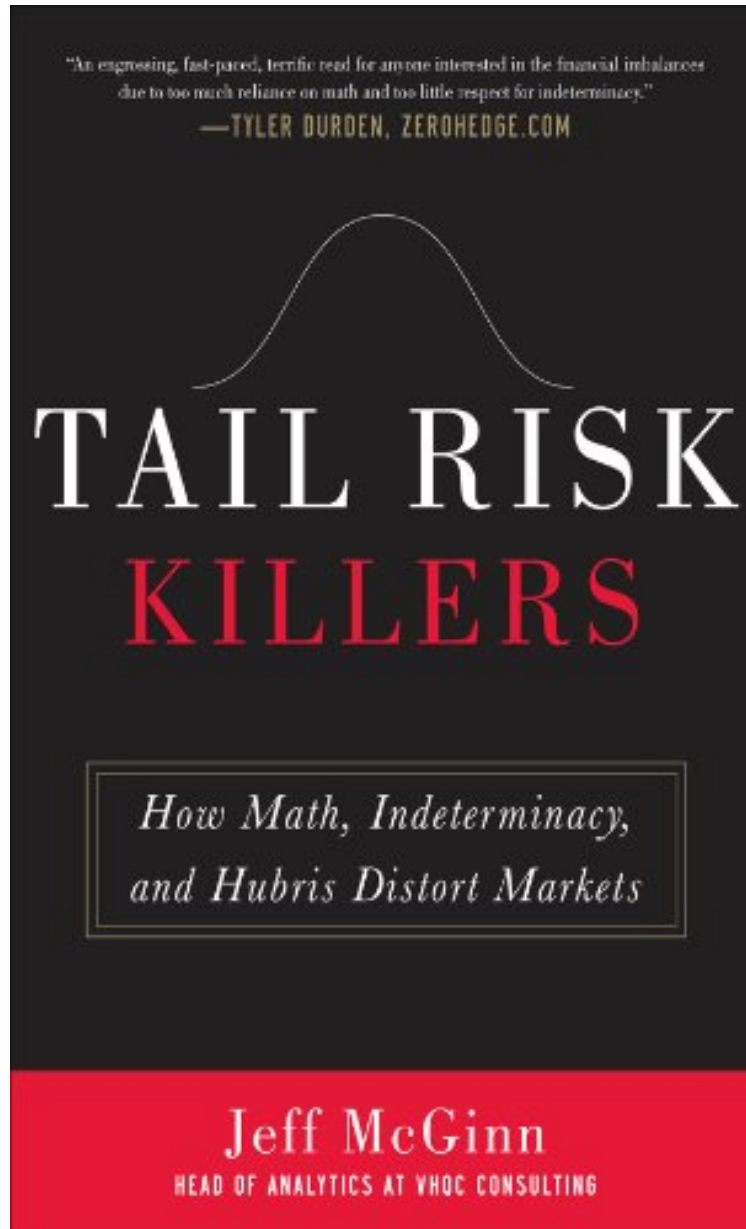


(Library ebook) Tail Risk Killers: How Math, Indeterminacy, and Hubris Distort Markets

Tail Risk Killers: How Math, Indeterminacy, and Hubris Distort Markets

Jeffrey McGinn

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#1843520 in eBooks 2012-01-06 2012-01-06 File Name: B006M9CI3A | File size: 28.Mb

Jeffrey McGinn : Tail Risk Killers: How Math, Indeterminacy, and Hubris Distort Markets before purchasing it in order to gage whether or not it would be worth my time, and all praised Tail Risk Killers: How Math, Indeterminacy, and Hubris Distort Markets:

2 of 2 people found the following review helpful. A good start

By Dr. Lee D. Carlson

The first thing that can be said about this book is that it is not really that critical about the use of mathematical modeling in finance. Quite the contrary, it offers the reader many valuable insights into some of the mathematical concepts used in mathematical finance that may not be found in the usual books on the subject. If readers can get beyond statements such as "the price of stability is pathology" and some of the unsubstantiated claims about interest rates driving everything in finance, they will find that the book is worth the time for reading and studying. Due to its informal style, the book should be viewed as a first introduction to risk management and as such is highly recommended for those readers who may be entering the field. It could also be of interest to mathematicians who desire an understanding of the main issues in risk management that are widely discussed in the financial press. One particular topic that the author clarifies effectively is the distinction between an ordinary probability measure and what is called a "risk neutral" probability measure. Risk neutral measures are usually not discussed at all in texts and monographs on probability theory. Some concepts in the book are tossed around without clarification however, such as Godel incompleteness, which is supposed to play a role in substantiating the author's concept of "indeterminism". The author also takes a leap into speculative philosophy when he speaks of how determinism and causality can be "defeated" via our imagination. History and interpretation can be "blended"; he says in order to guide future actions. His thoughts on these topics are too curt for much elaboration, but readers with a background in agent theory may find common ground here. In discussing the theory of dynamical systems the author quotes the mathematician Sheldon Newhouse as saying that a dynamical system can be so unstable so as to negate any understanding of it. Readers who are familiar with the Newhouse results and the theory of dynamical systems in general may find that the author's interpretation here is too extreme. The tools and properties used to characterize unstable systems in fact themselves offer at least a partial understanding of these systems. The author also makes an odd claim that the financial markets are "always a work in progress", but does not offer a language or framework that could be used to draw such a conclusion. If mathematics is unable to capture this "work in progress", what conceptual framework will allow one to do this? And do mathematicians who work in finance really have a "totalitarian urge to impose order and symmetry" on the "indeterminate chaos" of financial markets? The reviewer has found on the contrary that most financial mathematicians have an appreciation for the limitations of their financial models in terms of predictive ability. Indeed they have a reasonable "common sense" view of the world, this being even more so for those seasoned mathematicians who have been in the financial business for a long time. The author though does not merely engage in philosophical and theoretical musings but also uses illustrations and graphs based on empirical data to justify some of his conclusions. It is again important to note that these graphs and the discussions of them really imply that the author does believe in a measure of "regularity" in financial markets. He frequently makes commentary on the consequences of using financial instruments such as interest rate swaps, credit derivatives, and monetary tools to hedge inflation. His language in this regard is one that clearly implies some degree of predictability for the consequences of these instruments. He is correct in doing this.

15 of 15 people found the following review helpful. Want to know why today's market is so weird?

By Lauren Rakes

McGinn's book does a good job of explaining why this market feels so weird. Basically, too many years of Fed liquidity support, growth in Wall Street's structured risk management instruments, and miscellaneous government transferring of risks (collectively referred to by McGinn as "tail-risk killing") gave us for a long time a historically calm market; and now it is time to pay the piper. As a result of this paradigm shift, what worked (to some degree) in the past (models, trends, mean reversion, whatever) are not likely to work in the future (liquidity/solvency issues, risk transfer running to its limits - i.e., who else can we transfer risk to now?). His key point is summarized on page 110 "... tail-risk killing activities/strategies incentivize leverage in an effort to maintain returns in increasingly crowded trades, raising the vulnerability of the financial system as a whole. Bond prices, implied volatilities, spreads and defaults ultimately move in a dramatic way when leverage reverses." He adds to this point in the following sections p 119 "Since crises are unpredictable, a balance between illiquid assets, cashable assets and cash-like assets is wise. This has little to do with "diversify into uncorrelated assets" arguments." p 132 "As the world shifts from an easy liquidity, colored-by-noise framework to a liquidity-starved austerity, most models won't provide much advantage.... What really matters in the described phase transition is good information, intuition, and an ability to be resourceful and stubborn. Confidence comes from being "broadly" right. This is the human edge." McGinn offers several nuggets in the book: Investment (more like risk hedging) ideas that include using gold, treasuries, CDS, VIX, others. These ideas are sprinkled across the book. High level hedging rules for Position Risk; Skew Risk; Leverage Risk; Systemic Risk. A portfolio structure designed to make money in the middle (think bell curve where middle is the nice "normal" area of returns) and manage exposure to the tails. Axioms on risk management with a focus on liquidity, leverage and volatility. He also adds some "neat stuff" Introduces some of the mathematical theories that the market quants use to model the market (and discusses their shortcomings). Pulls in some Talmud and biblical references to risk management. Makes historical reference to support a number of points made. He sums up his approach for investors on page 310 saying "Risk management for those taking residual risk is managing liquidity (cash/near cash provisioning), reducing return volatility (diversification), and hedging nonstationarity (cheap exposure to the other side of crowded

trades). "This is a rich and eclectic book. I had to go through it twice to organize the thinking it contains. The publisher says the book is written in a "conversational style." That means you will need to structure it yourself. It does not mean it is an easy read: there is a lot going on in this book. The book is filled with nuggets. It is worth parsing through. The work to parse it cost it one star. Otherwise, this is an excellent addition to marketplace literature.

Reshape your investing strategy for an increasingly uncertain world "An engrossing, fast-paced, terrific read for anyone interested in the financial imbalances due to too much reliance on math and too little respect for indeterminacy." — Tyler Durden, ZeroHedge.com The world does not unfold according to a fixed set of rules. It is a dynamical system whose evolution looks like a bell curve with fat "tails." The same is true of financial markets. However, every day we rely on the certainty and precision of mathematical strategies that assume the contrary to control and grow wealth in markets. Tail Risk Killers shows you how the rigidity of model-based thinking has led to the fragility of today's global financial marketplace, and it explains how to use adaptive trading strategies to mitigate risk in impending market conditions. Risk management veteran Jeff McGinn pokes holes in prevalent assumptions about how financial markets act that tend to underestimate the likelihood of occurrence of extreme events. Through clear, conversational writing, real-world anecdotes, and easy-to-follow formulas, he provides a glimpse into the way tomorrow's successful traders are viewing financial markets—with an eye for probability distributions. While illustrating how to protect your assets from tail risk, he shows you how to: Implement the six axioms for risk management Prepare for the unintended consequences of central banks suppressing tail risk Identify and avoid the dark risks hidden in today's derivative-laden financial system Anticipate the fate of credit default swaps that may not face extinction McGinn argues that the intervention of central banks has robbed global markets of their opportunities to adapt, but this highly relevant book shows you that it is not too late to adapt your portfolio to survive the extreme events that happen more often than popular financial models suggest. Tail Risk Killers helps you discover useful information and processes beyond the focus of industry standards, helps you connect the dots of evolving trading strategies and time your next trade for maximum profitability.