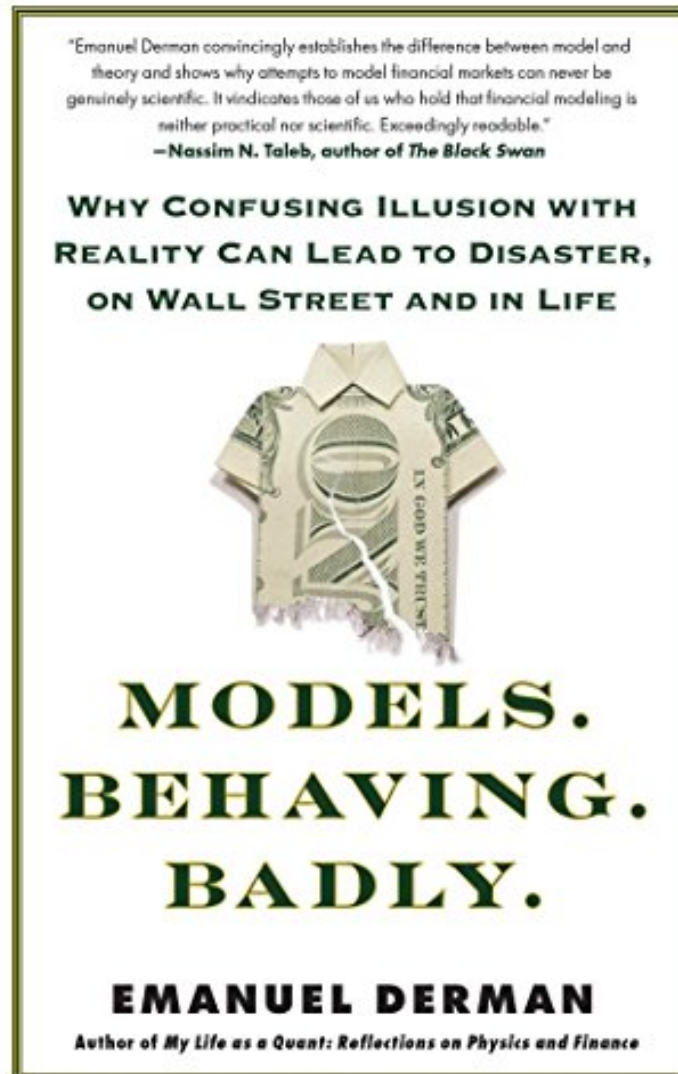


[Mobile ebook] Models.Behaving.Badly.: Why Confusing Illusion with Reality Can Lead to Disaster, on Wall Street and in Life

Models.Behaving.Badly.: Why Confusing Illusion with Reality Can Lead to Disaster, on Wall Street and in Life

Emanuel Derman

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Emanuel Derman : Models.Behaving.Badly.: Why Confusing Illusion with Reality Can Lead to Disaster, on Wall Street and in Life before purchasing it in order to gauge whether or not it would be worth my time, and all praised Models.Behaving.Badly.: Why Confusing Illusion with Reality Can Lead to Disaster, on Wall Street and in Life:

4 of 4 people found the following review helpful. Poor, with Misleading Title By Fredric M. Blum I was hoping for a

critical discussion about various models pertaining to finance and investing primarily, and maybe other applications as well. The title implies that the book discusses the pros and cons of models, why some work better than others. Unfortunately, the book doesn't do that. There's very little meat; it's mostly mashed potatoes. The first chapters consist of all sorts of philosophy about what a model is and isn't, like it's only an approximation of reality. We already know that. That's why they're called "models." This sophomoric revelation is certainly not worth most of a whole book. Finally, several chapters along, the book eventually starts talking about financial models, beginning with definitions of various financial instruments. Unfortunately, the definitions are not well presented, extremely brief, and I think in some instances probably wrong. But at least the book is now into the meat, right? Wrong. Only a couple of models are mentioned, and there's virtually no discussion of the pros and cons of those. In short, the book is not about "models behaving badly." It's mostly philosophical BS. Save your money.

8 of 9 people found the following review helpful.
Catchy title: wish that it fit the book
By Graham H. Seibert
This book is a potpourri of a very intelligent man's favorite themes. An author should have an idea of his intended readership when he writes the book. He must've had himself in mind; I cannot imagine much of anybody with interests as eclectic as Emanuel Derman. Having chosen his title, he has an obligation to explain what a model is. He begins by saying what it is not. It is not a theory, and it is not fact. A model is a metaphor, a simplified representation of reality, necessary when reality itself is too multifaceted to easily grasp. The value of the model depends on how well it represents those aspects of reality in which the user is interested. A model airplane, his example, is useful because it looks like a real airplane and has similar aerodynamics. The kid who makes a model airplane knows full well that it is much smaller and the internal structure and is nothing like a real airplane. For the kid's purpose, that doesn't matter. A theory represents reality. A theory that has been proven is the fact. The Pythagorean theorem is a fact, as our Newton's laws of gravity, Maxwell's laws of electricity and magnetism, and so on. One of the valuable parts of the book is a short history of science in the realm of electricity and magnetism. Derman, whose professional training was in physics and spent half of his career doing it, elegantly and succinctly takes the reader through the groundbreaking theorems describing these phenomena, electricity and magnetism, which can only be examined indirectly - through their effects rather than the thing in itself. Derman was raised in Jewish neighborhoods of South Africa. His account of his childhood is fascinating, evoking in this reader a nostalgia for the kind of community that every kid should be lucky enough to have. It was a community of caring people, intellectual challenge, social involvement, and a vast amount of adventure. His description of his own involvement with apartheid seemed a little bit formulaic; what can you say? For a far better treatment of South Africa of that era, by a woman whose father led the Jewish opposition to apartheid, read "Into the Cannibals Pot" by Ilana Mercer. There is a pretty good exegesis on the various names for God in the Hebrew language, and the two, three, and four levels of circumlocution used by the most devout to avoid saying the name of God. He somehow equates God with a theory rather than a model. To that I would not say yes or no, simply "Huh?" He then goes into philosophy with Baruch Spinoza. What he finds to be incredibly deep looks to me like navel gazing. And at last we get into the world of finance and find not very much, at least not compared to so many other recent books such as the Black Swan, How Markets Fail, Money and Power, Boomerang and many, many others. He talks at extremes. He gives very simple, high school level descriptions of securities such as stocks and bonds, then maybe a collegiate description of derivatives, and then jumps into Black Scholes models. Is unbalanced, and fundamentally not very useful. The take-home messages are quite simple. Your hedge fund manager is not earning his 20 percent if he is making money in a rising market. No model works all the time; you should not give up your intuition and trust totally in models. Making money in the stock market is hard work. And other platitudes. Lastly, Derman is not very sanguine about the current course of events. He considers the bailout of Wall Street an outrage, and does not sound very bullish on the future of the long-standing alliance between capitalism and democracy.

0 of 0 people found the following review helpful.
interesting but at times difficult
By R. H OAKLEY
Derman's book covers more than just the failure of financial models to predict the 2008 financial meltdown. Derman goes back to basic principles to explain what financial models can do and not do. In the process of doing so, he discusses the philosophy of Spinoza and history of physics. Derman, who has done high level work in both physics and finance, is obviously a brilliant person. Those of us who lack his brilliance may find parts of the book difficult, but it is worth the effort.

Emanuel Derman was a quantitative analyst (Quant) at Goldman Sachs, one of the financial engineers whose mathematical models became crucial for Wall Street. Then reliance investors put on such quantitative analysis was catastrophic for the economy, setting off the ongoing string of financial crises that began with the mortgage market in 2007 and continues through today. Here Derman looks at why people-- bankers in particular --still put so much faith in these models, and why it's a terrible mistake to do so. Though financial models imitate the style of physics and employ the language of mathematics, ultimately they deal with human beings. There is a fundamental difference between the aims and potential achievements of physics and those of finance. In physics, theories aim for a description of reality; in finance, at best, models can shoot only for a simplistic and very limited approximation to it. When we make a model involving human beings, we are trying to force the ugly stepsister's foot into Cinderella's pretty glass slipper. It doesn't fit without cutting off some of the

essential parts. Physicists and economists have been too enthusiastic to acknowledge the limits of their equations in the sphere of human behavior--which of course is what economics is all about. *Models Behaving Badly* includes a personal account of Derman's childhood encounters with failed models--the oppressions of apartheid and the utopia of the kibbutz. He describes his experience as a physicist on Wall Street, the models quants generated, the benefits they brought and the problems, practical and ethical, they caused. Derman takes a close look at what a model is, and then highlights the differences between the successes of modeling in physics and its failures in economics. Describing the collapse of the subprime mortgage CDO market in 2007, Derman urges us to stop the naive reliance on these models, and offers suggestions for mending them. This is a fascinating, lyrical, and very human look behind the curtain at the intersection between mathematics and human nature.