



FINANCIAL PREPAREDNESS

"One of life's most painful moments comes when we must admit that we didn't do our homework, that we are not prepared." ~ Merlin Olsen

Issue #217
April 11, 2025

Normalstan vs. Extremistan

Most investors were probably shocked by the recent waterfall action of the global stock market. I was not. Although I was unsure of its timing or severity, I knew that such extreme events occur from time to time, like an earthquake or the eruption of a volcano. I can also understand how thanks to Recency Bias and greed, many investors (especially the less experienced) either could not or did not want to consider the possibility that such an event could occur. After many months and years of steady, incremental gains, they suddenly asked, "Hey, who moved my cheese?" And then proceeded to make up stories to tell themselves about how the market would be back to where it was in a year.

Ever since I read [The Black Swan](#) by Nassim Taleb, I've been warning my clients (as well as my readers, starting with [Issue #2](#)) that certain domains produce more extreme results than what would normally be expected. Most domains are in what Taleb calls Normalstan. The results they produce are generally constrained to a certain range by say the laws of physics or gravity. When you plot the outcomes of such domains, it results in a nice, symmetrical, normal (Gaussian) bell curve with thin tails on the left and right extremes. An example of this would be the height of men in a certain country. Most observations would cluster around say 5'9". Sure, occasionally you'd find a guy who was 6'7" or so, but you'd never find a guy who was eight feet tall.

However, some domains are in Extremistan. They produce wild, unexpected results from time to time (for example, the eruption of the [Krakatoa volcano](#) in 1883) that cause history to leap. Generally, these domains are [complex systems](#) that have different properties than non-complex systems (specifically, they are called *emergent properties*). Complex systems produce results that cannot be predicted in advance because no one can predict how the interaction of their “participants” will play out. Examples of complex systems include financial markets, war, politics, [supply chains](#) and weather.

When Taleb describes the extreme results of complex systems (which he calls Black Swans), he tries to get the reader to understand just how catastrophic a negative Black Swan could be (there are also good, positive Black Swans, such as a great scientific discovery). For example, a large object from space colliding with the Earth, the [Spanish Flu](#) that killed 50 million people in 1918, a civil war that dragged on for a decade in his native Lebanon, a solar flare that takes out much of the world's electronics and electrical grid.

Here I must mention that never before have humans been surrounded by so many complex systems. And when one suddenly collapses (which is pretty much the eventual fate of all of them), it can (and probably will) result in cascading failures of other complex systems. When one pauses long enough to contemplate the wide variety of possible negative events (most of which can't even be envisioned due to (1) unpredictable emergent properties and (2) the tendency of the human brain to ignore low-probability tail events), you begin to understand the sense of terror that Taleb tries to evoke. Learning about complex systems often compels one to [become a prepper](#).

Let's review some of the current situations we face from various complex systems:

A record amount of global debt and unfunded liabilities (debt creates fragility).

A world of fiat currencies (backed by nothing) and central banks (engaged in central planning).

The U.S. stock market is close to its record valuation in 1929, yet the overwhelming majority of companies around the world have become *de facto* [social justice nonprofits](#) devoted to achieving the goals of the United Nations and the World Economic Forum.

Complex, highly leveraged trading strategies employed by many hedge funds [appear to be blowing up](#).

The vast majority of stock trades today are placed by computer algorithms run by high frequency traders, hedge funds etc. where latency is measured in picoseconds.

Derivatives with a notional value of hundreds of trillions of dollars are outstanding.

The commercial real estate market is about to blow up from bad loans, and many regional banks have significant exposure.

The U.S. consumer is tapped out and shows increasing signs of financial distress.

A war is raging in Europe, with the EU eager to militarize its economy and join the fray.

A regional war continues in the Middle East, threatening commercial shipping in the Red Sea.

The U.S. and China ([the world's largest trading partner](#)) have started a trade war. (BTW, I haven't seen anyone talking about this, but if Chinese imports to the U.S. stop, [we will quickly run out](#) of many inputs, commodities and finished goods, so stock up while you can.)

[Europe has gone completely insane](#) and is rapidly descending into tyranny. NATO is effectively finished.

House Republicans have a razor thin majority. If they lose a couple of members for various reasons, it could result in a very different outcome.

The vast majority of countries in the industrialized world face a demographic collapse by 2040.

Millions of people around the world continue to migrate from the Third World to countries in the First World. These people have little to nothing in common.

Could the interaction of these complex systems produce any extreme negative events or cascading failures?

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Before starting a new diet or exercise regimen, you should consult with a doctor, nutritionist, dietician, or

personal trainer.