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## Don't always bet on black

Nassim Taleb, author of *The Black Swan* and [Fooled by Randomness](#), is interviewed in this month's [Fortune magazine](#). The interview is excellent, and so are his books. But when Taleb's theories go mainstream, it's time to start thinking about what is likely as well as what is possible.

The crux of his argument is based on [Karl Popper's falsifiability theory](#). It was once assumed by Europeans that all swans were white but, no matter how many white swans were seen, the theory could never be proved, only disproved (which, in fact, it was with the discovery of black swans in Australia). Just because something has never been seen before doesn't mean it doesn't exist.

The risk models used by the world's largest financial institutions, which rely solely on what has happened in the past to predict what will happen in future are, therefore, useless (and, in Taleb's opinion, extremely dangerous).

The meltdown of the US mortgage market and the hundreds of billions lost by said financial institutions has thrown Taleb's theories into the limelight. Although he's described this financial disaster as a 'grey swan' at best (being somewhat predictable), people have thrown the past out the window and are looking for black swans all over the place.

It's now time to remember that black swans are rare. Flip a coin 10 times and the probability that you flip 10 heads or 10 tails in a row is 1/512. But flip a coin a thousand times and the probability that you'll get a run of at least 10 heads or 10 tails, at some point, is more than 85% (it's been a while since I've done probability theory, so correct me if I'm wrong – I get 85.6%). Play for long enough, and it's highly likely that you'll get a freakish run or two.

But they'll be few and far between. And at the moment many securities, especially in debt markets, are being priced as if there's a black swan swimming in every pond. Set yourself up so that the rare events won't send you broke – little or no debt, thoughtful diversification and a thorough understanding of what you own – and small risks can be rewarded with extremely attractive returns.