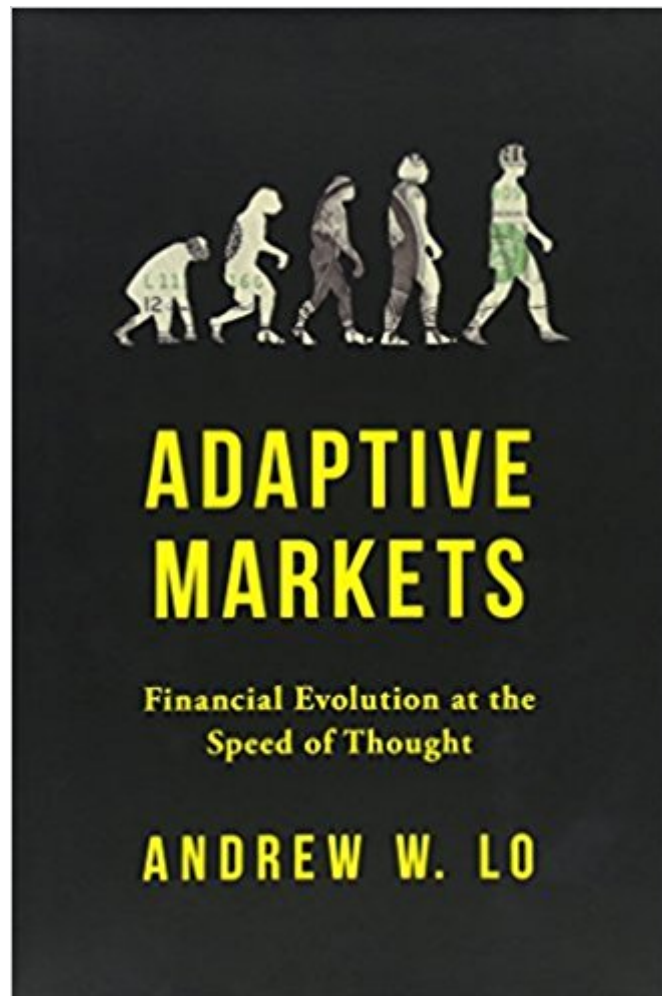




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Adaptive Markets: Financial Evolution At The Speed Of Thought



Synopsis

A new, evolutionary explanation of markets and investor behavior Half of all Americans have money in the stock market, yet economists can't agree on whether investors and markets are rational and efficient, as modern financial theory assumes, or irrational and inefficient, as behavioral economists believe—and as financial bubbles, crashes, and crises suggest. This is one of the biggest debates in economics and the value or futility of investment management and financial regulation hang on the outcome. In this groundbreaking book, Andrew Lo cuts through this debate with a new framework, the Adaptive Markets Hypothesis, in which rationality and irrationality coexist. Drawing on psychology, evolutionary biology, neuroscience, artificial intelligence, and other fields, *Adaptive Markets* shows that the theory of market efficiency isn't wrong but merely incomplete. When markets are unstable, investors react instinctively, creating inefficiencies for others to exploit. Lo's new paradigm explains how financial evolution shapes behavior and markets at the speed of thought—a fact revealed by swings between stability and crisis, profit and loss, and innovation and regulation. A fascinating intellectual journey filled with compelling stories, *Adaptive Markets* starts with the origins of market efficiency and its failures, turns to the foundations of investor behavior, and concludes with practical implications—including how hedge funds have become the Galápagos Islands of finance, what really happened in the 2008 meltdown, and how we might avoid future crises. An ambitious new answer to fundamental questions in economics, *Adaptive Markets* is essential reading for anyone who wants to know how markets really work.

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Customer Reviews

"Mr. Lo makes a convincing argument and he also uses the book to lay out some interesting ideas--such as a huge, diversified fund that would invest in a range of potential cancer treatments."--Economist"[A] remarkable new book. . . . Lo's book will be read and read widely. . . . His insights should allow investors and regulators alike to manage risks better. They should read it."--John Authers, Financial Times"This new book will become another essential read for anybody interested in financial markets. . . . [It] is a thoroughly interesting and enjoyable read. It is not technical, the explanations are super-clear, and there is some excellent story telling."--Enlightened Economist"[Lo] has a knack for providing a telling anecdote or story to illustrate his point. More important, he also avoids being condescending or triumphalist."--Matthew Partridge, Money Week"Using research in evolutionary biology, psychology, neuroscience and artificial intelligence, Mr. Lo . . . explains how human behavior shapes the markets, leading to swings between stability and instability, profit and loss, innovation and regulation."--Pensions & Investments"Andrew Lo's Adaptive Markets is a masterly synthesis of the traditional, rationality-based approach and new approaches based on psychology and neuroscience, evolutionary theory, and techniques such as computer simulations and artificial intelligence."--Diane Coyle, Project Syndicate"Andrew Lo's ambitious book offers a welcome, fresh look at how financial markets work and why they sometimes fail. . . . Adaptive Markets makes a valuable and welcome contribution, rewarding the reader by broadening and improving our understanding of finance and markets--in stable and unstable times."--Milton Ezrati, City Journal"The financial markets we create similarly reflect 'principles of evolution--competition, innovation, reproduction and adaptation'. In this important book, Lo of the Massachusetts Institute of Technology demonstrates the radical implications of this insight."--Martin Wolf, Financial Times"[Adaptive Markets] is a summation of developments in fields ranging from economics and behavioral finance to neuroscience and artificial intelligence--all influences on the adaptive markets hypothesis Lo proposes as a framework for finance that considers both rational and irrational behavior."--Institutional Investor"By reading Adaptive Markets, investors and their advisors will benefit from a better understanding of the reasons, based in biology and human nature, that the market is not efficient."--Laurence B. Siegel, Advisor Perspectives

"Andrew Lo combines wonderfully broad scholarship and a delightfully instructive style to present dramatically new perspectives on how markets work and how they can be regulated more effectively. This important book will teach and entertain, and should influence those charged with keeping markets healthy."--Simon A. Levin, Princeton University"Adaptive Markets will appeal to anyone who distrusts dogmatic economic theories and thirsts for a coherent view of how market

economies produce both great gain and great pain for societies. Andrew Lo integrates a deep understanding of finance with a broad knowledge of biology, psychology, and ethics to offer a tantalizing vision of how financial engineering could become a powerful force for a more just, healthy, and prosperous world."--Peter Hancock, President and CEO, AIG

"We tell stories, we learn from them, and we make them up. In this magnificent book, Andrew Lo explains how our attraction to stories drives markets, explains past catastrophes, and suggests future opportunities for world-saving financial engineering. And he packages it all in fascinating stories of his own."--Patrick Henry Winston, Massachusetts Institute of Technology

"Andrew Lo is a brilliant financial economist, visionary innovator, bold contrarian, gifted writer, and an unrelenting idealist. These traits are evident in this wonderful book, which traces the 'evolutionary explosion of financial innovation' that began with Vanguard's creation of the first index mutual fund in 1974, tracking the S&P 500 Index. I continue to hold to index funds, but Dr. Lo's book persuades me to keep a mind that is open—or at least ajar--to the new world of investment technology, investor preferences, and transaction efficiency, and to the wisdom of those who are smarter than I am."--John C. Bogle, founder of the Vanguard Group and the First Index Mutual Fund, and author of *The Little Book of Common Sense Investing*

"This is a wonderful book. Andrew Lo traces a journey in which he reconsiders rationality in economics, moving from the efficient market hypothesis to his own Adaptive Markets Hypothesis through psychology, neuroscience, biology, and studies of financial innovations and crises. The book presents many valuable findings and is also full of emotion--enthusiasm, joy, frustration, and pain. It is itself a manifestation of the important finding that rational thinking and emotion go together."Nobuhiro Kiyotaki, Princeton University

I teach in a business school but have no background in finance. This book is readable to the financial layperson and takes you on a journey through a revolution in the field - re-grounding finance in the discipline of evolutionary biology and psychology from its roots in neoclassical economics and physics. But the more important shift in perspective comes in the later chapters where Lo envisions a future of financial regulation and financial engineering. His "Star Trek finance" not only proposes ways to handle systemic risk in the financial system, but ways to leverage finance to solve societal challenges like cancer and climate change.

Lo has been developing an alternative to the "efficient market hypothesis" taught at virtually every major business school. Lo provides evidence of market "inefficiencies" and points to factors likely responsible for those. Some are due to the way the human mind acquires and processes

information ("behavioral finance"). This is a very thoughtful book. It will not help you buy or sell specific securities, but understanding market dynamics is worthwhile not only for the market professional but for the serious amateur.

Professor Lo combines Finance, Economics, Psychology and Evolutionary Biology to expand our understanding of Finance and markets. He asserts that markets have important gaps in the efficiency of markets due to evolutionary forces that determine the survival or extinction of financial entities. This book uses no mathematics but describes the results of many, many advanced studies across several fields. The style is plain, clear and very engaging.

Lo is the best - this book is his ground-breaking MIT work written for the general audience and is absolutely fabulous.

An innovative blend of economic theory, finance thinking, and modern biology and psychology. The book offers a wide array of insights and develops a thoughtful alternative both to the conventional theories and common alternatives.

Very good book on why markets work the way they do.

no real solutions or ideas on how to address.

There are some heavy chapters, specially when he focuses on biology and evolution to explain his point, an important part for sure, but I think he could get to it in a shorter way. But overall it is a superb book on how to understand the markets and his hypothesis will have much to say for now on. This could be the new standard in some years.

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