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Changing thought processes

Fooled by Randomness puts forth a case for appreciating the role of luck in life and keeping away from our propensity to confuse fortune with reason. An OER Review

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ooled by Randomness is a primer on the obstacles that human beings face while reasoning around probability. Taleb argues that human beings are prone to misattribute the results of human endeavours to skill and knowledge that are, in fact, just coincidental and random events.

A market trader and a professional skeptic, Taleb claims to be a mathematical novice, but he is clear on one thing: the importance of understanding the structure of random events, their significance and, especially, insignificance. He clearly sees that this understanding is more important than actual calculations as he has seen innumerable traders - “blow up”, in the picturesque jargon of the trade - when a seemingly successful career is brought to a spectacular end by some “unexpected” market collapse.

There are many ways of being the fool of randomness. One, as here, is to fail to predict the rare event. Nothing can be more certain than that the unexpected will happen sooner or later, but lulled into a sense of security by the periods of relative calm in between, people forget to allow for it. Another is to see significance in some random pattern. Taleb explains with crystal clarity why the more often you look at some fluctuating quantity (the value of your share portfolio, for example), the less meaning your observations have. Yet he sees traders who watch prices move up and down in real time on screen - the changes are so small as to be completely random - and think they are learning something.

**Rose tinted glasses**

Taleb’s argument is that people are often tricked, mainly by the architecture of their own brains, into thinking that things that happen at random are actually happening by design. Adam Smith, the great Scottish economist and philosopher, wrote more than two centuries ago of “the overweening conceit which the greater part of men have of their own abilities [and] their absurd presumption in their own good fortune.” Many investors and business executives who think they are geniuses are merely the beneficiaries of good fortune. “We tend to think that traders are successful because they are good,” Taleb writes. But the truth is that “one can make money in the financial markets totally out of randomness.”

Another, trend that is the “survivorship bias”: in   
a random population, some items will be more visible   
than others.

The lesson here for investors is powerful and frightening. How much can you rely on the track records of investment advisers, mutual fund managers, newspaper columnists, or even the market as a whole in making decisions about your investment portfolio? Not nearly as much as you probably think.