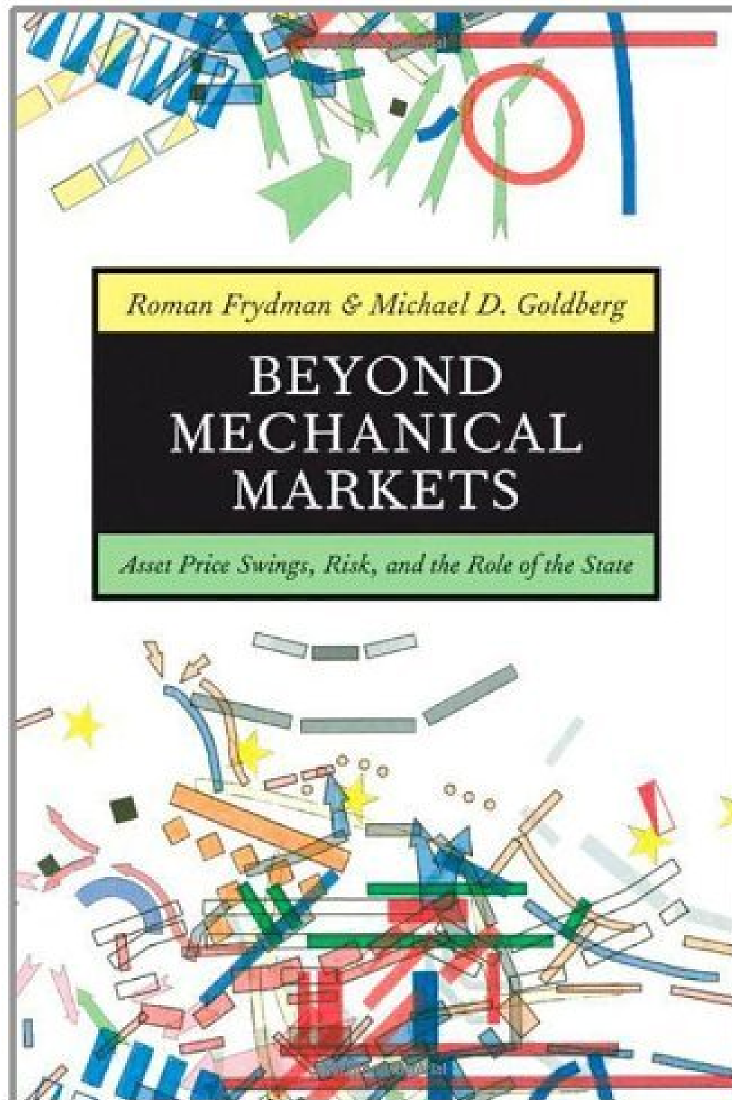
Beyond Mechanical Markets: Asset Price Swings, Risk, and the Role of the State

Roman Frydman, Michael D. Goldberg
*DOC | *audiobook | ebooks | Download PDF | ePub*



DOWNLOAD READ ONLINE

#1653262 in eBooks 2011-02-07 2011-02-07File Name: B004P1JEZW | File size: 26.Mb

Roman Frydman, Michael D. Goldberg : Beyond Mechanical Markets: Asset Price Swings, Risk, and the Role of the State before purchasing it in order to gage whether or not it would be worth my time, and all praised Beyond Mechanical Markets: Asset Price Swings, Risk, and the Role of the State:

13 of 16 people found the following review helpful. Subtle and powerful concluding resolutionBy CuriousI tend to disagree with most of the previous review, though he said he only read four chapters so...The authors very clearly state their audience, they aim to make the underlying assumptions of economists' discourse (and thus policy prescriptions)

more concretely illustrated to these very economists and the general populace (a daunting task in either instance, let alone both).I do agree that if they laid out some of their concluding points earlier it would have helped to digest some details building to it for those not familiar with the professional literature (or better the authors' previous work). I think though the goal was for readers to learn through a process of digestive thinking, rather than direct steering to an overall advocacy/understanding/approach (rather they acknowledge some can accept a degree of their points over a spectrum that may fall short of 100%).It is a very important issue of course (if the way we think about the world is flawed, certainly it will make any attempts to improve the world much more suspect), and one that would take much convincing to uproot the profession of its pretensions (of exact knowledge, barring random shocks, as opposed to the presence of changes in parameters and relationships with expectations, which could be based on an ever changing set of factors).The final chapters in particular are incredibly substantive, and point to new understandings of risk behavior on a very practical level. According to their model based on more plausible assumptions, as well as their empirical work testing against reality, risk is based not on volatility but the length of upswings and downswings in assets (relative to earnings with stock prices and purchasing power in exchange rates for example). This is a very intuitive understanding, astoundingly still generally absent from much of the academic literature and risk management by private institutions and regulators. Also with instability of economic relationships in terms of exact estimates, though qualitatively useful (quantitative instability likely due to changes not only forecasts, but forecasting strategies, and thus coefficients).I think some of the beginning epistemological arguments may strike some as too abstract or conversely repetitive and obvious (again a problem of a wide audience), but I think it deserves its own treatment in a book on the philosophy of the science of economics (which they have done). I do think that given the fact they have more to offer from their own research, they might have done readers a favor emphasizing and re-emphasizing their improvements in understanding discussed at the end from the very beginning and repeatedly (though extensively discussed in their earlier book). For example that risk is not based on how much prices go up or down day to day (volatility), but how far they have risen in the recent past (relative to those benchmarks), that upswings in prices don't come from falls in risk preferences (and in fact the exact opposite based on evidence, swings raise risk assessment) but rather are driven by expectations of higher returns. These seem quite obvious in retrospect, though again terribly under recognized. Also that relationships based on (likely any finite) given information sets will break down over time.Still this is a book which both pragmatists and intellectuals would benefit from reading by leaps and bounds (as evidenced by the ringing endorsements from leading thinkers in both arenas).14 of 20 people found the following review helpful. Understanding this important topic is made difficult because the authors do not express themselves clearly at all.By JackalThe authors start by going back to Knight and Hayek to make the point that there is genuine uncertainty about the future. Traditional finance models do not take this into account. I fully agree with the gist of this argument. However, it is not at all a novel argument and this chapter reads like a disjointed dissertation chapter. The novel part comes in the second half of the book. Here the book starts to become very blurry. I think for two main reasons:(1) The authors have not thought about the target audience of the book. Is it regulators (maybe), academics (probably not), traders (probably not but they might pick up the book), economists (probably)? My guess in parenthesis. The key problem is that the authors do not seem to have made up their mind.(2) The authors never state arguments up-front. Instead they proceed in a meandering manner assuming that the reader is able to tease out their key arguments. This is totally unacceptable.Some books are difficult to understand but you get a feeling that the author has done everything to make the content accessible. I don't mind struggling to get through such books. In this particular case, I don't get the feeling that the authors have something very unique or clear to state. I might be wrong, but one need to make decisions under uncertainty. I have given four chapters of the book an honest attempt.UPDATE 2013: Just want to make sure I don't give out one star without it being fully deserved. I have given the book another chance and again I was struck by the poor quality of language. Sadly, the authors just do not command the English language.7 of 7 people found the following review helpful. Adaptive economicsBy investingbythebooksBeyond Mechanical Markets is among the best and most rewarding books I have read for a long time. Two renowned professors at NYU and UNH, present an economic theorymdash;Contingent Market Hypothesismdash;that explains how the financial markets really work. I believe most seasoned investors will agree, and even applaud the reasoning, though a naiuml;ve practitioner might say there is nothing new here. In reality it is actually a forceful attack on contemporary economic and finance theory. I have never read a more elegant explanation on why the Efficient Market Theory (EMT) has such empirical failings, nor have I genuinely understood the epistemological flaws with Behavioural Finance (BFT) before. Financial markets are neither predictably ldquo;rationalrdquo; nor irrational. Both fundamental and psychological factors matter, but not in a way that can be pre-specified with mechanical rules.The bookrsquo;s main purpose is to bring back the notion of imperfect knowledge and non-routine change in fundamentals into economics and finance. There are many well-grounded statements in the book that contrast current mainstream theory, e.g.: Outcomes of financial markets are not predetermined with a minor random error component (EMT); We are not think-alike robots in a mechanical system (Rational Expectations Hypothesis, REH); Sustained larger swingsmdash;bubblesmdash;in asset prices are not due to irrationality (BFT). It is understandable why most academics prefer a deductive approachmdash;with rigor and consistency in focus. But knowledge in social sciences evolves over time and when facts change, we change our minds

and therefore our forecasting and forecasting strategies.The book consists of two parts: The Critique and The Alternative. Both are intriguing readings. The Critique is very educational. Even true believers in efficient markets will get some musings. Itrsquo;s also fascinatingmdash;and scarymdash;to witness how some descriptive theories from doubting professors can develop into a decisive dogma. Anyone reading the original works of John Muth (REH), Paul Samuelson (Martingale Property Model) and Eugene Fama (EMT) will be surprised how this fusing could turn out into strong beliefs that the outcomes of financial markets are predetermined. Why are we not more sceptical to todayrsquo;s mantra with index funds? Actually, some of the assumptions behind these theories are so absurd it is almost funny.In the Alternative, the authors reintroduce some of Keynesrsquo; thoughts with a slightly new interpretation which is probably the most interesting part of the book. Keynesrsquo; segmentation of market participants into shortndash;term and value speculators and their dynamic interactions, is one of the foundations in their theory. Non-routine changes in the currently important fundamentals, occasionally reflexive forces, moderate guarded revisions due to uncertainly, the speculatorsrsquo; different investment horizons and risk perceptions are key variables to explain swings in asset prices and their boundaries although not their magnitude and duration. And risk is not volatilitymdash;it is the gap between price and value. The Contingent Market Hypothesis, although not perfected yet, is appealing in many ways. Even some of the ldquo;puzzlesrdquo; are no longer anomalies with their theory.But the book has some minor flaws too. The final chapter on policy feels a bit sketchy. The target audience is slightly unclear. It is written in a non-specialist language but without good insights in economics and finance it is a difficult read. The sentences sometimes even complicate an already complex subject. Moreover, the basic conclusions are repeated too often in my opinion. Better if the book had been shorter and more concise.All in all, itrsquo;s a great thought-provoking book. A measured economic theory that acknowledges the workings of portfolio managers and financial analystshellip; ldquo;The fact that it is possible, and that some individuals do succeed, provides powerful incentives to look for signs of change and attempt to speculate on them.rdquo;This is a review by investingbythebooks.com

In the wake of the global financial crisis that began in 2007, faith in the rationality of markets has lost ground to a new faith in their irrationality. The problem, Roman Frydman and Michael Goldberg argue, is that both the rational and behavioral theories of the market rest on the same fatal assumption--that markets act mechanically and economic change is fully predictable. In Beyond Mechanical Markets, Frydman and Goldberg show how the failure to abandon this assumption hinders our understanding of how markets work, why price swings help allocate capital to worthy companies, and what role government can and can't play. The financial crisis, Frydman and Goldberg argue, was made more likely, if not inevitable, by contemporary economic theory, yet its core tenets remain unchanged today. In response, the authors show how imperfect knowledge economics, an approach they pioneered, provides a better understanding of markets and the financial crisis. Frydman and Goldberg deliver a withering critique of the widely accepted view that the boom in equity prices that ended in 2007 was a bubble fueled by herd psychology. They argue, instead, that price swings are driven by individuals' ever-imperfect interpretations of the significance of economic fundamentals for future prices and risk. Because swings are at the heart of a dynamic economy, reforms should aim only to curb their excesses. Showing why we are being dangerously led astray by thinking of markets as predictably rational or irrational, Beyond Mechanical Markets presents a powerful challenge to conventional economic wisdom that we can't afford to ignore.