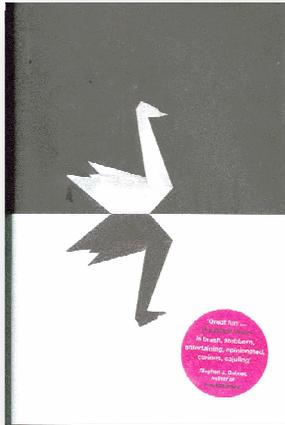


The Black Swan, by Nassim Nicholas Taleb

A book review by Ian Jay

One risk faced by the project manager is the unknown unknowns. A means of understanding and coping with high impact events we cannot forecast is the topic of this book.

Risk is commonly explained in terms of probability distributions, of which the normal distribution or 'bell curve' is best known. In reality, and particularly in the realms of projects, there is little information upon which to build any objective or formal view of risks using such a model. This text explains why that is so. It also explains the hazard of using the 'bell curve', and its assumptions about the world, when trying to anticipate future events. One problem is historical data with which to build such models. Recorded history is selective in nature and gives a biased picture of the past.



One of the main problems with forecasting is the historical basis of the data used. For instance, research publications present findings which had a positive impact on a topic, but rarely those experiments that yielded no appreciable change. In the same way things that did not work are discarded and what worked in a specific instance is promoted as a general solution. The author explores this theme with an example of studies presenting the common characteristics of the worlds richest men. As he points out, these characteristics may also be shared with failures, a point missed in such presentations. Historical data can be blind to certain events making a forecast based on that data inherently inaccurate.

The author goes on to make the point that the future is almost entirely unknowable. The human mind is blind to this fact and never remembers its past failures when predicting tomorrow. As a result we continue to repeat the errors of the past, trying to predict with tools that are inadequate or irrelevant to the task they are put. He makes this point particularly strongly in regard to the use of the 'bell curve' in financial markets, which is his area of expertise. He draws on other thinkers where he needs to. For instance explaining that Popper argued that "to predict historical events you need to predict technological innovation, itself fundamentally unpredictable".

The 'Black Swan Event' is a rare event that has extreme impact and with hindsight was predictable. The description also applies to an important expected event that fails to materialize. A key point made in the book is that these events are the ones that shape the modern world. As a result history is written to explain them, post event. In other words history is not written to predict them, because we do not know the future with sufficient precision to identify which extreme impact event will come next. A final point about the 'Black Swan' is that it can be a positive as well as a negative event in terms of its outcome. Several examples of positive events are given; one example from financial markets is that in the past fifty years half the total returns were made in ten trading days.

After explaining what extreme events are and why we do not see them in our futures, the author suggests some strategies to guard against the negative impacts and to profit from the positive ones. One strategy is the 'Barbell' where a strong defensive position is taken against the negative events, and an aggressive but small risk in the high risk areas. In effect the downside risk is minimized and the upside is unlimited. Because these events are by definition improbable many limited risks have to be taken in the areas with the high upside potential.

The book presents a completely new way to regard risk and to view it with a positive frame of reference. As the author explains, if you can predict what you will know tomorrow then you already know it today. The trick is to prepare today to take advantage of tomorrows luck.

'The Black Swan, The Impact of the Highly Improbable' by Nassim Nicholas Taleb 2007 Allen Lane ISBN 9780713999952

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