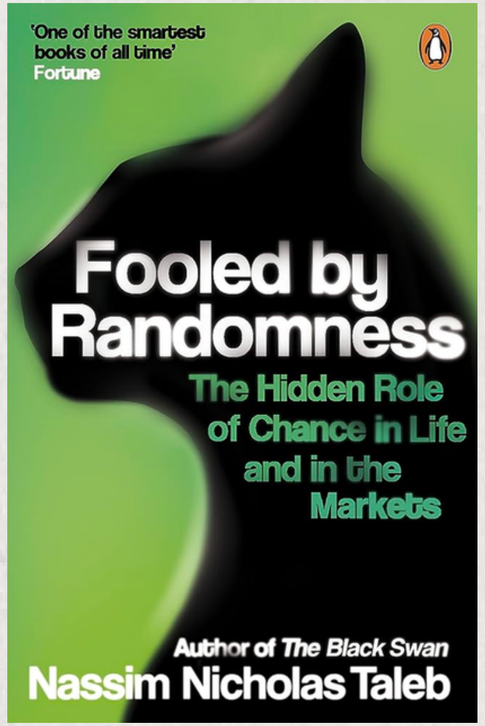
Presented by Dhruvi Punjani and Arhant Raj Modi

Fooled by Randomness

The Hidden Role of Chance in Life and in the Markets



Nassim Nicholas Taleb

Trader, practitioner of mathematical finance and hedge fund manager with over 50 years of experience

Why should you take his advice?

He is the famous author of the Black Swan

Net worth of 80-90Mil USD

Could it be that your perceptions of luck, skill, and success are merely illusions cloaked by the randomness of life's events?

Do skills and talent matter?

Is it all coincidence?

Is it merely Luck?

Success is predertimined?

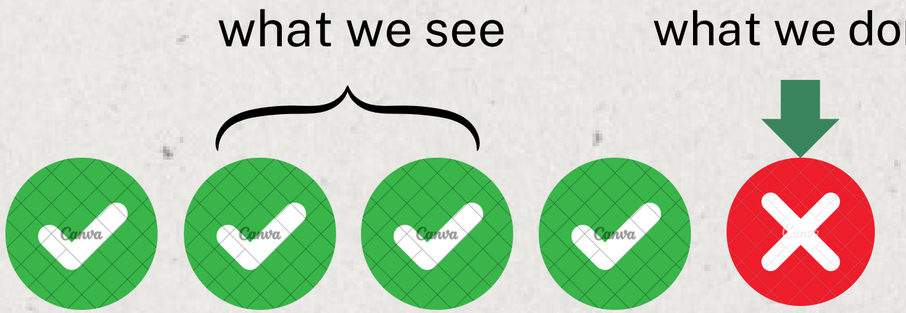
Is life random?

Survivorship Bias

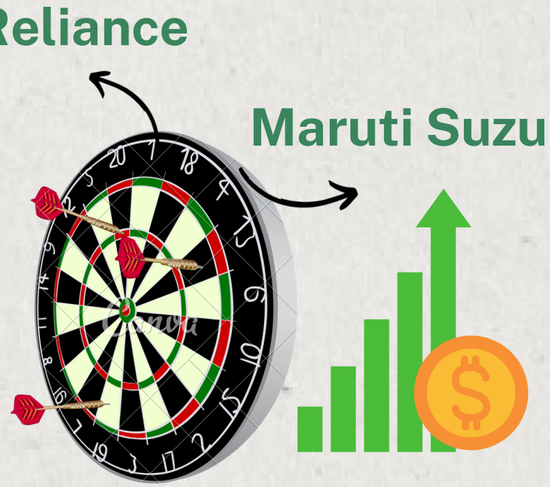
Case 1

How I made 12% investing in a market that declined 10%

How I lost 12% investing in a market that declined 10%



Case 2



But WHAT IF....?

Skewness Effect

Expectation > Probability

Event	Probability	Outcome	Expectation
A	999/1000	$1	999/1000*1=$0.999
B	1/1000	-$10000	1/1000*-1000=$-10
		TOTAL	$0.999+$-10=$-9.001

Expectation= Probability*Pay off

We want to maximise profit expectancy NOT profit probability

Here expectation for Event A is $0.999 and expectation for Event B is -$10. So, there is an expectation for a loss of $9.001, close to $9

It is seen that frequency or probability is irrelevant and needs to be judged in combination with the magnitude of outcome.

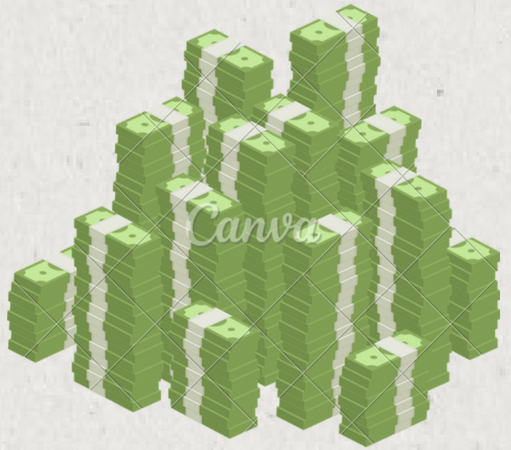
90% chance of losing 10%

10% chance of gaining 200%

Would you take this risk?

Dr. Taleb takes advantage of this skewness issue. He believes in:

occassionally bleeding some but never experiencing a cut throat loss



winning once but big time

BULL AND BEAR ZOOLOGY

Dr. Nassim argues that “bullish” and “bearish” are often hollow words with no application in a world of randomness

Event	Probability	Outcome	Expectation
Market goes UP	70%	Up 1%	70/100*1=0.7
Market goes DOWN	30%	Down 10%	20/100*10= -3
		Result	-2.3

Here the expectation of the market going up is 0.7 and the expectation of the market going down is 3. Ergo, the total expectation of the market going down is 2.3

It is not how likely an event is to happen that should be the point, the point is always how much is made when it happens. Similarly, the frequency of profits is irrelevant, the magnitude of the outcome counts

Black Swan Problem

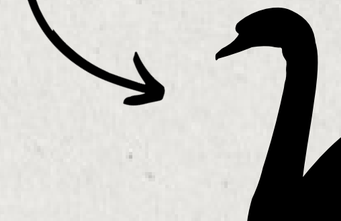
This has never happened before

≠

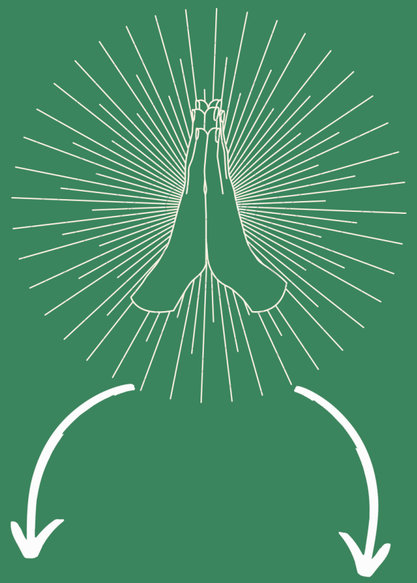
Will never happen

No amount of observation of white swans can allow the inference that there is no black swan, there can always be ONE!

A black swan can just be lurking around the corner!



Pascal's Wager



If you believe in god, and you the existence of a divine power is proved, you are to benefit from it

But if you believe in a god and the existence is denied, you are at no loss from that belief

Dr. Taleb advices investors to use the same principle of Pascal's wager:

- Get the benefit of a potential strategy that has worked in the past
- If it does not work, you will return to market average
- However, don't use historical data to determine your risk exposure

Traits of a Market Fool

01.

Marrying your positions

02.

No plan for losses

03.

Overestimating Accuracy

04.

Denial

Thank you very much!