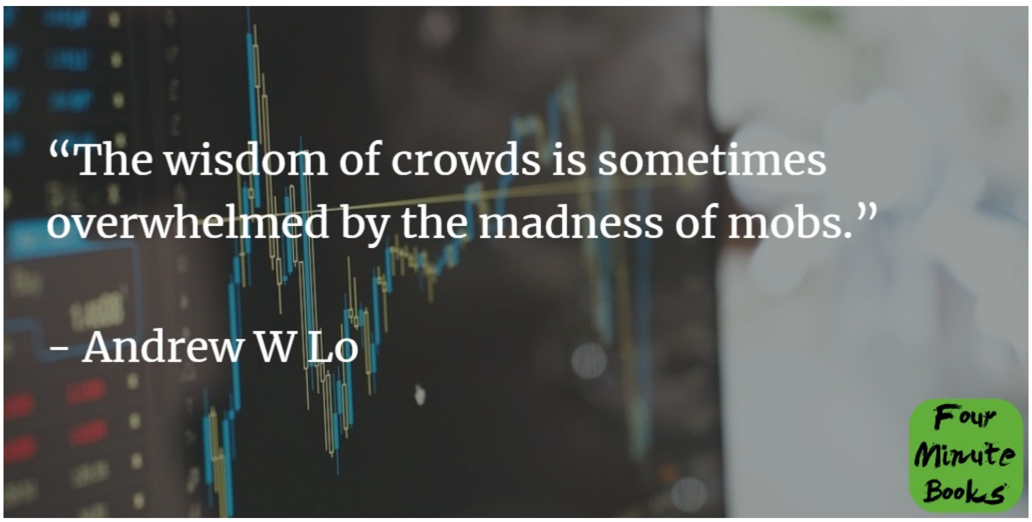
Adaptive Markets Summary

fourminutebooks.com

1-Sentence-Summary: *Adaptive Markets gives you a better understanding of how the movement of money in the world works by outlining the characteristics of the market, some of which are more like living creatures than you might think.*

Read in: 4 minutes

Favorite quote from the author:



Have you ever invested in stocks? Chances are you have and you might not even know about it. If you have a 401k or other retirement savings, for example, then you do have money in the market. And even if you don't think it affects you, the world's economic health depends on markets staying healthy.

Think about it this way. Do you remember how tough things were in 2008? Maybe you were looking for a job back then and found it difficult. Well, that's because banks and business owners rely heavily on overall economic health. So whether you like it or not, your success depends on the health of the market.

Don't worry if you feel lost in all of this though. That's what Andrew Lo will take care of in *Adaptive Markets: Financial Evolution at the Speed of Thought*. This is a book that will help you get a grasp on the past, present, and future of the financial world.

Here are the 3 most helpful lessons on the evolution of finance:

1. The most well-known theory of how the market works is the Efficient Market Hypothesis, which declares that stock prices reveal a company's health.

2. Competition, adaptation, innovation, and the improvements they make are driven by the power of the survival of the richest.
3. Use these theories to take advantage of compound interest by making wiser investments in the stock market.

After this one you'll be all ready to invest your money and make great returns! Let's jump right in!

Lesson 1: The Efficient Market Hypothesis says that a company's stock price is an indication of its health.

You're probably wondering how the markets work in the first place, right? I know when I started investing a couple of years ago it all felt a little confusing. That's why it's important to know about the Efficient Market Hypothesis, which is the prevailing theory explaining the mechanisms of the market.

The main idea of this theory is that asset prices, like those of stocks or bonds, will always accurately tell the story of a company's overall health, profitability, and value. It's not perfect, but experts agree that the Efficient Market Hypothesis is the best.

To understand this, consider the example of Morton Thiokol, a company that helped NASA with the construction of rockets in the 80's. When the Challenger Space Shuttle exploded in 1986, some of the company's faulty equipment used in the construction of the shuttle was to blame.

Share values of the company dropped significantly in the wake of these tragic events. This isn't a surprise due to the major setback the company now faced.

This hypothesis also accounts for the irrational emotional behavior of people. It does this with the idea that everything in the market evolves and happens for a reason. For example, when the market cap weighted indexes feature was introduced, it made investing cost less time and money. More investors began to using it. The tool transformed the landscape of investing and is in almost all mutual funds today.

Just like natural selection, competition and innovation make for an ever-changing and improving market.

Lesson 2: Survival of the richest is the force by which businesses make improvements that help make the world a better place.

You know about natural selection and the phrase "survival of the fittest" that describes it. This theory says that only species with the best traits for survival will continue on. These characteristics also begin to show up more often.

The same is true for economies. Instead of species trying to survive, however, it's investors, regulators, hedge funds, and companies that are competing to stay afloat. In these terms "survival of the fittest" becomes "survival of the richest." In other words, only the optimal qualities lead to wealth, so those traits will begin to stand out in the evolution of the market.

Let's take a look at an example. Hedge funds began with Alfred Winslow Jones in the late 40s. Beginning with $100,000, Jones bought healthy stocks with growth potential and sold short those that weren't performing as well. In this way he was hedging his bets, which is where the name hedge funds comes from. Jones's method was wildly successful, and he saw returns over 20%.

Although firms still operate with a lot of secrecy, we still see this same pattern today. **This evolutionary pattern means that superior species, or in this case techniques for investing, reign supreme while the weaker ones die out.** The market is a constant ebb and flow of good ideas thriving and bad ones fading away.

Lesson 3: If you want to invest in the stock market but feel lost, just use these theories to guide you.

Because we know that the Efficient Market Hypothesis works well, we can conclude that stock prices reflect a company's true value. Another word for this is equilibrium. While prices move up and down occasionally, overall the market wants to be at this state of stability. It's this fact that lets us trust in long-term investments as a way to make good money from the stock market.

I remember my first investment of only a few thousand dollars. Putting it into an index fund, I would watch almost daily to see how much I made. Unfortunately, I lost hundreds of dollars within just a few months. But a wise mentor told me to just keep the money in and wait it out. **I followed his advice and since then, I've made my money back and a whole lot more.** That was only a couple of years ago, and projections on my investments have me excited about a comfortable future ahead.

You can take advantage of the same principle by investing wisely. But be careful for some stocks that stagnate. In Japan, for example, the market crashed in 1991 and didn't recover for 20 years. That's a case where waiting it out wouldn't be the best option.

If you watch wisely and get good advice from advisers, you can know when to get out and when to stay in. Eventually you'll be riding high on all the money you've made from your know-how of the market!

Want to get more out of everything you read?

Get our reading guide. You'll remember more, better, and longer - no matter what you read.

Get the 20-page PDF »

Adaptive Markets Review

Adaptive Markets is an excellent book. I love the analogy that the market is more like a living organism than a physics or math equation. If you know about compound interest and want to take advantage of it but feel lost about how to do so, you should read this book.

Read full summary on Blinkist >>

Free Preview >>

Learn more about the author >>

Who would I recommend the Adaptive Markets summary to?

The 22-year-old economics student who wants a better understanding about the flow of the system, the 54-year-old with a lot of money in stocks that isn't sure how to proceed with them, and anyone who wants to learn the science of money.