

**Taleb, Nassim Nicholas - The Black Swan**

Random House, 2007, [Behavioural Finance] Grade ★★★★★

To call this book an investment classic is an understatement. *The Black Swan* has had a huge impact also beyond the enclosed world of finance. A Black Swan is today a part of everyday vocabulary. Former trader and now author/philosopher Nassim Taleb wasn't first to introduce the bird and unfortunately though the wording has stuck, the underlying meaning has not – but still.

*“A Black Swan is a highly improbable event with three principal characteristics: It is unpredictable; it carries a massive impact; and after the fact, we concoct an explanation that makes it appear less random, and more predictable than it was.”* Hence, it's an outlier (but not as rare as most expect) where statistics has little to say about probabilities and still it's an event where people will paint a picture of retrospective predictability – the event becomes obvious with hindsight. The concept distinctly sums up my uneasiness of the trust that is put in historical belle curved statistics and my fascination with how humans need to make sense of their world and therefore after-rationalize to be able to feel in control of their life and destiny. There is nothing new here for those who have read their Benoit Mandelbrot and behavioural finance, but it is presented in a “massive impact” way. Much of the text and its concepts have been incorporated into my reasoning.

With a nod to Mandelbrot the author exemplifies two types of uncertainties in the world with the imaginary places Mediocristan and Extremistan. The first is a linear place where the belle curve rules and *“when the sample is large no single instance will significantly change the aggregate”*. The second is a non-linear place of power laws where *“inequalities are such that one single observation can disproportionately impact the aggregate [...]”*. People's height and weight is from Mediocristan while their wealth and financial markets are from Extremistan. The problem is that we treat most areas as if they were from the former. To some extent the problem of not seeing the Black Swan coming is a “sucker's problem” since it occurs relative to someone's expectations.

As not all Black Swans are instantaneous surprises, an open mind can turn some Black Swans into Gray Swans. A big chunk of the book deals with predictions. The more knowledge people have the more confidence they gain in projecting an “inside the box” Mediocristan future. In reality forecasting is useless as unknown unknowns will change the path of events and forecast errors degrade the prediction in an exponential way over cumulative time periods. Instead we should prepare to cope with consequences, minimize the negative effects and also to gain from positive Black Swan events. Apart from a discussion around a barbell strategy there is relative little tangible stuff on the topic of how to prepare. Still, some general advice is given; Try to avoid making large bets on predictions and prepare for other outcomes; try to position yourself in asymmetric situations where the favorable outcomes - should they occur - are larger than the possible negative ones; *“favor experimentation over storytelling, experience over history, and clinical knowledge over theories”*; and *“train yourself to spot the difference between the sensational and the empiric.”*

The book is a mix of philosophy, statistics, finance, neurology, mathematics and quirky anecdotes - an improbable set up for a bestseller. The learned Taleb in many ways succeeds in his pursuit to be a renaissance man. The Bibliography reads like the library of Alexandria. The book is also filled with - mostly justified - sarcasm and arrogance. Even as I find myself agreeing with most of the spite, the author's distaste for those less intellectually elevated in the end becomes off-putting. There is a lack of humor and self-distance. I can't help but wonder if there is a measure of insecurity behind the ranting intellectual snobbism?

The book is an appeal against the stupidity that follows from our psychological biases and our unwillingness to deal with their effects even though they are well known. It takes a subject that might be seen as technical and brings it into a philosophical and intellectual domain, which puts it in a different light – simply superb.

Mats Larsson, December 4, 2013