

Thorp, Edward O. – A Man For All Markets

Random House, 2017, [Finance] Grade ★★☆☆

Ed Thorp is to quantitative investors what Ben Graham is to value investors – the founding father. Thorp, a mathematics professor and overall science genius, has an incredible investment track record. From 1969 to 1988 the two Princeton Newport Partnership funds showed an annual return of 19.1% and 15.1% vs. a return of 10.2% for S&P 500. Further, between 1992 and 2002 Thorp's statistical arbitrage portfolio returned 18.2% per year with 6.7% annualized volatility compared with 7.8% and 15.1% respectively for S&P 500. Still, this isn't as much a book on investing as it is an autobiography plus – unfortunately – a strangely added on mix of chapters with personal finance advice and contemplations on financial markets.

There are 4 sections in the book. First we learn about Thorp's modest upbringing with a reclusive father and a mother who ran off with another man and Thorp's college money. The young Thorp uses knowledge and reasoning as his way forward in life. Since he is largely self-taught he is motivated to think differently and empirically test theories. When Thorp as a young academic asks world famous physicist Richard Feynman if it is possible to beat the game of roulette and receives a negative answer, he is encouraged – if Feynman thinks it is impossible then there will be no competition. The first part of the book is a bit flat and the text makes it obvious how important it was for the underdog Thorp to be smart. The book comes to life in the next two sections.

Thorp uses his unusual combination of mathematical knowledge and practical bent to first figure out ways to tilt the odds in the favor of the gambler in Black Jack and then does the same with roulette. In both cases he validates his systems by heading to the casinos and making some serious big bucks. In beating the game of roulette he uses the first handheld computer, constructed together with Claude Shannon, the father of information theory. After being banned, cheated on and

threatened by the casinos, Thorp survives a murder attempt and re-focuses on Wall Street.

What Thorp brings is the notion of the necessity of a combination of an edge and risk management to stay in the game. For Thorp the edge is found in the budding derivatives markets. He first comes up with a groundbreaking method of better valuing options and designs a strategy of buying undervalued options and selling overvalued ones. After a lunch and a game of bridge with Warren Buffett Thorp launches the Princeton Newton Partnership, using the same model as Buffett's partnership. Sometime later Fisher Black and Myron Scholes launch their Black-Sholes Model of valuing options, the same model that Thorp has been using for a while. What follows is a period when Thorp plays cat and mouse with the academic establishment, coming up with ways to price derivatives and then trading on this knowledge until similar academic findings are published. In 1988 he, after a regulatory scandal unrelated to Thorp, closes the partnership. After two decades the academics pretty much have caught up. Instead a Thorp switch to statistical arbitrage and for another decade continues his investment success. In 2002 he finally closes down to spend more time with his family as the influx of hedge funds is starting to eat away his edge.

The final part of the book is a strange jumble of 10 chapters with fairly ordinary texts, ranging from compound interest to the 2009 financial crisis, that in my view only clouds the structure of the book. I think they should have been edited away. Surely there would be nothing wrong with publishing a book of “only” 250 pages?

As the author explains, when he thinks about problems he does it in words, numbers, images and in models – combine this versatile thinking with curiosity and drive, and great things are achieved. Thorp is a remarkable man with an astonishing career but this is not a remarkable book.

Mats Larsson, June 26, 2017