



Article from

**The Stepping Stone**

July 2018

Issue 69

## COMMUNICATION

# Book Review: *The Wisdom of Finance*<sup>1</sup>

By Mary Pat Campbell

I highly recommend Mihir A. Desai's *The Wisdom of Finance: Discovering Humanity in the World of Risk and Return* for actuaries, for a variety of reasons. First, are you tired of trying to explain what you do to friends and family? Of being just a “number cruncher”? You can give this book to them to explain the ins and outs of risk transference, risk-return trade-offs, leverage and embedded options.

You could use the book as a conversation-starter, such as this observation on the connection between insurance and witchcraft:

Historian Alan Macfarlane notes that “punishment of witches was not merely for past offenses ... [it] was regarded as a prerequisite for healing from witchcraft and an insurance against future disasters.” And historian Owen Davies notes that, with the rise of insurance, “not only was the scope and impact of misfortune mitigated but blame for the experience of misfortune began to be appointed to the failures of these welfare mechanisms.” If the alternative is drowning your neighbor after declaring her a witch, complaining about the insurance company denying your claim isn't so bad.

You can finally say to your children, “Aw, my sweet little terminal values,” or to your parents, “I love having you as my negative beta assets,” and be appreciated.

OK, maybe not.

The book is good for the non-finance person:

- First, it is very short—less than 200 pages, and less than seven hours listening time for an audiobook.
- The author makes core financial concepts comprehensible for non-finance people. He uses examples from history, literature, art, poetry, movies, TV and even song lyrics (“She take my money when I'm in need?...”).

- There is almost no math whatsoever in the book—just a small amount of arithmetic when Desai explains how financial leverage works.

There are roughly two parts to the book: The first half deals with the pretty theory involving risks, returns and value creation. The second, messier, half looks at how people behave and feel surrounding finance, and even ends with a chapter titled: “Why Everyone Hates Finance.”

Let's look at that last idea—because this book is more important for people who actually work in financial fields than for those outside looking in. In this book, Desai takes a denigrated subject, even by some of its own practitioners, and makes it more human (with all the bad and good that entails).

The problem has been that finance has become more and more about numbers—and we see it as more abstract and divorced from what it is: a tool created by humans to accomplish specific things. Much of finance was originally developed to fund wars—and it's also been used to fund exploration, to protect people from disaster, and to make development possible.

Spurred by a blog post,<sup>3</sup> in comments someone asked: “[A]ctually, to what extent do you think being an actuary can help people?”

I had to think a while, and I came up with this answer:<sup>4</sup>

Actuaries tend to be very far removed from the beneficiaries of their work. We sit in cubicles, staring at computer screens. We wrangle with messy data. We have legacy spreadsheets we are trying to tame into something that gives us sane answers. ...

We've seen in a major way that risk exists. We're all going to die; it's just a matter of when. If you own stuff, that stuff can get destroyed or damaged and might need to be replaced. If you do stuff, something bad could happen, and you could get sued. It would be nice if there were ways that we could prepare for these risks, reduce the costs for preparing for these risks, and be able to count on that protection. ...

So the whole point is that we [actuaries] are trying to help people reduce the financial impact of very real risks, by transferring these risks into affordable, regular premiums—and setting it up so that you can depend on that protection being there. It took lots of disasters and failures, and a long time of developing the tools of actuarial science, for us to have a dependable insurance system. I've gone back and researched a lot of the 19th century insurance biz ... and it's ugly.

It can help to keep this big picture in your mind while you do your work. This is a very details-oriented profession (those details are very important); but this does not mean you cannot see how it contributes to helping people deal with risk better.

It can be difficult, when you're wrangling with the details, to be able to see the bigger picture. But it's important. I've seen many people like those in a recent *Money* magazine article who felt their jobs are "socially useless."<sup>5</sup> We compare ourselves to teachers, doctors or firefighters—and often the most tangible things we produce are PowerPoint decks and spreadsheets. It can really sap meaning out of your work.

This book really helps one connect to the core ideas of finance; why it's important to have good, ethical finance; and how that can build and protect value for people in the world.

Desai talks about both the good and bad in finance—not just in terms of real history but also fictional reflections. In terms of history, we hear about how idiotic annuity pricing helped fuel the French Revolution, how bottomry helped fuel global trade and market, and how the AOL-Time-Warner merger destroyed value, among many other historical stories. As for fictional illustrations, we have the 1980s movie *Working Girl* describing why mergers occur, Mel Brooks' *The Producers* highlighting the principal-agent problem, and 19th century British literature explaining the value of holding a diversified portfolio of options when it considers the marriage market for young women.

To entice actuaries further, the book starts off talking about risk and insurance—it's right there in the first chapter! And it brings to light two names forgotten in today's actuarial circles: Flitcraft and Peirce, and their connection to Dashiell Hammett and *The Maltese Falcon*. In the book (not the movie) Sam Spade is telling another character a story of one of his earlier cases, where a man named Flitcraft disappeared one day, and Spade tracked him down after a number of years—Flitcraft had been in a near accident, when a beam fell off a building going up. It shocked him, and he decided to make a complete change in life—and then he settled back into the pattern he had before: same kind of job, same kind of wife and kids, and living in Spokane instead of Seattle, albeit with the surname Pierce.

As Spade remarks: "I don't think he even knew he had settled back naturally in the same groove he had jumped out of in Tacoma. But that's the part of it I always liked. He adjusted himself to beams falling, and then no more of them fell, and he adjusted himself to them not falling."

Well, Flitcraft and Peirce, as we learn in Desai's book, refer to two people from the realm of probabilities and insurance. Allen

J. Flitcraft was known for his series of *Life Insurance Manuals*, which held lists of life insurers, their application agreements and policy forms (which often had premium schedules).<sup>6</sup> His book was a vade mecum for life insurance agents in the late 1800s and early 1900s.

Charles Sanders Peirce was known for many intellectual developments, such as the randomized trial for scientific experiments. Of interest to actuaries, he was a key figure in the development of modern statistics, and introduced the terms "confidence" and "likelihood."

Because of this book, I have started digging into more about these people, as well as others mentioned, such as Joseph de la Vega (one of the earliest authors of a book on stock trading, in 1688), Wallace Stevens (the American poet who also was an executive at The Hartford) and Robert Morris (who Desai terms as being "the man who could have been on the \$10 bill" in place of Hamilton).

The point is that finance in general, and actuarial work in specific, are part of a long, human story, and this book helps us connect to that story. We need this reminder from time to time, just to ground ourselves. ■



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## ENDNOTES

- 1 Desai, Mihir A. 2017. *The Wisdom of Finance: Discovering Humanity in the World of Risk and Return*. New York: Houghton Mifflin.
- 2 "Gold Digger" by Kanye West.
- 3 Grant. What is so Bad About Being an Actuary? 2009. *Wisdom and Wonder*. Nov. 2, <http://www.wisdomandwonder.com/article/4120/what-is-so-bad-about-being-an-actuary> (accessed April 17, 2018).
- 4 meep (aka Mary Pat Campbell). Life in the Back Office. 2011. *Live Journal*. March 20, <https://meep.livejournal.com/1885876.html> (accessed April 17, 2018).
- 5 Salisbury, Ian. 2018. These Are the Workers Most Likely to Admit Their Job Is "Socially Useless." *Money*, April 6, <http://time.com/money/5229480/socially-useless-jobs/> (accessed April 17, 2018).
- 6 As an example, see the 14th annual edition of Flitcraft's *Life Insurance Manual*, published February 1901, [https://books.google.com/books?id=MaQ5AAAAMAAJ&printsec=front-cover&dq=flitcraft+life+insurance+manual&hl=en&sa=X&ved=0ahUKEwi82cr4y8HaAhUCMd8KHTw\\_AuMQ6AEILDAB#v=onepage&q=flitcraft%20life%20insurance%20manual&f=false](https://books.google.com/books?id=MaQ5AAAAMAAJ&printsec=front-cover&dq=flitcraft+life+insurance+manual&hl=en&sa=X&ved=0ahUKEwi82cr4y8HaAhUCMd8KHTw_AuMQ6AEILDAB#v=onepage&q=flitcraft%20life%20insurance%20manual&f=false).