



Why Stock Markets Crash: Critical Events in Complex Financial Systems

By Didier Sornette

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The scientific study of complex systems has transformed a wide range of disciplines in recent years, enabling researchers in both the natural and social sciences to model and predict phenomena as diverse as earthquakes, global warming, demographic patterns, financial crises, and the failure of materials. In this book, Didier Sornette boldly applies his varied experience in these areas to propose a simple, powerful, and general theory of how, why, and when stock markets crash.

Most attempts to explain market failures seek to pinpoint triggering mechanisms that occur hours, days, or weeks before the collapse. Sornette proposes a radically different view: the underlying cause can be sought months and even years before the abrupt, catastrophic event in the build-up of cooperative speculation, which often translates into an accelerating rise of the market price, otherwise known as a "bubble." Anchoring his sophisticated, step-by-step analysis in leading-edge physical and statistical modeling techniques, he unearths remarkable insights and some predictions--among them, that the "end of the growth era" will occur around 2050.

Sornette probes major historical precedents, from the decades-long "tulip mania" in the Netherlands that wilted suddenly in 1637 to the South Sea Bubble that ended with the first huge market crash in England in 1720, to the Great Crash of October 1929 and Black Monday in 1987, to cite just a few. He concludes that most explanations other than cooperative self-organization fail to account for the subtle bubbles by which the markets lay the groundwork for catastrophe.

Any investor or investment professional who seeks a genuine understanding of looming financial disasters should read this book. Physicists, geologists, biologists, economists, and others will welcome *Why Stock Markets Crash* as a highly original "scientific tale," as Sornette aptly puts it, of the exciting and sometimes fearsome--but no longer quite so unfathomable--world of stock markets.

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Editorial Review

From Publishers Weekly

It's everybody's favorite topic of conversation at the moment: why did the Dow and the Nasdaq tank so horrifically, and where did all the money go? UCLA professor Sornette does his best to tackle those questions. While CNBC anchor Ron Insana's recent Trend Watching took a reader-friendly look at the history of market bubbles, Sornette's approach is decidedly different. Befitting his status as an expert in geophysics, the author loads the text with enough charts, graphs and advanced economic theory to choke John Kenneth Galbraith (one chapter subheading, for instance, is "The Origin of Log-Periodicity in Hierarchical Systems"). It's a meaty book, with helpful autopsies of past crashes ranging from tulip mania in the Netherlands to the Nasdaq crash of April 2000, as well as information on how crashes might be predicted in the future. Unfortunately for the average investor who tends to get burned after these bubbles, Sornette's conclusion is that a mixture of "systemic instability" and plain old human greed means that market bubbles aren't about to disappear anytime soon. And neither, of course, will the subsequent crashes.

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Review

"Sornette is both a statistical physicist and a member of a new breed of scientist: the econophysicist. . . . But Sornette's book is not just about finance and economics; it is also a mesmerizing introduction to game theory, fractals, catastrophe theory, critical phenomena, and much more. No prior knowledge of finance or economics is needed to understand the book. . . . Throughout the book, Sornette makes numerous, vivid comparisons with many other fields in which the various mathematical tools he describes can be applied."--**Frank Cuypers, *Physics Today***

"The book is written in a readable style and does not require technical knowledge. Any reader interested in a serious approach to the origin and possible prediction of financial bubbles will enjoy reading it."--**Josep M. Porra, *Journal of Statistical Physics***

"A highly recommended, enjoyable, well-researched, and thought-provoking book for anyone interested in stock markets and the modeling of financial processes."--**Rick Gorvett, *Journal of Risk and Insurance***

"While it's difficult to pinpoint what type of trader would enjoy this book the most, I think there's something for everyone, whether you're a quaint, technical trader or a fundamentalist. . . . I feel that I'm smarter after finishing this book; I thoroughly enjoyed the lengthy journey, and would recommend this to any stock market enthusiast."--**Jeff Pierce, *Seeking Alpha***

From the Inside Flap

"A professor of geophysics gives a very different perspective, informed by his scientific training, on the stock market. I am sure that his view will be highly controversial, but the book is fascinating, and mind-expanding, reading."--Robert Shiller, author of *Irrational Exuberance*

"*Why Stock Markets Crash* addresses a current and enduring concern for all investors, the seemingly mysterious twists and turns the markets take. Didier Sornette's insights into why markets behave as they do are fresh, productive, and provocative. This work is bound to become an important baseline for anyone trying to understand what will happen next in the stock and currency markets not only in the U.S. but in

Europe and Asia as well. It is well written and accessible to non technical audiences."--Richard N. Foster, Director, McKinsey & Company

"This is a most fascinating book about an intriguing but also a controversial topic. It is written by an expert in a very straightforward style and is illustrated by many clear figures. *Why Stock Markets Crash* will surely raise scientific interest in the emerging new field of econophysics."--Cars H. Hommes, Director of the Center for Nonlinear Dynamics in Economics and Finance, University of Amsterdam

"In turbulent times for financial markets, more books than usual are published on such subjects as financial crashes. This book is different. First, it is written by an internationally recognized expert in non-linear, complex systems. Second, it promotes some new ideas in both finance and science. In addition, it offers the general reader an insight into finance, both practical and academic, as well as some of the issues at the cutting edge of science. What more could one ask for?"--Neil F. Johnson, Department of Physics and Oxford Center for Computational Finance, Oxford University

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