

P E R S P E C T I V E S

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Behavioral finance

The Undoing Project – a friendship that changed our minds

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In my December article on behavioral finance, I wrote about one of the pioneers in that field, Richard Thaler, who won the 2017 Nobel Prize in economics. In this issue, I'd like to review a 2016 book, *The Undoing Project – A Friendship That Changed Our Minds*, about the two men who started behavioral finance.

One reviewer said *The Undoing Project* might well be Michael Lewis's best book ever. That's quite an accolade for an already celebrated author with six *New York Times* best-sellers. Three of those – *The Blind Side*, *Moneyball* and *The Big Short* – became highly acclaimed, Hollywood blockbuster films.

With *The Big Short*, about the 2008 financial crisis, and *Flash Boys*, about high-frequency trading, Lewis has proven to be a master at making complex subjects simple and interesting. He's done the same with *The Undoing Project*.

I loved *The Undoing Project* for three reasons:

First, Lewis did a wonderful job explaining some key lessons of behavioral finance. Before, prevailing theories of economics and finance assumed that most people made judgments and decisions rationally and consistently. This assumption led to conclusions that supported supposed experts who sought to beat the markets using their superior brain power; and who said the markets were efficient and largely unbeatable.

Behavioral finance documented that, people make *significant* and *systematic* errors in their judgments and decisions. Lewis shows how this helped *undo* much of the reigning belief system.

I also loved Lewis's colourful stories about the two main characters: Daniel Kahneman and Amos Tversky.

Born in Tel Aviv, Kahneman spent his early childhood in France, where his family was forced into hiding from the Germans during World War II. He moved to British Palestine after the war, just before the creation of Israel. Tversky was born and raised in Haifa, British Palestine. Both men played pivotal roles in the Israeli defence force in the wars following Israel's creation. Their early lives helped shaped their later work.

Second, I enjoyed Lewis's account of how the collaboration between these two very different personalities resulted in the genius of their creativity.

Tversky was a larger-than-life, extroverted, super-optimistic, mathematical genius. Many smart people claimed he was the smartest person they ever met.

Kahneman was introverted, prone to introspection and pessimism. Described as "Woody Allen without the humour," he constantly questioned his own thinking. Kahneman saw the errors he made and assumed others made the same ones. This provided much of the fodder for his and Tversky's joint investigations on human nature.

Their partnership started when Kahneman invited Tversky to give a guest lecture to one of his classes at Hebrew University. Kahneman did the unthinkable: He questioned Tversky's findings. Tversky, to his credit, recognized the value of Kahneman's mind, and that his colleague could add to his own thinking.

Their most productive period was the 1970s, working side by side at Hebrew University. In 1978 they moved to North America to two different universities. Although they still collaborated, their separation caused them to drift apart.

Tversky died of cancer in 1996 at age 59. Kahneman won the Nobel Prize in Economics in 2002 for the work they did together.

Kahneman originally coined the term *The Undoing Project* to describe the psychology of people attempting to undo, in their minds, events they wish hadn't happened. Kahneman put much thought into this, partly because of the regret he felt for having drifted apart from Tversky.

One can only imagine how much more we might have learned about our minds if that amazing partnership had carried on longer. ■



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