

# The Ambachtsheer Letter

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## INVESTMENT BELIEFS AND BLACK SWANS:

### ARE OUR PERCEPTIONS OF REWARD AND RISK TOO 'NORMAL'?

*"A single observation can invalidate a general statement derived from millennia of confirmatory sightings of millions of white swans. All you need is a single black [one]"*.

From "The Black Swan"  
By Nassim Taleb (2007)

*"The people of Goldman Sachs lost a packet when something happened that their computers told them should only occur once every 100 millennia ... ."*

From "The Economist"  
August 16, 2007

#### Fooled by Randomness?

Some of you may remember Nassim Taleb's 2002 investment book "Fooled by Randomness" with its message that we think we know more than we really do. In his new "Black Swan" book, Taleb paints the same 'fooled by randomness' thesis on a broader 366-page canvass. His writing style continues unchanged too. Reviewers describe it variously as provocative, arrogant, quirky, fascinating, impertinent, elegant, extreme, dilettantish, encyclopedic, snobby, enlightening, insufferable, scholarly, astonishing, self-absorbed, and funny. (We're not making this up!)

Hopefully many more of you will remember last month's *Letter* titled "Investment Beliefs in the 21<sup>st</sup> Century: Separating Signal from Noise". Its essence was to suggest that for long-horizon investors, it is useful to see the changing world and its financial markets through the lens of alternating optimistic/pessimistic investment regimes of 10-20 years duration. That's the way the 20<sup>th</sup> century unfolded, and we suggested that same framework is likely to be useful to visualize investing in the new 21<sup>st</sup> century. The 'action' message that came out of this perspective was to not simply assume that all the 'unhappy' news for the next 10-20 years was compressed in 2000-2002 period, and that we have been living in a new extended coherently 'happy' investment re-

gime since 2003. Instead, the 20<sup>th</sup> century investment regime framework suggests caution and steady risk control measures will continue to be the order of the day for years to come.

We wrote that August *Letter* before reading "The Black Swan". In this sequel *Letter* we subject the views we set out last month to Taleb's black swan test. Do they pass the test? Or is the August *Letter* just another manifestation of being fooled by randomness? We go from there to assess the practical implications of taking a black swan view of the future.