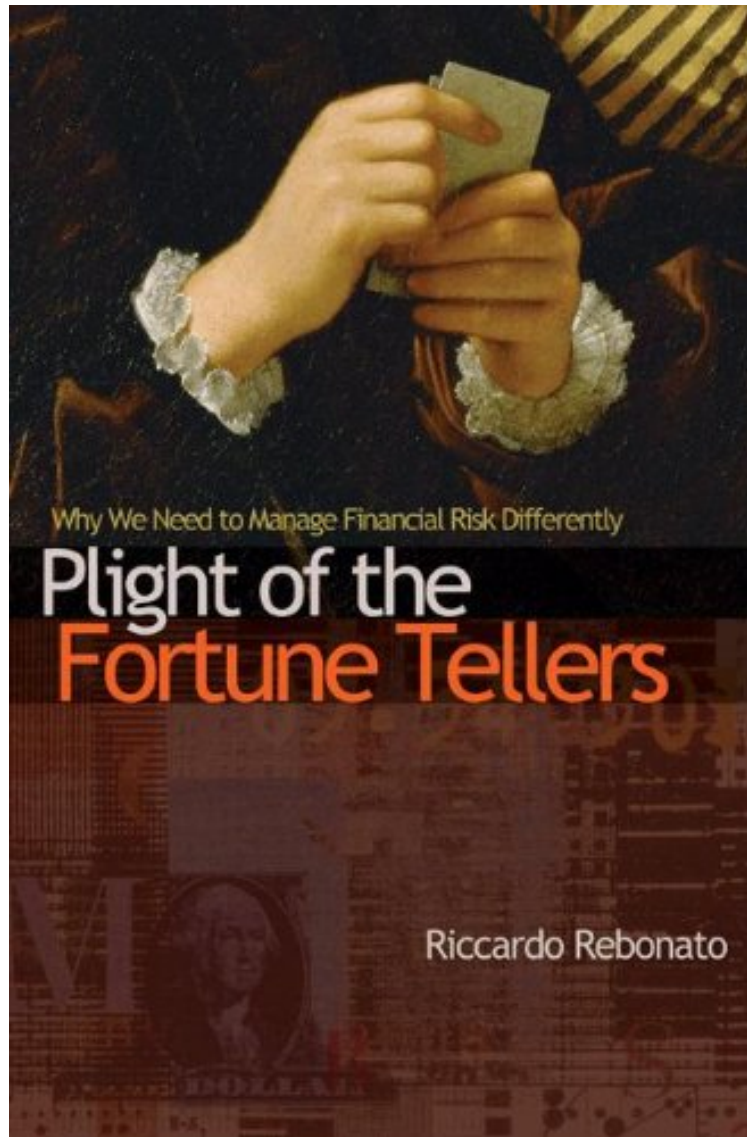


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Plight of the Fortune Tellers: Why We Need to Manage Financial Risk Differently

Riccardo Rebonato

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Riccardo Rebonato : Plight of the Fortune Tellers: Why We Need to Manage Financial Risk Differently before purchasing it in order to gauge whether or not it would be worth my time, and all praised Plight of the Fortune Tellers: Why We Need to Manage Financial Risk Differently:

1 of 1 people found the following review helpful. I really enjoyed reading how Riccardo differentiates events that have low probability ...By Shashi DhungelAfter listening to the author's analysis in Econotalk podcast (If you do not know what econotalk.org is I suggest you take a peek. I assure you, you will bump into things that you will like) I

bought this book and read first few chapters with deep interest. Riccardo Rebonato has a very impressive resume. I really enjoyed reading how Riccardo differentiates events that have low probability and high impact and the events that have high probability and low impact. He explains how frequentist approach of probabilities does not yield impressive results in situations where lot of social factors comes into play. He prefers Bayesian approach every time there is some useful information to add to the equation. For example, predicting whether republican or democrat will win the next presidential election based on how many past elections were won by republicans and how many by the democrats is just a fool's errand. His explanations of housing boom and bust and how it created instability in the US economy is very well thought and an interesting perspective.

2 of 2 people found the following review helpful.
EXCELENT book on Bayesian statistics, frequency statistics, risk, and uncertainty
By Rawley Thomas
This is a truly EXCELENT book on Bayesian statistics, frequency statistics, risk, and uncertainty. It has clarified my thoughts on my own research. We need to know when models are working and when they are failing. The deviation statistics measure when LCRT valuation models are working and when they are not. As long as stock prices remain within Rawley Ranges of Bounded Rationality, both the valuation model and the price dispersion model are working. When prices fall outside of these ranges, something is WRONG! The models are not working. Either the structure is incorrect, the models are missing relevant variables, or a Black Swan uncertain event never seen before has occurred. (Frank Knight's definition to distinguish risk from uncertainty is most relevant here.) It all fits together! I wish his Chapter 10 had covered Benoit Mandelbrot's research on fat tailed distributions and associated frequency risk measures. He might have referenced Bart Madden's work on System Thinking and associated research into continuous improvement based on feedback from the data.

Review Originally Written for the Book Club of the CFA Society of Chicago where I serve on the Education Committee.
Rawley Thomas
Co-Editor of: The Valuation Handbook: Valuation Techniques from Today's Top Practitioners.
Co-Author of: ValuFocus Investing: A Cash-Loving Contrarian Way to Invest in Stocks

1 of 1 people found the following review helpful. An interesting book on finance and risk
By Ian K. Riccardo Rebonato wrote Plight of the Fortune Tellers in a way that is accessible to a relatively wide readership. The book deals with complex issues in financial risk, but includes no equations. However, this is not a book that will be interesting to those without some background in markets and finance. If you have not studied finance at all you would probably miss some of the points that Dr. Rebonato makes. Considering the fact that the entire world financial system would have failed in 2008 without massive government intervention it is pretty clear that financial risk needs to be looked at in a different way. This book provides some foundation for this, but the issue is much larger, with a significant political dimension. What Dr. Rebonato does is provide an analysis of risk that you will rarely find in finance courses. In fact, I had just finished a finance course when I read this book. For one of the class projects we used five years of monthly return data (e.g., sixty monthly returns). On several occasions we estimated the 5% Value-at-Risk. What I had not considered and what Dr. Rebonato points out at some length was that this estimate was questionable. There were only a few data points out at that end of the curve. As Rebonato points out, trusting any analysis with so few data points requires careful thought. The book follows this pattern: looking more deeply into the financial techniques and assumptions that are frequently used without many questions. The book also makes an argument for Bayesian statistics. Like most people (and the readers the book is aimed at) I studied classical "frequentist" statistics, so its hard for me to know how valid Rebonato's argument is. I did, however, order a copy of Doing Bayesian Data Analysis: A Tutorial with R and BUGS. At one point in the book Rebonato discusses why there should be risk officers or risk analysis professionals at investment banks. He had previously discusses cases where rogue employees had caused huge losses, but oddly he did not list "risk police" as a reason for risk professionals. This seems odd to be me because investment banks have a problem that risk analysis can address: traders are trading with other people's money. A trader stands to gain if their bets pay off. At worst they get fired if they lose and, as those at Long Term Capital Management found out, this does not necessarily end their career. Without risk professionals to oversee a bank's risk, there is the danger that the traders will "blow up" the bank. Or the hedge fund. I recommend this book for anyone interested in finance and it is certainly approachable for someone with a business focused MBA background. For those with a more quantitative focus the book will provide an important perspective on what they have learned in class. I should, perhaps, have given the book five stars. Rebanato sets himself the difficult task in writing a book for a more general readership. As a result, there is a limit to the detail provided. Rebanato argues for a Bayesian approach, but I have no idea how Bayesian statistics might be used. Given the objective of the book, this is understandable and probably unavoidable. But its still a frustrating feature of the book.

Today's top financial professionals have come to rely on ever-more sophisticated mathematics in their attempts to come to grips with financial risk. But this excessive reliance on quantitative precision is misleading--and puts everyone at risk. In Plight of the Fortune Tellers, Riccardo Rebonato forcefully argues that we must restore genuine decision making to our financial planning. Presenting a financial model that uses probability, experimental psychology, and decision theory, Rebonato challenges us to rethink the standard wisdom about risk management. He offers a radical yet surprisingly commonsense solution: managing risk comes down to real people making decisions under uncertainty. Plight of the Fortune Tellers is a must-read for anyone concerned about how today's financial

markets are run. In a new preface, Rebonato explains how the ideas presented in this book fit into the context of the global financial crisis that followed its original publication. He argues that risk managers are still stuck in a probabilistic rut, and need to engage with the structural causes of real events.