

Michael Mauboussin's new book is an interesting collection of old and recent articles.

Overall, the book is a good read and provides a lot of food for thought.

More Than You Know by Michael Mauboussin

In *More Than You Know*, Michael Mauboussin, Legg Mason's chief investment strategist takes a page out of E.O. Wilson's book, *Consilience*, and another out of Charlie Munger's *Latticework of Models* to put together a rich, multi-disciplinary framework that is certain to add value to any investor's process. The book is composed of over one hundred articles written by Mauboussin over the years; the articles are grouped in four sections:

- ◆ In the first section of the book on **Investment Philosophy**, Mauboussin discusses many issues near and dear to the professional investors' hearts, including evaluating winning investment ideas, uncertainty and risk, expert opinion versus the wisdom of the market, management, leadership and incentives in the money management business. One of the key takeaways from this section is that to outperform the competition, it must first be properly identified.
- ◆ The second section explores the **Psychology of Investing** and includes a treasure trove of research that is not well understood by many market participants. Mauboussin also explores the topic of emotions and intuition in the decision making process. He shows us that imitation is frequently observed in nature, thus helping to explain why we observe it frequently among financial market participants. Imitation, says Mauboussin, can cause investors to deviate from their stated fundamental investment approach and provides important clues into our understanding of risk.
- ◆ The third section of the book covers **Innovation and Competitive Strategy**. In this section, Mauboussin discusses the evolution of industries, Schumpeter's creative destruction process, how companies stay ahead of the curve, how to balance the long term with the short term, and the survival of the fittest. We also learn that the best often retool their skills to take their performance to a higher level (i.e.: Tiger Woods re-working his swing after dominating the Masters Golf tournament in '97).
- ◆ Mauboussin's final section explores the **Sciences of Complexity** and their application to financial markets. This section alone is worth the price of the book. The essays in this section explain how markets are efficient and also inefficient, examines the short-comings of conventional financial models, and shows why it is futile to make simple cause-and-effect links in markets. One may not think that investors have much in common with insects such as ants and bees, but Mauboussin shows that studying social insects and other complex systems can offer insightful lessons on how decentralized groups coordinate to effectively solve problems. And one of the best examples of a complex adaptive system is the stock market....

Research discussed by Mauboussin suggests that when investors err independently, markets are functionally efficient. Importantly, we can, says Mauboussin, define the conditions under which markets are efficient and use this as a way to consider when markets are inefficient. Many conventional financial models assume that stocks prices changes are normally distributed around the standard bell curve. A normal distribution is a powerful analytical tool, primarily because you can specify the distribution with only two variables, the mean and standard deviation. Models based on normal distributions are widely employed in investment management and financial markets, but they all have a fundamental problem says Mauboussin: the bell curve does not describe the real world very well. In particular, Mauboussin notes that models based on normal distributions do not capture "fat tails:" infrequent but very large price changes. Mauboussin observes that the failure of risk-management models to fully account for fat tails has led to some high-profile debacles. In recent years, says Mauboussin, scientists have renewed their efforts to find connections between the hard and social sciences. He argues that investors can benefit from looking beyond their narrow discipline. Mauboussin believes that consilience among scientific disciplines will play a crucial role in advancing our investing knowledge. He notes that economists often greet the investment-related work of physicists, psychologists, and sociologists with skepticism. While the lack of economic training can put these other scientists at a disadvantage, ultimately the insights that researchers gather from cross-disciplinary collaboration will provide the deepest insights into the working of companies and markets.

Trillions of dollars are exchanged in markets every day. Yet, despite the high stakes and the considerable resources researchers have committed to understanding markets, there is much we do not grasp. In conclusion, Mauboussin celebrates the idea that the answers to many of the questions investors ponder every day will emerge only by thinking across disciplines.