

Taleb's Stranded Swan?

TSF Commentary – June 3, 2009

By [Janet Tavakoli](#)

Before penning my [previous commentary](#), I contacted Nassim Nicholas Taleb to check whether there were any inaccuracies in a *Wall Street Journal* [article](#) about the performance of his previous black swan fund, Empirica Kurtosis Ltd. The article said the fund had a 60% return in 2000 followed by "losses in 2001 and in 2002." In 2003 and 2004 it had low single-digit gains, a period when hedge funds posted average returns of 20% and 9% respectively. The fund's size was around \$375 million when most of the assets were returned to investors.

In my query to Taleb, I also asked for confirmation that the fund experienced a voluntary wind-up...more on that later.

Taleb did not respond. Considered with his previous coy reply regarding *GQ's* [mythical \\$20 billion](#), I gave up hope of clarification. I enjoy [debating philosophy](#), but debate is no substitute for size of actual gains.

I was particularly interested in Empirica Kurtosis's reported anemic performance in 2001, because according to Taleb, the 9/11 terrorist attacks of 2001 were a "black swan" event.¹

How can a black swan fund do so poorly when the black swan finally appears?

Imagine a scenario: When the black swan appears, investors panic. The fund manager wants to cash in gains when volatility soars. Nervous investors want the manager to buy more "insurance," when it is expensive and ill-considered. But investors should not be blamed for a black swan fund's anemic performance any more than a pilot would blame nervous passengers for a bumpy plane ride. Management takes credit (and juicy fees) for the gains, so it should take responsibility for overall performance. This scenario may not be relevant for Empirica Kurtosis, but then, what is the explanation?

What about the voluntary wind-up I mentioned earlier?

Taleb's web site stated EMPIRICA WAS NEVER CLOSED [emphasis in original].² That may be true if one is only referring to Empirica LLC, a risk management operation. But in my opinion, it is incomplete to assert this without mentioning the voluntary wind-up of Empirica Kurtosis Limited.

Taleb never responded to my query about the wind-up. The Bermuda-based trustee was more helpful and confirmed that Empirica Kurtosis Limited was indeed wound up in 2004/2005.

Winners' Swan Dive

Big wins and big losses always occur after any market move. Winners are eager to claim they were smart—not lucky.

The big picture should be big enough to provide perspective. A black swan fund may have a good year followed by losses and mediocre returns. Empirica Kurtosis Limited may have become an example of a black swan fund with clipped wings.

(See also: "[Taleb Kills \\$20 Billion Mythical Swan](#)," June 1, 2009)

Endnote: On June 3, 2009 I sent this to Taleb to give him a chance to respond to my commentaries if he chose to do so: "[I]f you look at the following linked commentaries, I am happy to issue appropriate corrections, revisions, updates, or more if it is in order." Taleb did not respond.

¹ Excerpted Transcript May 8, 2007 – *The Colbert Report* (Stephen Colbert interviews Taleb)

Taleb: Take Google, September 9/11, the rise of the internet, Harry Potter...They were unexpected and no one saw them coming, and after they happened, oh yah, it was so explainable by historians, scholars and academics, but before they happened, they were so unexpected.

[Later]

Colbert: So you say...9/11 could not be predicted.

Taleb: It is very very hard to predict these events.

[Apparently Taleb never heard of the August 2001 presidential briefing: "[Bin Laden Determined To Strike in U.S.](#)" based on a July 2001 intelligence report.]

Colbert: ...I'm glad to hear that, because that means the 9/11 Commission was a waste of time. Because we shouldn't have investigated why it happened, right?

Taleb: You need you need [sic] to investigate to see if it is predictable or not...

Colbert: But why? Why investigate something that can't be predicted, because there is nothing to learn from it.

Taleb: No, after the fact, Okay, you have to look at...uh...first of all you can learn something from the event, it's not like you can't learn at all.

Colbert: Okay

Taleb: But 9/11, 9/11, what I'm saying is that its there is so many events like 9/11 that could have taken place, you see, so, its just to see if there's responsibility, is there any vigilance or no vigilance. This is why we investigated 9/11.

Colbert: ..Is Iraq a Black Swan? We couldn't have ever foreseen it would go poorly, we would never have known that was not going to go well...

Taleb: No, wars, wars, yah, listen, wars since Napoleon...we learned that wars...wars are more and more unpredictable, more and more complex, the link between action and consequence becoming fuzzier, and I think that the war in Iraq was a mistake...we should have seen that it could have led to these dire consequences. [Only since Napoleon?]

Colbert: We should have but we didn't, therefore we couldn't.

[Later]

Colbert: It seems like you're essentially saying the future is unpredictable.

Taleb: No, I'm saying, yes, my idea in the book is to show two things: number one that the future is rather unpredictable, it is dominated by Black Swans and these black swans are not predictable, and the second point that is quite central, is that we humans...all right?...try to concoct stories to convince ourselves that the future is more predictable than it actually is...[Like Taleb's Napoleon story?]

Colbert: The future is essentially not predictable.

Taleb: Yes, it's not.

Colbert: By that logic, doesn't it mean that in the future you will be able to predict things, because you are predicting that you cannot predict things?

² The only mention of Empirica on Taleb's [web site](#) was as follows: "Owned **Empirica LLC** a trading/hedging/protection operation (currently the business became the Black Swan Protection Protocol managed by the traders at **Universa** –I am an advisor). Note that EMPIRICA WAS NEVER CLOSED. **Current Corporate Boards:** a few hedge funds. A [prophetic novel](#) by Viken Berberian about Empiricus Kapital." There was no mention of Empirica Kurtosis Limited (Empirica Kurtosis), a fund, or of its returns even though it seems it may have been part of this operation at one time. The fund's returns are not mentioned in Taleb's [Wikipedia profile](#) (as of this writing). The returns for Empirica Kurtosis Limited are mentioned in [Mark Spitznagel's Wikipedia profile](#), but in an incomplete way. Spitznagel was a partner with Taleb in this venture: "Empirica was reported to have made a 60% return in 2000 and lower (though unconfirmed) returns from 2001 to 2004."

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[Credit Derivatives & Synthetic Structures](#) (1998, 2001), [Collateralized Debt Obligations & Structured Finance](#) (2003), [Structured Finance & Collateralized Debt Obligations](#) (John Wiley & Sons, September 2008), and [Dear Mr. Buffett: What An Investor Learns 1,269 Miles From Wall Street](#) (Wiley, 2009).

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