

Mauboussin, Michael J. – More Than You Know

Columbia University Press, 2006, [Behavioural Finance] Grade ★★★★★

As a leading thinker on investments Michael Mauboussin, strategist at Legg Mason and formerly at Credit Suisse First Boston, has through his widely read writings influenced how equities are viewed today. This book is an inspiring tour on a number of topics related to investment philosophy and strategy, market psychology, risk and equity analysis - often presented with a fun and surprising new perspective.

The main insight of Mauboussin's work is that you will become a better investor with a deeper understanding if you approach problems from a multidisciplinary perspective. With more tools at hand you are more effective as problems vary. Charlie Munger who has been one of the most prominent proponents of this thought has stated that investors should aspire to build a number of mental models from various academic and practical disciplines. It's often through the unexpected merger of knowledge from different areas that innovation & new thinking are born.

The book consists of a number of collected essays that were originally written while the author was working at CSFB. These have then been edited and placed in five chapters after different types of topics. In his foreword Mauboussin singles out Al Rappaport of Harvard and Bill Miller at Legg Mason as important influences. It is therefore not surprising to find value based management and so called complexity theory as two of the most important topics discussed.

The first part of the book however, covers investment philosophy where the content of the essays often narrows in on the statistical aspects of investing. With examples from gambling and behavioural finance, investors' and their managers' understanding – or rather lack of understanding - of the statistical nature of their profession is exposed. In the chapters on investment psychology

examples are instead taken from biological swarm studies and experiments within neurology. Mauboussin is mostly interested in collective behaviour and is somewhat critical towards much work within behavioural finance that is too focused on the individual. Irrational investors do not necessarily accumulate into irrational markets.

Mauboussin's most important work relates to complexity theory. Drawing on lessons from biology, chaos theory and work done at Santa Fe Institute, so called complex adaptive systems points to a stock market that produces something larger than its parts. The system shows non-linear causalities with unstable feed-back loops and so called "fat tails" as results. As the system to a large extent is made up by the interaction between the agents included in the system, it is not possible to understand it through studies of the individual parts. This alternative way of understanding markets, which resonates well with George Soros reflexivity theory, will equip you with a variant perception compared to many others on the stock market. This in itself could give you an edge as an investor.

This book is not the usual academic behavioural finance text. As the essays are written at a bank and the target audience are investors it is also a practical text. After discussing a behavioural quirk or describing a feature of the market, Mauboussin not only goes on to explain what this means for investors but also gives advice on remedies and measures to handle the topic at hand. The combination of odd angles, deep thinking and practical advice in this book is hard to top.

In my view complex adaptive systems is a better way to describe financial markets than the so called modern portfolio theory. Nowhere will you pick up on this important topic and have more fun at the same time than in *More Than You Know*.

Mats Larsson, December 21, 2011