

FINANCIAL WORLD BESTSELLERS...

REVIEW OF THE MONTH

Designed to fail

“A DELICIOUS FIX OF SCHADENFREUDE.” **JOHN EATWELL** REVIEWS *WHEN GENIUS FAILED: THE RISE AND FALL OF LONG-TERM CAPITAL MANAGEMENT* BY ROGER LOWENSTEIN

The label “international best seller” on a paperback is often an indication that there is little of enduring interest between the covers. Roger Lowenstein’s book is an important exception.

Yes, it is written with the verve of a “real-life” thriller. Yes, it provides a delicious fix of schadenfreude. And yes, it offers a blow-by-blow account of the events that resulted in the collapse of LTCM in September 1998. But *When Genius Failed* is far more than that. It also offers a serious critique of the misuse of statistical models in financial analysis.

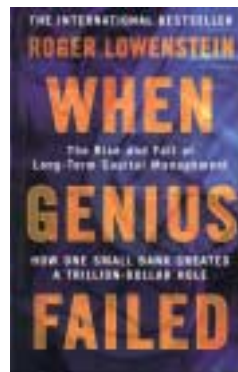
While it’s true that a simplistic belief in the Holy Grail of Black-Scholes models has been replaced by a focus on the morphology of historical crises, the behavioural assumptions underpinning the models, most notably the modelling of strategic behaviour, has not been sufficiently questioned.

John Meriwether, former CEO of LTCM, said two years after the activities of his hedge

fund had led the West to the edge of financial catastrophe: “There are times when markets can be much more chaotic than one would ever predict.” But as Lowenstein points out, it was not chaos that was the problem here, but the design of LTCM’s trading strategy.

A fundamental error was the belief that markets would not move in the same direction at the same time. In other words, it was the strategic analysis interaction of market contagion that was deficient. In extreme circumstances micro-risks create macro contagion, via exchange rates, interest rates or the general level of stock prices.

The dynamics of this process are known but not well understood – beyond JM Keynes’ “beauty contest”. This book is an important guide to the consequences of our ignorance.



John Eatwell is director of the Cambridge Endowment for Research in Finance. Roger Lowenstein. *When Genius Failed: The Rise and Fall of Long-Term Capital Management*. Fourth Estate, 2001, £7.99.

Stephen Valdez. *An Introduction to Global Financial Markets*. Palgrave MacMillan, 2000, £23.99.



An Introduction to Global Financial Markets provides a broad and balanced introduction to the principal global financial markets and institutions from the key global centres – US,

Japan, UK, Germany and France. The book will appeal to students of banking, finance, economics and business, as well as professionals hoping to gain an insight into financial markets and institutions.

Peter Fusaro and Ross Miller. *What Went Wrong at Enron*. John Wiley, 2002, £11.50.



What Went Wrong at Enron is the first comprehensive overview of what happened to precipitate what was, for a short time, the largest bankruptcy in US history. The book offers a fascinating

backdrop to the whistle-blowing, backstabbing, grandstanding, deception, posturing and silence – complete with Sherron Watkins’ infamous memo – that helped destroy the myth of straight-talking, look-you-in-the-eye US capitalism.

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- 3 Nassim Nicholas Taleb. *Fooled by Randomness*. TEXERE Publishing, 2001, £18.99.
- 4 Moorad Choudhry. *The Repo Handbook*. Butterworth-Heinemann, 2001, £54.
- 5 John Hull. *Options, Futures and Other Derivatives*. Prentice Hall, 1999, £39.99.
- 6 Roger Lowenstein. *When Genius Failed: The Rise and Fall of Long-Term Capital Management*. Fourth Estate, 2001, £7.99.
- 7 Robert Steiner. *Mastering Financial Calculations*. FT Prentice Hall, 1997, £29.99.
- 8 Mary Jackson and Mike Staunton. *Advanced Modelling in Finance Using Excel and VBA*. John Wiley, 2001, £39.95.
- 9 Paul Harding. *Mastering the ISDA Master Agreement*. FT Prentice Hall, 2002, £60.00.
- 10 Peter Fusaro and Ross Miller. *What Went Wrong at Enron*. John Wiley, 2002, £11.50.

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