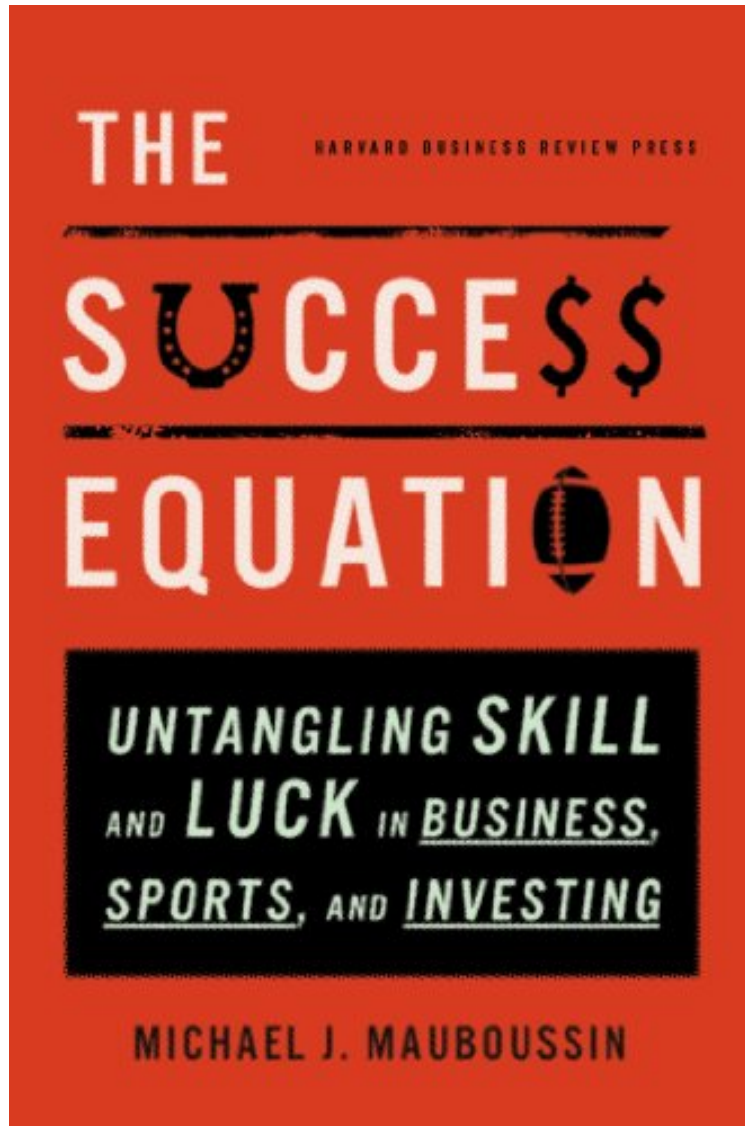


(Get free) The Success Equation: Untangling Skill and Luck in Business, Sports, and Investing

The Success Equation: Untangling Skill and Luck in Business, Sports, and Investing

Michael J. Mauboussin

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Michael J. Mauboussin : The Success Equation: Untangling Skill and Luck in Business, Sports, and Investing before purchasing it in order to gage whether or not it would be worth my time, and all praised The Success Equation: Untangling Skill and Luck in Business, Sports, and Investing:

1 of 1 people found the following review helpful. Highly enjoyable and comprehensible read. By DonThe latest book by Michael Mauboussin explores the impact of luck and skill in business, sports, and investing. Since 1993, Mauboussin has been an adjunct professor at the Columbia Graduate School of Business, where he has won awards for

his teaching. It is easy to see why he is so popular with students. Mauboussin was extremely well received when he spoke to CFA Society Toronto about his last book, *Think Twice: Harnessing the Power of Counterintuition*. Prior to that, he wrote *More Than You Know: Finding Financial Wisdom in Unconventional Places*. All three books are insightful and well worth reading. A key motivation of *The Success Equation: Untangling Skill and Luck in Business, Sports, and Investing* is the fact that sports offer a rich vein of skill-versus-luck analysis. Sports data, combined with statistical analysis and behavioral psychology, contribute valuably to the study of business management and investing. *The Success Equation* covers several compelling themes, including the luck-versus-skill continuum, the importance of sample size, mean reversion and dynamic processes, and key lessons in improving the art of guesswork. The luck-versus-skill continuum ranges from all luck (e.g., roulette) to all skill (e.g., running marathons). Between these extremes, hockey has a large luck component whereas basketball primarily involves skill. The analysis of this topic draws heavily on athletics because of the vast and detailed records generated by sports and the many practical lessons that can be extracted from them. Recognizing where an activity lies on the luck-versus-skill continuum can shape strategy, hone skills, help in dealing with uncertainty, and improve performance in numerous ways that are relevant to investing. Sample size is key to understanding luck versus skill. Investors should consider the sample size (if an activity is controlled mainly by luck, a small sample will not do), understand history, which helps in skill-based activities more than in luck-based activities, and categorize events by simple/complex payoff and narrow/extreme outcome. The complex/extreme combination resembles the "black swans" highlighted in Nassim Taleb's work. Mauboussin notes that most financial blowups have resulted from naively applying statistical methods in a world of black swans. Mean reversion and dynamic processes are related. Understanding the mean-reversion process is critical in investing because one can do all the right things but still underperform until the odds catch up. Just as important, however, is recognizing a dynamic process. A change in the process revises the odds and shifts mean reversion to a new mean. The book ends with 10 key ways to improve one's chances at guesswork. In addition to the three ways discussed earlier, they include learning from feedback, looking for ways in which situations may interact, and knowing one's limitations. Mauboussin's writing style makes for a highly enjoyable and comprehensible read. Sports-based examples are used effectively throughout. Most readers will readily recognize the differing natures of the various sports and grasp how an understanding of those differences translates into the analysis of investment and business problems. Also commendable is Mauboussin's conscientious provision of academic references. Some 60 pages, about 20% of the total, are devoted to notes and citations that amplify points and offer background and further reading. *The Success Equation* makes a valuable contribution to the literature on decision making when both luck and skill are involved. It is thoroughly researched and well written. I highly recommend the book to anyone interested in making better investment choices.

3 of 3 people found the following review helpful. Integrating Intuition with Deep Thinking By Andrea M. Schara Wondering what makes it so hard to make good decisions? Reading or really seriously studying Mauboussin's new book (<http://www..com/The-Success-Equation-Untangling-Investing/dp/1422184234>) is a fascinating education in how the brain misperceives the environment in predictable ways. Mauboussin identifies the ways we can be tricked by short cut thinking and rules of thumb decision-making. He even makes it seem possible, before breakfast, to understand a bit about correlations and decision-making linkages, statistical thinking and reversion to the mean. By carefully explaining the difference between luck and skill and how we often mistake one for the other, Mauboussin helps us enhance our ability to perceive the world. For example, it makes sense but still requires untangling luck and skill to acknowledge that luck plays a significant role in which team wins the Stanley Cup or the Super Bowl. Once skill is evenly matched among the participants, there is some room for luck to make a difference. There can be interplay between skill and luck when one is very disciplined in acquiring skill. Often people mix up luck and skill as in a coin toss. The fact that one event is not influencing another is lost when people begin to feel lucky and believe that a hot hand can influence outcomes. Good luck in coin tosses or other activities where one event is not influencing another, can automatically cause our brains to revert to cause and effect thinking, leading us down a rabbit hole where we can easily misperceive the world around us. For example, it is common to think that because you flipped a coin and got heads seven times you are somehow a bit lucky but mostly skilled and therefore you are willing to bet that heads will come up on your next toss. We actually have to learn that one coin toss is not influencing another, no matter our feelings or the story we tell ourselves about our hot hands. A feeling about our hot hand cannot predict the next toss of the coin or the next team that will win or the next great stock, but luck can play a role in our success (or failure). In the old days we could rely on stories we heard, or even gossip from a neighbor, to predict the future and understand others. But Mauboussin reminds us that serious scientists are careful about sources of evidence and the challenges of prediction. To overcome habits of believing stories, he suggests we need a disciplined approach. Mauboussin references the work of Daniel Kahneman and Amos Tversky, the foremost authorities in the psychology of predictions, to give us well-tested examples. Mauboussin helps us increase our ability to get beyond automatic ways of sensing how the world works and engage in more challenging ways of perceiving the environment. Mauboussin notes that we can, with some effort, break down the function of the brain into two parts, an automatic system (that can be influenced by the higher centers of the brain), and the analytic system. The latter can analyze and make complex computations that over time may become an

automatic response that is skillful. Feedback is an essential part of altering our automatic responses. Those who want to become a strong and skilled performer can work on: 1) the analysis of how to do things properly, 2) the psychology of the effort, and 3) the influence of the social system that one is a part of. To learn a new skill may take only 50 hours, but to become more of an expert requires a thousand hours of effort. Many of our automatic ways of thinking are based on the way our ancestors managed to survive. Now days there are dangers that lurk in ignoring a more fact based and mathematical way through the social jungle. We have to learn how stories that mix up luck and skill can lead us astray. Be careful when your friends tell you which stock to buy or when your doctor tells you how his last patient did, without benefit of knowing the base rate of how most patients did. Calling into question our automatic ways of understanding the world costs our brain a lot of energy. Comprising only 2% of our bodies in weight, the brain requires 20% of our energy so we tend to want to conserve energy and therefore question embracing the mental effort. One-way around this problem is to make it fun to look at processes that enhance our ability to predict. Mauboussin does this by using sports examples and creating web-based games that connect to his book. You can watch one tennis player win a point to see how this influences who will win the match. [...] Then just what can we learn from Colonel Blotto about spreading our resources to defeat Goliath? [...] My favorite is trying to beat the mind reader. [...] But I probably should spend more time understanding how the reinforcing property of success works. [...] Another challenge Mauboussin discusses is the idea of a continuum for predictions. Even if we are reasonably good at figuring out the likely outcome in sports, when we move into larger social systems there are more unusual events that can occur and for which we cannot prepare. Tail events, which are outside our expected range of possibilities, like 9/11 are "black swan" occurrences that by definition not only cannot be predicted but are difficult to prepare for. Think how many people are angry because they believe that someone should have seen "it" coming. There are many possible outcomes Mauboussin shows us to any one event. History is not destiny. Moreover, if you do see it coming then you still have to have an emotional backbone in order to hold onto one's beliefs in the face of intense opposition. Benjamin Graham said, "Have the courage of your knowledge and experience. If you have formed a conclusion from the facts and if you know your judgment is sound, act on it - even though others may hesitate or differ". (Mauboussin, Page 172) A few knowledgeable leaders can alter the social system and its habitual way of doing business. In the book Money Ball, recruiters used insider information to hire the best people. They talked about how the players looked, hit and fielded, but there was not a fact-based process to look at the link between behaviors and team wins. By correlating behaviors, like: when do they hit, how often did they get on base, and when did they drop the ball, Billy Bean began to see patterns of behaviors correlate with team wins. Bean not only identified some links between the talents of individual players and team outcomes, he then altered the way players were selected. He used facts to show a connection between who gets on base and the team's ability to win a game, and this was a more successful perception of success than highlighting a player's batting average. Billy Bean was able to see the more complex variables using statistics and seeing connections. Mauboussin notes the importance of understanding reversion to the mean. Reversion to the mean identifies system level properties enabling us to consider an individual's very good or bad performance outcomes over time. Put another way, extreme results are unlikely to continue, like the upward trajectory of the price of Apple stock. Regression analysis allows us to see how individual performance, which in some case may be influenced by luck, smooth out over time. Out performing may be luck, but in some cases, as in mutual fund success, superior skill can be clearly distinguished. In that case it takes long periods of time to see who can do better than luck alone would predict. You can see some of this in game format on Mauboussin's web site. [...] Mauboussin usefully suggests ways for readers to improve skills, such as using checklists, encouraging feedback and/or hiring a good coach to give an outside viewpoint and help manage "magical thinking". He also suggests writing down the outcome we expect when making decisions. These disciplines enable us to learn from mistakes and exercise humility about our ability to evaluate risk and to predict outcomes. As Mauboussin points out, we are all in the business of forecasting. Considering the psychological, analytical and procedural barriers to untangling luck and skill, this book gives us clarity on processes involved in decision-making and tips to improve performance. Reading or studying this book helps us to learn about deep processes that are not commonsense or intuitive. We can develop discipline about decision-making processes that impact our lives and have fun while we are doing it. Or we can also depend on skill and hope for luck. Andrea Schara [...] 2 of 2 people found the following review helpful. Skill or Right place at the right time? By M. Deibler How much is success due to skill versus luck? This book introduces that topic and tries to explain it. I recommend this book highly. The only complaint I have is that most people respond to "luck" negatively. "I wasn't lucky, I worked hard to get where I am!!!" Yes, you did, I'm sure. I would use skill versus right place at the right time, which people respond to better. Read this book, it will change the way you think about success.

Much of what we experience in life results from a combination of skill and luck. From the Introduction

"I just finished reading the most enjoyable business book I've read in a long time - although relegating The Success Equation, by Legg Mason Chief Investment Strategist Michael J. Mauboussin to this category would be a grave disservice, significantly understating its sophistication and selling short its achievement." -- David A. Shaywitz on

Forbes.com About the Author Michael J. Mauboussin is an investment strategist and has been in the financial services industry for more than twenty-five years. He has also taught at the Columbia Graduate School of Business since 1993, and is on the board of trustees at the Santa Fe Institute. He is the author of two previous books, *Think Twice: Harnessing the Power of Counterintuition* and *More Than You Know: Finding Financial Wisdom in Unconventional Places* and is coauthor, with Alfred Rappaport, of *Expectations Investing: Reading Stock Prices for Better Returns*.