Lunch with the FT: Nassim Nicholas Taleb

By David Wighton
Published: March 28 2008 20:56 | Last updated: March 28 2008 20:56

I am sure I am going to dislike Nassim Nicholas Taleb. In his books on the importance of the improbable – *Fooled by Randomness* and *The Black Swan* – he adopts an unpleasantly sneering tone towards the fools who just don’t get it. He spreads his contempt around liberally. But he is particularly dismissive of economists, businessmen, the French and financial journalists in suits.

As a financial journalist in a suit, I am spoiling for a fight. I had also been irritated by the chaotic structure of *The Black Swan*, which made it hard to read in a hurry the night before. To cap it all, he's late.

Having been shown to a corner table in the Lebanese restaurant in midtown Manhattan he had selected, I sit for some minutes sharpening my questions. Then I notice Taleb trying to attract my attention from a table across the room and realise he must have been there all the time. As I shake his hand he explains that even though he had not been to the restaurant for years the proprietor, a fellow Lebanese (or “Levantine” as Taleb would say), insisted on showing him to the best table.

I put my two tape recorders on the table, feebly joking that I want to protect myself against a “Black Swan event” where one failed to work. He quickly corrects me, saying I have misunderstood the central idea of his latest book. It is not about events that are merely improbable and unpredictable. But about those that have a massive impact.

“What would be the consequence of a tape recorder failing? Minimal. We would just have another lunch,” he says with a smile that makes him look vaguely like a Lebanese Sean Connery (to whom he has apparently compared himself). I ask him for advice on the menu and we order a selection of starters followed by a mixed grill for me and a mouloukhieh soup for him.

For a writer obsessed with the influence of unpredictable events, Taleb’s books have been strikingly well-timed. *Fooled by Randomness* was published just before September 11 2001. In *The Black Swan*, he returns to the idea that we all, including Wall Street traders, tend to underestimate the risk and impact of rare events. It came out last year, a few months before it became clear that Wall Street had underestimated the risk of an unprecedented downturn in US house prices – with disastrous consequences.

After working on Wall Street for 20 years, Taleb is scathing about its risk management and forecasting models which are more “therapy” than anything useful. This is because they rely on past experience, like the Europeans who thought all swans were white until they discovered black swans in Australia.

Taleb, 48, who has studied at the University of Pennsylvania’s Wharton School and the University of Paris, goes after some big targets. These include Myron Scholes, the Nobel prizewinner behind the Black-Scholes model, a cornerstone of mathematical finance. Scholes’ lofty response to the attacks was that he did not want to “glorify” Taleb by refuting what he said.

When the book came out, Taleb says he got hate mail from some Wall Street traders and investors who felt under attack. “They said it was garbage. But the world has changed. Now people say I was stating the obvious.”

Although most attention tends to focus on “bad” Black Swans, there are also good Black Swans, he says, for instance in scientific research and drug discovery. “There is a lot more randomness in biotechnology and any form of medical discovery. The role of design is overestimated. Every time we plan on trying to find a drug we don’t because it closes our mind. How are we discovering drugs? From the side-effects of other drugs.” Researchers very often “change their story” when they discover something by accident to give the impression it was by design. “The biggest discovery in cancer came from a mustard gas accident in Italy, not from the 130,000 compounds systematically tested by the National Cancer Institute. They were not looking to improve the lives of older men when they discovered Viagra.”

As a Wall Street trader, Taleb focused on arbitrage, making money by exploiting tiny pricing anomalies between different markets. He became convinced that the financial markets systematically underestimated the risk of big improbable events and says he made a fortune for his then employer – First Boston – when the stock market crashed in October 1987.

Eventually, he set up his own business to exploit the underpricing of Black Swan risks. This
was not, as has been widely reported, a hedge fund betting on Black Swans. “You can’t say I’m going to make money every 50 years because you have to pay the bills.” Instead, the business was mainly selling clients Black Swan insurance, packages of securities that would rise in value on big market moves.

A hedge fund has now been set up based on Taleb’s ideas. But he has little involvement with it, having decided to devote himself to being a full-time writer following the success of his book.

Taleb says his scepticism was influenced by the cultural complexity of his childhood. His parents were Greek-Orthodox, French citizens living in Lebanon, where he grew up during the civil war. “If you are an Arabic-speaking, Greek-Orthodox going to a French school it makes you deeply sceptical if you have to listen to three different accounts of the Crusades – one from the Muslim side, one from the Greek side and one from the Catholic side.”

This triggered a very simple idea that he has been thinking about all his life. “That is that things in the real world are far messier than in recorded history or in memory.” But we find it hard to live with such messiness so we tend to look for causes and patterns that do not exist, what he terms the “narrative fallacy”.

I am beginning to warm to Taleb. While his rather random style of thought can be irritating in print, it is entertaining in conversation. And the bumptious tone of the book comes across in person as the enthusiasm of someone hungry for knowledge.

His heroes are “erudites”, those who want to know more. “The people I go after are the false experts, those who do not accept the limits of their knowledge. My book is a footnote on Socrates.”

So what has he got against the French? “Nothing. It’s a joke,” he says, but then rather spoils it by claiming that the French “can’t think outside the box”.

And journalists? “Lots of my friends are journalists,” he says with a straight face. But they are under constant pressure to clarify a chaotic world.

The real villains are those whose refusal to admit the limits of their knowledge can cause serious damage. These include economists “predicting 30 years of social security deficits when we don’t know what we are going to have for lunch tomorrow” and the doctors who thought they knew more than they did and killed their patients. “Until the 20th century, the risk of dying was increased by going to a doctor, particularly in a hospital.”

Some of his critics have claimed that, taken to its logical conclusion, Taleb’s scepticism would lead to a kind of passive nihilism. Not so, he says. He is not arguing that all forecasting is pointless, for example. “I am saying that we should first know the error rate and then make the prediction. Because the error rate is far more relevant than the prediction.”

I ask how his views have shaped his life. The key is to separate “the domain of the empirical and the domain of the sacred” he replies. “I select a very small number of things to be sceptical about, such as markets, and on these I am hypersceptic. But I want to be fooled by randomness in art. I want the ceremonial of religion, we are made for it.”

Taleb is conducting experiments to test his theory that we can only cope with so much scepticism and that people who are sceptical about religion are gullible in other ways. “Most people are sceptical about the wrong things and gullible about the wrong things.” He admits his extreme scepticism can lead to extreme conservatism. “I believe it is dangerous to mess with complex systems and traditional things, such as religion or the environment.”

As we finish our coffee I ask Taleb, who lives with his wife and two children in New York, whether he has any family in Lebanon. His face lights up. “Do you want to see a picture of my house?” he asks, as he reaches into his bag to retrieve his laptop.

He shows me some beautiful shots of Mount Lebanon and his home village of Amioun. “Sixteen out of 16 of my great-great grandparents are buried here. And this is where I am going to be buried,” he says pointing to a church. “I can see it from my window.” I was going to ask whether his heritage was important to him. But the answer seems obvious now.

By this stage I have been completely won over if not completely convinced. But I still have a bone to pick about The Black Swan.

I pay the bill and, as we walk out, I ask about the messy structure of the book. “I deliberately made it impossible to speed read. I wanted to surprise the reader with stories. I was playing with the narrative fallacy and using the randomness card.”

It sounds suspiciously like self-justifying nonsense. But after our lunch I can’t help giving him the benefit of the doubt.

David Wighton is the FT’s New York bureau chief

--------------------------

Al Bustan, New York
1 x hummus
1 x tabbouleh
1 x chicken liver with pomegranate
1 x mixed grill
1 x mouloukhieh
1 x mineral water
1 x espresso
1 x Turkish coffee