	Conventional Behavior	Unconventional Behavior
Favorable Outcomes	Average good results	Above-average results
Unfavorable Outcomes	Average bad results	Below-average results

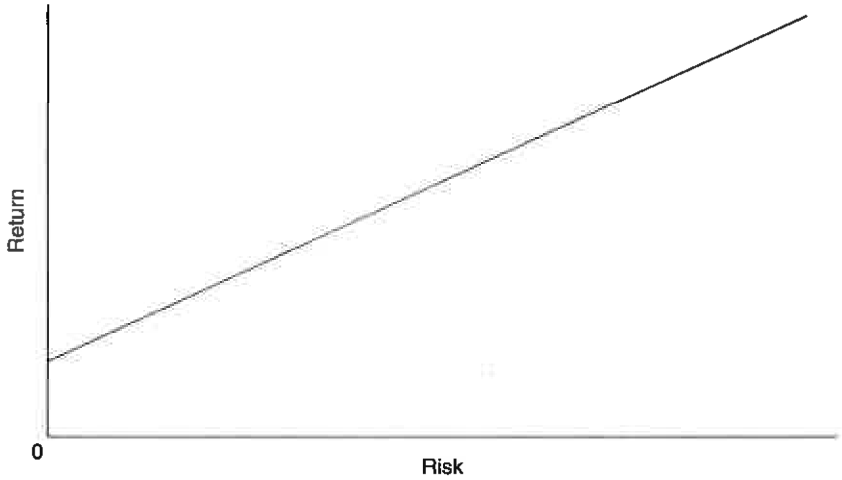

Figure 5.1

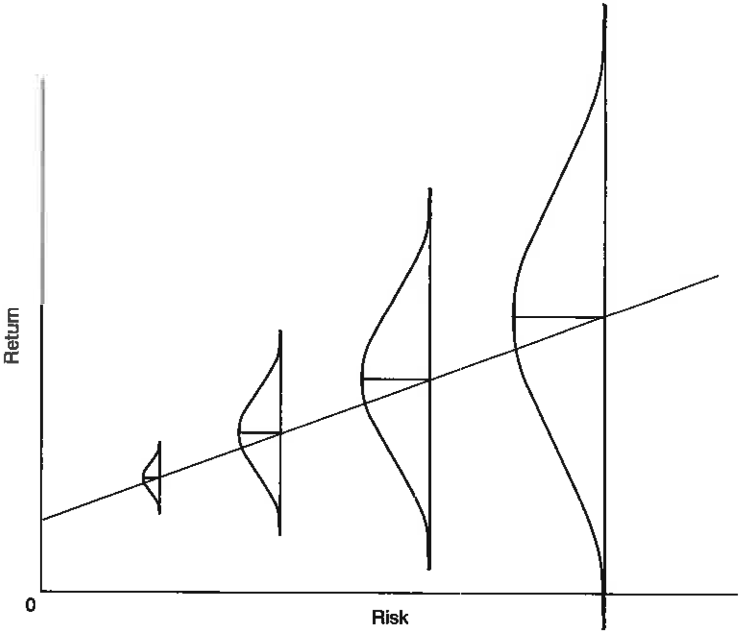

Figure 5.2

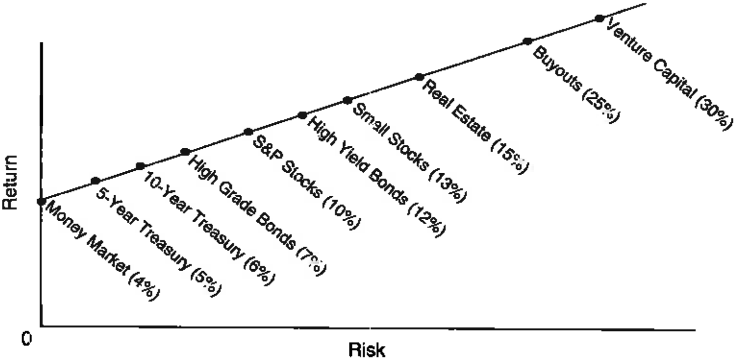
Venture Capital (30%)
Buyouts (25%)
Real Estate (15%)
Small Stocks (13%)
High Yield Bonds (12%)
S&P Stocks (10%)
High Grade Bonds (7%)
10-Year Treasury (6%)
5-Year Treasury (5%)
Money Market (4%)
Return
0
Risk

Figure 6.1

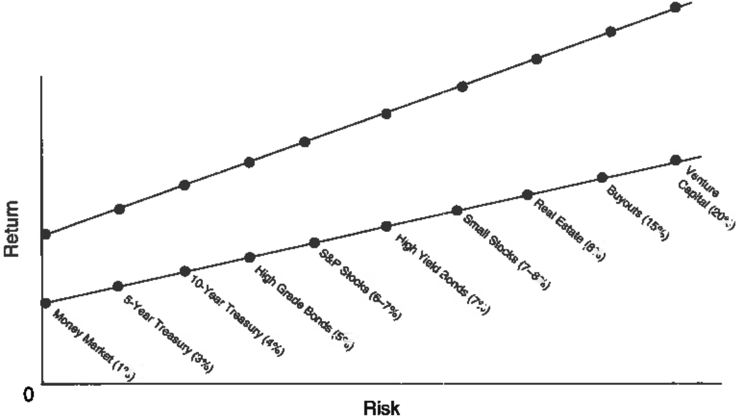
Return
Risk
0
Money Market
5-Year Treasury (3%)
10-Year Treasury (4%)
High Grade Bonds
S&P Stocks (6–7%)
High Yield Bonds
Small Stocks
Real Estate
Buyouts (15%)
Venture Capital

Figure 6.2

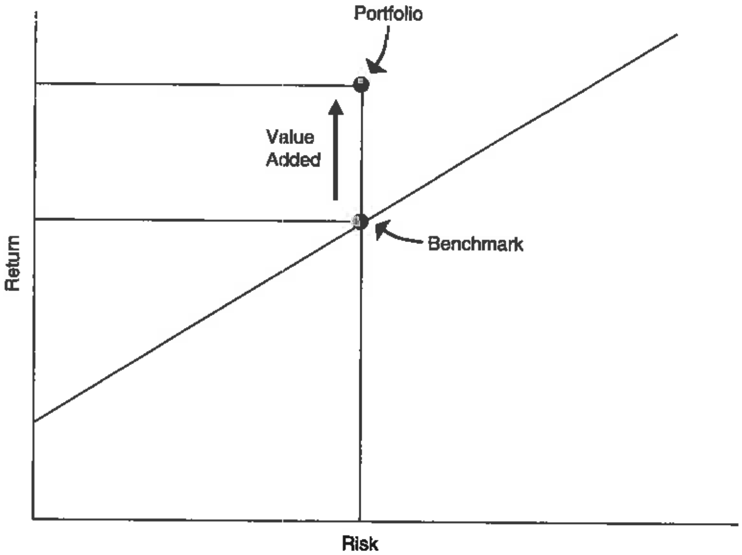

Figure 7.1

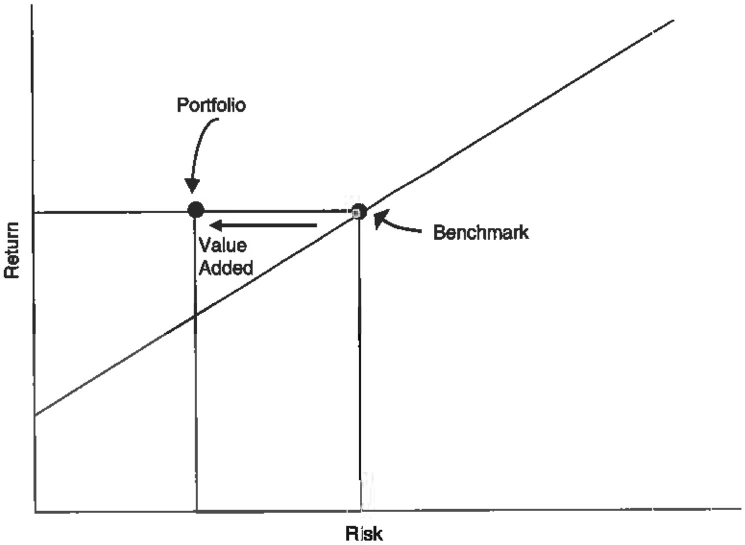

Figure 7.2

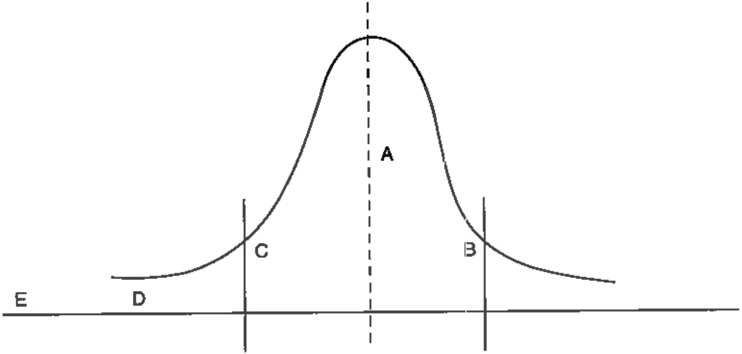

Figure 7.3

Here's a simple exercise that might help you take the temperature of future markets. I have listed a number of market characteristics. For each pair, check off the one you think is most descriptive of today. And if you find that most of your checkmarks are in the left-hand column, as I do, hold on to your wallet.

Economy:	Vibrant	Sluggish
Outlook:	Positive	Negative
Lenders:	Eager	Reticent
Capital markets:	Loose	Tight
Capital:	Plentiful	Scarce
Terms:	Easy	Restrictive
Interest rates:	Low	High
Spreads:	Narrow	Wide
Investors:	Optimistic	Pessimistic
	Sanguine	Distressed
	Eager to buy	Uninterested in buying
Asset owners:	Happy to hold	Rushing for the exits
Sellers:	Few	Many
Markets:	Crowded	Starved for attention
Funds:	Hard to gain entry	Open to anyone
	New ones daily	Only the best can raise money
	General Partners hold all the cards	Limited Partners have bargaining power
Recent performance:	Strong	Weak
Asset prices:	High	Low
Prospective returns:	Low	High
Risk:	High	Low
Popular qualities:	Aggressiveness	Caution and discipline
	Broad reach	Selectivity

"IT IS WHAT IT IS," MARCH 27, 2006

Perhaps a good way to sum up Taleb's views is by excerpting from a table in his book. He lists in the first column a number of things that easily can be mistaken for the things in the second column.

Luck	*Skill*
Randomness	*Determinism*
Probability	*Certainty*

Belief, conjecture	*Knowledge, certitude*
Theory	*Reality*
Anecdote, coincidence	*Causality, law*
Survivorship bias	*Market outperformance*
Lucky idiot	*Skilled investor*

The alpha/beta model is an excellent way to assess portfolios, portfolio managers, investment strategies and asset allocation schemes. It's really an organized way to think about how much of the return comes from what the environment provides and how much from the manager's value added. For example, it's obvious that this manager doesn't have any skill:

Period	Benchmark Return	Portfolio Return
1	10	10
2	6	6
3	0	0
4	–10	–10
5	20	20

But neither does this manager (who moves just half as much as the benchmark):

Period	Benchmark Return	Portfolio Return
1	10	5
2	6	3
3	0	0
4	–10	–5
5	20	10

Or this one (who moves twice as much):

Period	Benchmark Return	Portfolio Return
1	10	20
2	6	12
3	0	0
4	–10	–20
5	20	40

This one has a little:

Period	Benchmark Return	Portfolio Return
1	10	11
2	6	8
3	0	–1
4	–10	–9
5	20	21

While this one has a lot:

Period	Benchmark Return	Portfolio Return
1	10	12
2	6	10
3	0	3
4	–10	2
5	20	30

This one has a ton, if you can live with the volatility:

Period	Benchmark Return	Portfolio Return
1	10	25
2	6	20
3	0	–5
4	–10	–20
5	20	25

	Aggressive Investor	Defensive Investor
Without Skill	Gains a lot when the market goes up, and loses a lot when the market goes down	Doesn't lose much when the market goes down, but doesn't gain much when the market goes up
With Skill	Gains a lot when the market goes up, but doesn't lose to the same degree when the market goes down	Doesn't lose much when the market goes down, but captures a fair bit of the gain when the market goes up