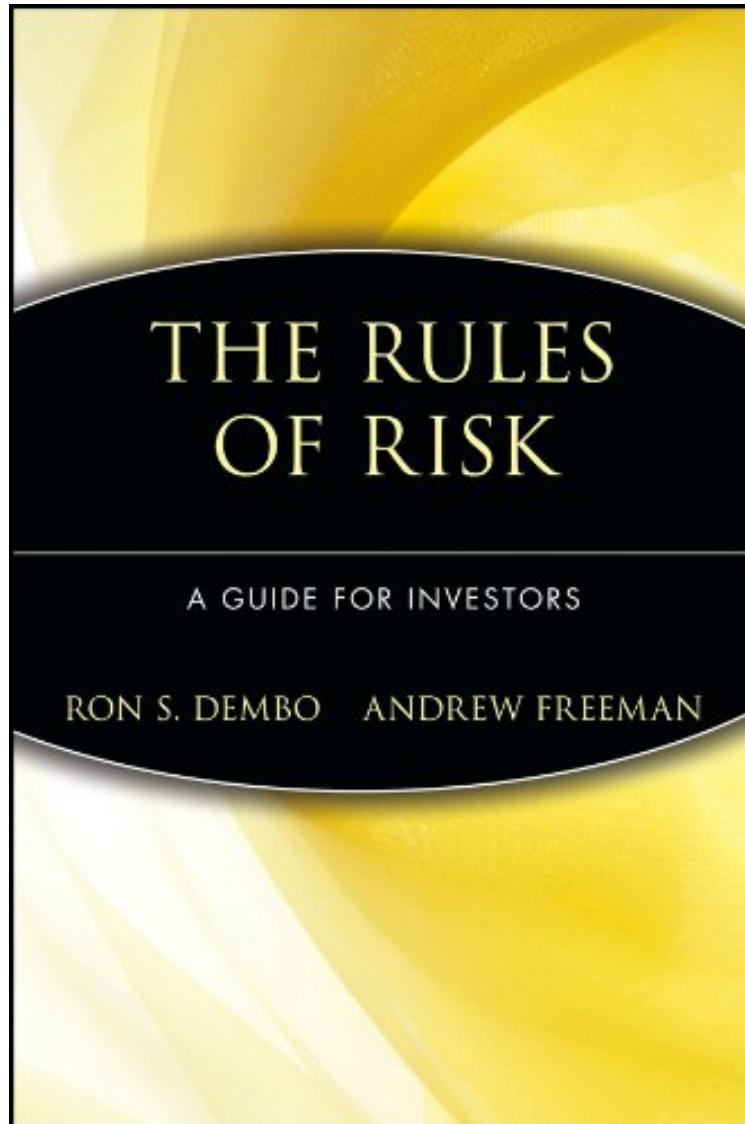


Seeing Tomorrow: Rewriting the Rules of Risk

Ron S. Dembo, Andrew Freeman
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Ron S. Dembo, Andrew Freeman : Seeing Tomorrow: Rewriting the Rules of Risk before purchasing it in order to gauge whether or not it would be worth my time, and all praised Seeing Tomorrow: Rewriting the Rules of Risk:

3 of 3 people found the following review helpful. An excellent perspective on riskBy AbacusThis book establishes a strong foundation in risk management. It leans substantially on decision theory and behavioral economics. Its main concept is "regret." Regret is downside risk. We can insure against that downside risk by buying a Put option. Even if we deal in illiquid markets where such options are not available, it is still key to calculate the economic value of regret or of that Put option (if it were to exist). Similarly, the upside of a transaction is equivalent to buying a Call option.

Mr. Dembo comes up with this equation: $Upside - \lambda(Regret)$. λ captures your risk tolerance. If your risk tolerance is high, λ will be small. The inverse is true too. With this straightforward model, the authors can explain a whole lot of economic incentives with a behavioral component. For instance, you can easily explain why most people would not mind playing roulette with just a dollar bill. But, the same people would not play with \$100 dollar bills. In effect, most people would rather take on a bad risk (with poor odds) on a small scale, than take on a better risk (better odds) on a larger scale.

0 of 0 people found the following review helpful. Don't forget the downside!

By Customer Most people consider only the upside when making investment decisions or any other major financial commitment, such as buying a house. We might give a passing thought to what might go wrong, but we rarely put as much effort in calculating the downside as we do calculating the upside. *Seeing Tomorrow* gives valuable insights, with numerous examples, into how this "upside bias" in our mental makeup can lead us to make unwise decisions. The authors draw on modern research into behavioural economics, with some striking conclusions. To give a very simple example, anyone who saw a \$10 bill lying in the street would almost certainly pick it up, but those same people would probably not complain if an unexpected fee of \$10 was imposed on a house purchase costing \$500,000. The financial loss or gain is exactly the same in both cases, but our actions will differ depending on the case. The value of this book lies in its clear explanations and practical examples. The authors show the reader how to calculate the Upside of a contemplated investment decision if all goes well and our Regret (downside) if things go badly wrong. They go on to show how to estimate one's tolerance for risk and apply it to Regret. The result of Upside minus Risk-Adjusted Regret tells us if the investment is worth making for us. The conclusion may be different for another person with a different tolerance for risk. This insight essentially explains why markets work at all. Even if we don't actually do all the calculations suggested by the authors when we make financial decisions, we can still benefit greatly by giving some attention to the possible downside and how we would feel if the investment failed. Of course, the potential Regret in buying this book is that it, like most of the genre, cause unrealistic expectations of certainty in investing - at last we have the magic tool that will ensure our success!

The book discusses mathematical concepts that may turn off some readers. The arguments are not always easy to follow.

1 of 1 people found the following review helpful.

Understanding risk management in everyday life By Govindan Nair This eminently readable book is for a curious general reader who wants to better understand how modern risk management techniques can actually be applied to thinking about and making choices in everyday life. Unless you are allergic to even the most basic of probability theory and statistics, you should find that this book places the building blocks of risk analysis - time horizons, risk measures, benchmarks and scenarios - in the hands of folks who are other than investment and risk management professionals, without entering into the arcane language of derivatives and portfolio theory. But the book is not itself a key to quick riches. The authors rightly point out from the beginning how the image of the so-called science of risk management provides an illusion of security that has been disproved again and again, with a long catalogue of risk management catastrophes among major names in high finance. They quote Peter Bernstein whose book called *Against the Gods* (which I have also reviewed on this website) provides a historical perspective on risk management, and ask whether belief in this false security of risk management is no better a modern version of ancient faiths which placed fate in the hands of deities and shamans. This book is original in that it reduces the complexity of risk to its base elements, and looks at circumstances of a given individual, and his or her specific risk tolerances, and the unique reasoning behind his or her choice-making. The chapters are articulated in language which is as jargon-free as possible (*Sweet Regret*, *Keeping Up With the Joneses*, *The Rap Trap* And *Evalauton*, etc.) for an important subject in which jargon unfortunately has been one of the barriers to more popular understanding. While it is highly improbable that this book will help you beat the market in managing your investments, you might see how it is possible to think more systematically about common decisions such as whether to buy a house, invest in a college plan for a child, or refinance a mortgage, as well as to understand some of the complexities of public policy choices in which risk is invariably a looming factor.

In high-stakes investing and business, success or failure largely depends on how well you play the game of risk-a game in which the rules of competition are constantly being rewritten. Strategies that proved effective in the past are no longer enough to win today. The key to success is not to rely on yesterday's news, but to peer into the future and ask what could happen tomorrow. Presenting a bold new way of thinking about risk, in *Seeing Tomorrow* Ron Dembo and Andrew Freeman offer a dynamic framework designed to enhance our ability to make important decisions, and consequently change how we manage our investments. By incorporating investors' individual circumstances and tolerances -as well as the unique reasoning behind their decision making-this innovative approach captures much more of how we actually think about risk. From the basic building blocks required for forward-looking risk management, Dembo and Freeman define and explore the roles and significance of such fundamentals as time horizons, risk measures, benchmarks, and scenarios. Once the foundation is laid, these elements are used to construct a solid architecture for risk management and risk-adjusted analysis that is not only general enough to be able to handle a multitude of risks, but also able to present many different measures of risk. With clear-cut explanations and intriguing real-world examples, *Seeing Tomorrow* leads you step by step through the authors' groundbreaking risk rules. These

include: choosing an appropriate time horizon, selecting scenarios, computing Value at Risk (VAR), assessing both the upside and downside of a potential deal, calculating Regret, and compiling a reliable Regret matrix. By combining Regret, Upside, and a measure of our tolerance for risk, the authors demonstrate how these components create a powerful new way of approaching decisions. They offer guidance on very specific real life problems-such as buying a house or suing someone-as well as on broad matters of strategy and investing. Written by two leading authorities in the field, Seeing Tomorrow is a milestone addition to risk literature that will dramatically alter the way you view, identify, and manage risk. It is must reading for investors and decision makers alike. "Seeing Tomorrow is a powerhouse in the understanding of risk. With their ingenious blend of psychology and rigorous quantitative analysis, the authors have created an authoritative and innovative handbook of risk management that is essential for both practitioners and theoreticians." -Peter L. Bernstein author, Against the Gods and Capital Ideas. "This excellent and readable book provides an innovative approach to choosing actions when the outcomes are uncertain. Anyone with an interest in improving their decision-making skills would benefit from reading this. Anyone with a professional interest in risk management must read it." -Stephen A. Ross Fischer Black Visiting Professor of Finance Massachusetts Institute of Technology Sloan School of Management Sterling Professor of Economics and Finance, Yale University. "Ron Dembo and Andrew Freeman have done an excellent job of describing how to think about and measure risk. This will become required reading for businesses and personal investment executives." -Ned C. Lautenbach.

"As a how-to book about managing risk, it's a worthwhile follow-up to Peter L. Bernstein's best-selling 1996 history of the field, Against the Gods: The Remarkable Story of Risk."-Business WeekFrom the PublisherA new paradigm for predicting the future of risk. In this ground-breaking book, Ron Dembo and Andrew Freeman have built a framework for a new risk paradigm that peers into the risk-taking of tomorrow. The innovative method described in the book reduces the complexity of risk to its base elements, and takes into account the individual's circumstances, tolerances, and the unique reasoning behind his or her choice-making.From the Inside FlapIn high-stakes investing and business, success or failure largely depends on how well you play the game of risk-a game in which the rules of competition are constantly being rewritten. Strategies that proved effective in the past are no longer enough to win today. The key to success is not to rely on yesterday's news, but to peer into the future and ask what could happen tomorrow. Presenting a bold new way of thinking about risk, in Seeing Tomorrow Ron Dembo and Andrew Freeman offer a dynamic framework designed to enhance our ability to make important decisions, and consequently change how we manage our investments. By incorporating investors' individual circumstances and tolerances-as well as the unique reasoning behind their decision making-this innovative approach captures much more of how we actually think about risk. From the basic building blocks required for forward-looking risk management, Dembo and Freeman define and explore the roles and significance of such fundamentals as time horizons, risk measures, benchmarks, and scenarios. Once the foundation is laid, these elements are used to construct a solid architecture for risk management and risk-adjusted analysis that is not only general enough to be able to handle a multitude of risks, but also able to present many different measures of risk. With clear-cut explanations and intriguing real-world examples, Seeing Tomorrow leads you step by step through the authors' ground-breaking risk rules. These include: choosing an appropriate time horizon, selecting scenarios, computing Value at Risk (VAR), assessing both the upside and downside of a potential deal, calculating Regret, and compiling a reliable Regret matrix. By combining Regret, Upside, and a measure of our tolerance for risk, the authors demonstrate how these components create a powerful new way of approaching decisions. They offer guidance on very specific real life problems-such as buying a house or suing someone-as well as on broad matters of strategy and investing. Written by two leading authorities in the field, Seeing Tomorrow is a milestone addition to risk literature that will dramatically alter the way you view, identify, and manage risk. It is must reading for investors and decision makers alike.