Buchanan, Mark – Forecast

Bloomsbury, 2013, [Economics] Grade ★★★

The raison d'être for this book as the author describes it, is to fill a void. After the financial crisis there has been an immense amount of books describing psychological and institutional reasons for the crash. Yet the discussion around the soundness of the economic theories used to make sense of the world has been relatively absent. The physicist, author and science journalist Mark Buchanan takes on the challenge and concludes that there are a number of better tools to use to navigate the treacherous waters of the economy. Unfortunately the picture Buchanan paints of these other tools is too desultory.

Throughout the text there are two main themes. The first is economics bashing, or rather efficient market theory (EMT) and equilibrium bashing. The other is giving examples on a number of alternative ways to comprehend the processes of the economy and the financial markets. It is probably the case that for the semi-interested public the theoretical critique against efficient markets hasn't filtered through sufficiently. But, although I agree with much of the bashing in principle, I start to feel that we are kicking someone that is already lying down. Those who are interested in this area know that equilibrium theories don't capture the dynamics of markets especially well. Let's move on and concentrate on the tools we should use instead!

In this respect Buchanan's focus is interesting because much of the work done in behavioural finance focuses on establishing irrational behavior of individuals. This can be funny, quirky and sometimes useful if it can be turned into an investment strategy. The really interesting point however would be to take the next step and work on a coherent theory - or at least a set of reasonably connected sub-theories - on how the market really works on an aggregated level. This is exactly the hunting ground that the author tries to cover. Topics like complexity theory, power laws, unstable equilibriums, black swans, Austrian economics with it's focus on an ever changing

entrepreneurially driven economy and figureheads like Hyman Minsky, Frank Knight and George Soros pass by in fast-forward speed. Unfortunately there is little new for those who have followed the area, little direction in the text and nothing to tie all the interesting loose ends tighter.

Then comes chapter 6 called Ecologies of Belief, which establishes markets "*as ecologies of interacting strategies*". In itself this is nothing ground breaking, it builds heavily on the thoughts of Andrew Lo and his Adaptive Market Hypothesis, but it presents some detail on phase transitions between predictable markets and unpredictable markets that was new to me and, more importantly, he takes a stance and decides that the market is a tug of war between strategies like value and momentum with the consequence that crowding into any strategy makes the market fragile and susceptible to crashes. Good, this is where you want the author to dig in, focus, develop and expand – to use his physics background to deepen our understanding. Instead he relapses into throwing more mud on equilibrium theory, discussing the perils of high frequency trading and the fragility of leveraged and connected financial systems.

Mark Buchanan is a good writer so the book is an easy read and it is packed with many of my favorite theories – the pieces of mosaic that make up my picture of markets. There is too much good stuff in this book to give it a really low grade. However, despite using in my view the correct tools you get the feeling that the author lacks some depth in market understanding that makes his punch against older faulty tools less potent. I would have liked Jim Simons of Renaissance Technologies to have written this book.

If you have read nothing about the critique against equilibrium based economics or the partial theories that are starting to fill the void when EMT has fallen then this book is not all that bad. If you have followed the area, don't expect *Forecast* to add much to your knowledge.

Mats Larsson, October 29, 2015