether or not these transactions have much impact in an economic sense or are in the long-term interests of stakeholders.

The author recalls that on Black Monday, 28 October 1929, the stock market plunged by 13%, reaching its nadir – an 89% decline – three years later in July 1932. Output collapsed by 1/3 and unemployment reached 25%. Ten thousand banks failed with a devastating effect on money supply and credit. Based on that experience 80 years ago, the focus is now on avoiding a severe credit crunch which could stifle trade and enterprise. However, this has to be achieved in the face of undercapitalised banks, which are forced by laws and regulations to reduce balance sheets and improve capital adequacy.

The book paints Milton Friedman, the Nobel Laureate, as a man of great vision and understanding, particularly for his influence on market reform in Chile. Through Friedman's money supply and inflation advice, Chile was turned from a basket case into the most thriving Latin American nation. Other writers have suggested that the Chilean crisis was induced by reactionary forces, supported by the United States. They argue that the long recovery for Chile – subsequent to a coup causing the violent death of a democratically elected president and thousands of his supporters – may not be such a good example of successful reform. Ferguson also notes the debate as to whether increasing economic growth and trade automatically benefit mankind or if this needs to be qualified by other factors such as wider inclusion and fair distribution.

The author also questions the rationale for owning real estate, noting, however, that it still makes a lot of sense to own your home, partly because it puts discipline into savings and building personal equity. Although, in principle, liquidity is valuable, for many, the fact that the asset is illiquid may help prevent them from squandering these (liquid) funds. Banks and others who have convinced homeowners to (re-) mortgage their home for other non-related investments have frequently brought misfortune to their clients who often lack the experience to properly assess the risk associated with new investments.

The book seems to reinforce some of the established wisdom about the need for caution in building individual and corporate balance sheets. It suggests that drawing on common sense and good judgement remain more important than relying on expert advisers. The best advisers may be those who look at history and take a philosophical approach in which limiting downside risk is as important as capturing upside potential. Old-fashioned rules like keeping adequate liquidity and spreading your eggs among several baskets still make sense. As an investor, you need to be sceptical of anything that grows very fast and avoid instruments or business you don't fully understand. Before dealing with anyone, it is important to establish the counterparty's honesty and integrity, recognising opulence and unreasonable levels of reward as warning signs.

Overall, *The ascent of money* is a good read, presenting today's markets in a historical perspective. When the current one-in-100-year crisis is over, a sequel would perhaps be even more interesting.