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# The Myth of the Rational Market: A History of Risk, Reward, and Delusion on Wall Street

*Justin Fox*

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## THE MYTH OF THE RATIONAL MARKET



A HISTORY OF RISK,  
REWARD, AND DELUSION  
ON WALL STREET

## JUSTIN FOX

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**Justin Fox : The Myth of the Rational Market: A History of Risk, Reward, and Delusion on Wall Street** before purchasing it in order to gauge whether or not it would be worth my time, and all praised The Myth of the Rational Market: A History of Risk, Reward, and Delusion on Wall Street:

2 of 2 people found the following review helpful. A rational look at an irrational subject By David Siegel A phenomenal, addicting, bracing account of the personalities and pitfalls of a science that is truly dismal. Careers made and squandered, fortunes made and lost, rationalists changing their views - it all adds up to a brilliant read, a book I

plan to read again soon. It's possible to come down on either side of the argument. But the way Fox has framed it, with a see-saw journey through the thickets of mental models and personalities and perverse incentives that continues to question the assumptions just (reasonably) laid down in each previous chapter, he has provided me with a context that I can build on. I really appreciate that. Having just finished the book, I'm not sure where I stand, but I have better tools for working on it now and for discussing with others. Just one technical mistake that I could find: In chapter 13, Fox shows his lack of math training when he explains that  $1/10^{160}$  is "a couple billion billion," which made me snort a noseful of cappuccino onto my iPad. I hope business schools and economics departments will make good use of this book. The world is a complex place. The stock market is not a cause-and-effect machine, any more than people are. A broad perspective helps prevent us from making stupid mistakes.

0 of 0 people found the following review helpful.  
Great Read  
By TFarwell  
A must for anyone interested in the modern history of financial economics, extremely well written, and wholly approachable for the investing layperson. Every portfolio, stock broker and casual investor ought to pick this book up and read. Fascinating.

3 of 3 people found the following review helpful. Great business book  
By Jeremy D. Vogan  
Is the financial market truly efficient, or is it simply behavioral? When stocks that seem overpriced stay that way is the judgment of the pit to be trusted? When a CEO makes a killing while his company's stocks take a battering should investors be concerned? And given our industry's ill-fated success at handily transforming poisonous personal loans with the use of tranches into triple-A CDOs, have we really learned anything at all since the collapse of the Dutch tulip bubble in the 1630s? These questions and many more are examined in this urbane, candid history of men and money. Fox navigates the troubled waters of the Street and the Academy with skill, giving credit where it is due but not hesitating to point out the Emperor's knickers around his royal ankles. The only disappointment to me was the discovery that there is no method of stock valuation for the side of the argument which maintains the irregularity of the market; there is no Black-Scholes for the unbeliever. But maybe that fact is indicative of the truth that, in the end, you really do have to choose between precise ambiguity and vague truth. And this book whispers an unsettling memento mori into the ear of the aspiring business leader: it doesn't matter which lens you choose, because in the end the view is the same through both of them... Great read, drills down relentlessly into the annals of time and pressure and personalities and opportunities and Other People's Money, to come up with timeless observations about finance and philosophy. JV

Do we really need yet another book about the financial crisis? Yes, we do—because this one is different. A must-read for anyone who wants to understand the mess we're in. —Paul Krugman, New York Times Book Review

Fox makes business history thrilling. —St. Louis Post-Dispatch

A lively history of ideas, *The Myth of the Rational Market* by former Time Magazine economics columnist Justin Fox, describes with insight and wit the rise and fall of the world's most influential investing idea: the efficient markets theory. Both a New York Times bestseller and Notable Book of the Year, longlisted for the Financial Times Business Book of the Year Award and named one of Library Journal Best Business Books of the Year, *The Myth of the Rational Market* carries readers from the earliest days of Wall Street to the current financial crisis, debunking the long-held myth that the stock market is always right in the process while intelligently exploring the replacement theory of behavioral economics.

From Publishers Weekly: Starred . At the core of the current financial crisis has been the widely held assumption that markets behave rationally. Fox, Time magazine editor-at-large, isn't the first to bring scrutiny—or censure—to the conceit, but his analysis is singularly compelling, and the rare business history that reads like a thriller. Fox leads us on a chronological journey of modern economic theory, featuring the cast of scholars who constructed the 20th- and 21st-century financial landscape, from Irving Fisher to such post-WWII figures as Milton Friedman, Harry Markowitz, Franco Modigliani and Merton Miller, Jack Treynor and William Sharpe. Fox offers a behind-the-scenes glimpse at academia's finest, complete with amusing anecdotes about the players and their theories, and illustrates how our economic behaviors and markets have been shaped by a gradually refined theory holding that the stock market prices are both random and perfectly rational. A must-read for anyone interested in the markets, our economy or government, this dense but spellbinding work brings modern finance and economics to life. (July)

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This wise and witty book is must reading for anyone who wonders what makes financial markets tick. Even those who have wrestled with this question for years will be glad to have read Fox's compelling history.

From the Back Cover: Chronicling the rise and fall of the efficient market theory and the century-long making of the modern financial industry, Justin Fox's *The Myth of the Rational Market* is as much an intellectual whodunit as a cultural history of the perils and possibilities of risk. The book brings to life the people and ideas that forged modern finance and investing, from the formative days of Wall Street through the Great Depression and into the financial calamity of today. It's a tale that features professors who made and lost fortunes, battled fiercely over ideas, beat the house in blackjack, wrote bestselling books, and played major roles on the world stage. It's also a tale of Wall Street's evolution, the power of the market to generate wealth and wreak havoc, and free market capitalism's war with itself. The efficient market

hypothesis—long part of academic folklore but codified in the 1960s at the University of Chicago—has evolved into a powerful myth. It has been the maker and loser of fortunes, the driver of trillions of dollars, the inspiration for index funds and vast new derivatives markets, and the guidepost for thousands of careers. The theory holds that the market is always right, and that the decisions of millions of rational investors, all acting on information to outsmart one another, always provide the best judge of a stock's value. That myth is crumbling. Celebrated journalist and columnist Fox introduces a new wave of economists and scholars who no longer teach that investors are rational or that the markets are always right. Many of them now agree with Yale professor Robert Shiller that the efficient markets theory “represents one of the most remarkable errors in the history of economic thought.” Today the theory has given way to counterintuitive hypotheses about human behavior, psychological models of decision making, and the irrationality of the markets. Investors overreact, underreact, and make irrational decisions based on imperfect data. In his landmark treatment of the history of the world's markets, Fox uncovers the new ideas that may come to drive the market in the century ahead.