

LEWIN CAPITAL MANAGEMENT LTD.

December 15, 2009

Dear clients and friends:

In the spirit of the season, please accept this copy of one of my favorite books, The Black Swan, by Nassim Taleb. I think this book is a real gem because it contains some key ideas that challenge conventional wisdom, particularly with respect to understanding risk.

One noteworthy idea is the observation that while many things that occur in nature are 'normally distributed' (statistics-speak to describe what most people commonly know as the "bell curve"), many aspects of business and finance are not.

This has important ramifications for the investment world. A cornerstone of modern finance theory is the idea that risk is volatility. Taleb discusses how using statistics to predict future volatility can lead to huge forecasting errors given the lack of normalcy in the underlying factor that is being predicted. The recent failure of sophisticated risk management systems in the U.S. brokerage industry is a clear example of this type of error, which could perhaps have been avoided with Taleb's insight.

Another more subtle conclusion to be drawn from Taleb's work is that selling options can be very dangerous. Writing an insurance policy is essentially akin to selling an option and where the insurance industry has tended to get in the most trouble is from writing policies in non-normally distributed fields, such as the stock, bond or mortgage markets. Indeed, the root cause of the US\$180 billion bailout of AIG was insurance, namely credit default swaps, that was sold using incorrect assumptions about the normalcy of loan defaults. Likewise, here in Canada, Manulife's problems with variable annuities stemmed from incorrectly assuming stock market returns were normally distributed.

Many people could benefit from understanding Taleb's ideas. I certainly enjoyed this book and I hope you enjoy it too. I wish the best of the season to you and your family.

Sincerely,

Dan