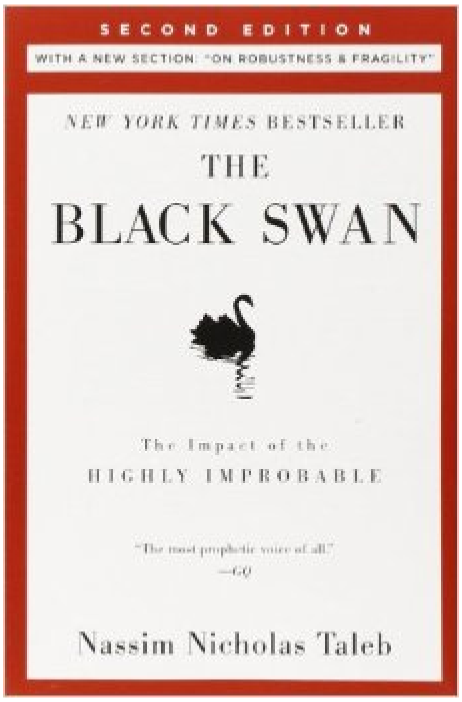
The Black Swan: Second Edition: The Impact Of The Highly Improbable: With A New Section: "On Robustness And Fragility" (Incerto)



Synopsis

A black swan is an event, positive or negative, that is deemed improbable yet causes massive consequences. In this groundbreaking and prophetic book, Taleb shows in a playful way that Black Swan events explain almost everything about our world, and yet weâ ”especially the expertsâ ”are blind to them. In this second edition, Taleb has added a new essay, On Robustness and Fragility, which offers tools to navigate and exploit a Black Swan world.

Book Information

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Customer Reviews

Starting with the good (chapters 15 - 17), within chapter 15 Taleb explains where the Bell curve works and where it does not. The Bell curve captures well variables that don’t deviate much from the mean. Otherwise, it does not work. Taleb suggests we often fool ourselves in believing that correlation, regression coefficients, or standard deviation convey much information. This is because those coefficients are unstable (and can flip sign when possible) depending on the time selected. This is because the underlying variables are often not stationary enough for these coefficients to be stable.Chapter 16 is excellent as an introduction to Mandelbrot’s fractal geometry as an alternative to Gaussian based investment theory. He supports well that these mathematical tools do capture randomness (of non-stationary variables) far better than the Normal distribution. However, he admits that Mandelbrotian models are not predictive. When looking at the same data set, he and numerous colleagues each came up with different underlying parameters to build fractal-like models. And a small difference in such parameters makes a huge difference in outcome. That's why you will not hear much of fractal geometry within the quantitative financial community. Nevertheless, this is a fascinating subject that deserves further exploration. For this purpose, I recommend Mandelbrot'sÂ The Misbehavior of MarketsWithin Chapter 17, Taleb further elaborates on the flaws of the Normal distribution. He underlines that half of the return of the stock market over the past 50 years was associated with just 10 days with the greatest daily change. This is an example where stock returns have outliers of such magnitude that using the Normal distribution is not appropriate. Taleb describes the run-ins he experienced with the living legends of modern finance including Myron Scholes and Robert Merton due to his rejection of the Normal distribution assumption that underlies all their models.The remainder of the book is not nearly as good. Hundreds of pages can be summed up in just stating that we can't predict rare events. Taleb goes way overboard in attributing everything to luck. He thinks MicroSoft beat out Apple just due to luck. Taleb does not consider that MicroSoft open system allowed it to mushroom while Apple locked itself into a proprietary corner. Also, according to Taleb both the rise and fall of Rome were due entirely to luck. But, Rome was best at developing military strategy and transportation networks. However, it eventually suffered from imperial overstretch. Explanations are not always narrative fallacies as Taleb believes. They often beat out ignorance.When it comes to advice, Taleb's recommendation is interesting. It consists in an asset allocation of 85% risk free investments (T-bill) and the 15% remainder into buying way out of the money Calls and Puts. By doing so, he positions his portfolio to capture the occasional mispriced Black Swans.This book is somewhat uneven in quality and is not nearly as good as his first book:Â Fooled by Randomness Revision (Not Available in US): The Hidden Role of Chance in the Markets and LifeÂ that has become a classic on Wall Street. Otherwise, it still is an interesting reading.If you find the subject of this book intriguing, let me suggest a few other books that are more rewarding. Scott Plous'sThe Psychology of Judgment and Decision MakingÂ explores the flaws in human judgments far more thoroughly and clearly than Taleb in `The Black Swan.' Perry Mehrling'sÂ Fischer Black and the Revolutionary Idea of FinanceÂ is also an excellent book. Ideally, that may be who Taleb would have liked to become. Fischer Black was brilliant and as skeptical as Taleb regarding much of the body of economics and finance. Yet, he left a great legacy of elegant models that people still use extensively including the famous Black-Scholes option model. Yes those models were often based on Taleb's dreaded Normal distribution. But, with minor modifications those models have remained valuable. Another recommendation is William Poundstone'sÂ Fortune's Formula: The Untold Story of the Scientific Betting System That Beat the Casinos and Wall StreetÂ that describes the career of a bright MIT mathematician, Ed Thorp. The latter showed how to successfully deal with uncertainty in gambling and investing. Even Taleb recognized Thorp's unique expertise within `Black Swan.'

If, as Socrates would have it, the only true knowledge is knowledge of one's own ignorance, then Nassim Nicholas Taleb is the world's greatest living teacher. In The Black Swan, Taleb's second book for laypeople, he gives a full treatment to concepts briefly explored in his first book "Fooled by Randomness." The Black Swan is basically a sequel to that book, but much more focused, detailed and scholarly. This is a book of serious philosophy that reads like a stand-up comedy routine. (Think Larry David...)The Black Swan is probably the strongest statement of enlightened empiricism since Ernst Mach refused to acknowledge the existence of the atom. Of course, in theory, everyone today is supposed to be an empiricist - all right-thinking intellectuals claim to base their views solely on positive scientific observation. But very few sincerely confront the implications of rigorous empiricism. Specifically, few confront "the problem of induction," illustrated here by the story of the black swan.Briefly: observing an event once does not predict it will occur again in the future. This remains true regardless of the number of observations one adds to the pile. Or, as Taleb, recapitulating David Hume, has it: the observation of even a million white swans does not justify the statement "all swans are white." There is no way to know that somewhere out there a black swan is not hiding, disproving the rule and nullifying our "knowledge" of swans. The problem of induction tells us that we cannot really learn from our experiences. It makes knowledge very problematic, if not impossible. And yet, humans do behave -almost without exception- as though they believe that experience teaches us lessons. This is forgivable; there is no better path to knowledge. But before proceeding, one must account for the limits that the problem of induction places on our claims to knowledge. And humans seem, at every turn, to lack this critical self-awareness.In one of the many humorous anecdotes that seem to comprise this entire book, Taleb recounts how he learned his extreme skepticism from his first boss, a French gentleman trader who insisted that he should not worry about the fluctuating values of economic indicators. (Indeed, Taleb proudly declares that, to this day, he remains blissfully ignorant of supposedly crucial "indicators" like housing starts and consumer spending. This is a shocking statement from a guy whose day job is managing a hedge fund.) Even if these "common knowledge" indicators are predictive of anything (dubious - see above), they are useless to you because everyone else is already accounting for them. They are "white swans," or common sense. Regardless of their magnitude, white swans are basically irrelevant to the trader - they have already been impounded into the market. In this environment, one can only profitably concern oneself with those bets which others are systematically ignoring -

bets on those highly unlikely, but highly consequential events that utterly defy the conventional wisdom. What Taleb ought to worry about, the Frenchman warned, was not the prospect of a quarter-percent rise in interest rates, but a plane hitting the World Trade Center!Yep, the precise facts of 9-11 were actually presaged by this French gentlemen, as a rogue wave that just might be lurking over the horizon. And, to the contemporary American mind, this is THE quintessential Black Swan. Of course, the Frenchman's insight was just a coincidence - the thing with Black Swans is that they cannot be foreseen.Taleb explains that conventional social scientists use induction to collect data, which is then plotted on the good old Gaussian bellcurve. With characteristic silliness, Taleb dubs the land of the bellcurve "Mediocristan" - and informs us that it is the natural habitat of the white swan. He contrasts Mediocristan with "Extremistan" - where chaos reigns, the wholly unexpected happens, power laws and fractal geometry apply and the bellcurve does not. Taleb's fictional/metaphorical 'stans' share something with the 'stans' of the real world: very ill-defined borders. Indeed, one can never tell whether one is in the relatively safe territory of Mediocristan or if one has wandered into the lawless tribal regions of Extremistan. The bellcurve can only help you in Mediocristan, but you have no way of knowing whether you have strayed into Extremistan - beyond the bellcurve's jurisdiction. This means that bellcurves are of no reliable use, anywhere. The full implications of this take a while to sink in, and are sure to cause huge controversy. In July, Taleb will debate Charles Murray (author of -what else?- the Bell Curve). I'll let you know who wins.Taleb frames his whole argument much more entertainingly than I could here, and he bolsters it with an astonishing command of both cutting-edge social science and the entire history of philosophy. This is an astonishing work of serious philosophy, and it reads like pulp fiction. Readers who enjoyed FBR will find here the same dry wit, the same literary erudition, and deep sense of the absurd that made that book so much fun. But this is better, by an order of magnitude - easily the best book I have read in 5 years. I smell a timely pop-science bestseller here to rival Gladwell or Surowiecki, but this is also a classic that will be read for decades to come.

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