

Hello Everyone,

Today's missive looks at black swan events. Wall Street will tell you no one can see them coming. Yet, supposed "black swans" like the 1929, 1987, and dot com crashes were all predicted by "fringe" analysts who were ignored. The same held true for the 2008 mortgage crisis. Men and women warned...but, were dismissed.

Conversely, I believe we can have positive "black swan" events. Airplanes, space travel, and quantum computer were all said to be impossible. Yet, here we are. :>)

As usual, I hope today's reading expands your understanding of the markets.

Signed, Your Saw-A-Real-Black-Swan-Once Financial Advisor,

Greg

## **KKOB 06.22.2018 Black Swans**

**Bob:** So, Greg, I know you want to continue this series about what will separate investors from their wealth. And, I know you are building toward something. So, what is the topic today?

**Greg:** Let's talk about black swans. I know you've heard the term before, right?

**Bob:** I have. Lots of financial advisors use it. I even looked up the origin once. For centuries, bird experts contended black swans did not exist. They had only ever seen white swans. Well, some time in the mid-1800's, British sailors came across black swans in Australia. So, when something that shouldn't happen then happens, they call it a black swan event.

**Greg:** Impressive. Now, when crashes come, Wall Street typically says, "No one could have seen it coming." It was, therefore, a black swan event. This is what they said about the crash of '87, and the dot com crash, and the 2008 mortgage mess.

So, Bob, let's play a game. Off the top of your head, predict some black

So, Bob, let's play a game. Off the top of your head, predict some black swan events you think could hurt the markets.

**Bob:** Well, a huge California earthquake would be considered a black swan. Or, a major terrorist attack...or a mega-bank failure...or a surprise Middle East war would all qualify.

**Greg:** I agree. So, with little effort, you just rattled off four black swans that every listener said, "Yup, that could happen." So, if we all know these things could happen, are they really black swans? I'd say no. And, if they aren't, why doesn't Wall Street account for them when they advise you about investing your money?

**Bob:** I don't know. But, my guess would be because they don't know the details. For example, I can predict an earthquake, but I can't predict when it will happen, its exact location, or its magnitude.

**Greg:** Bingo. Because black swan events are seemingly random, they can't be mathematically modeled. And, by now, your listeners understand algorithms (which are basically mathematically-based computer programs) account for over 90% of the trading volume on Wall Street. So, since Wall Street can't model black swans, they ignore them.

And, this is one big reason why we have occasional flash crashes. Something hits outside the parameters of the algorithm...they'd call it a black swan. Then, in nanoseconds, computer models freak out and start hitting the "sell-button". Then, the feedback loop commences. Boom. Flash crash.

**Bob:** Right. I've also heard them called fat-finger trades, but never really believed it. Still, you can't invest based on the possibility of a black swan...you'd never do anything. And besides, we seem to have bounced back from recent black swans rather quickly.

**Greg:** Great points, and you're right...though I would say some people still haven't recovered from the '08 housing mess---and Intel investors are still down almost 30% from the dot com highs 18 years ago. So, black swans matter. Still, how do your listeners account for unknowns without either ignoring them ---like the algorithms do--- or placing too much emphasis on them----which also isn't reasonable?

**Bob:** Again, I don't know, but I suspect you'll say diversify. That's what every financial advisor says.

**Greg:** Yes, I get that. And, that is my industry's approved answer. But, in previous talks, you and I have gone over how classic diversification models haven't worked since 2008. So, something changed then. And, when the facts change, you must change.

So, on Monday, I'll go over a huge fact-changer---that being the rise of the machines. And then, next Friday, we'll tie it all together. If I'm right, your listeners will not be surprised by the next supposed black swan.

**Bob:** Sounds good. How do people reach you?

**Greg:** My number is 508-5550, 508 triple 5 zero.

**Bob:** For those of you who want transcripts of what Greg and I talk about each week, just email him at [gregradiotranscripts@gmail.com](mailto:gregradiotranscripts@gmail.com).

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