## Ellis, Charles D. – Investment Policy: How to Win the Loser's Game (2nd edition)

*Business One Irwin, 1993, [Finance]* Grade ★★★★★

This is one of the books that actually changed the world - well the investment world at least. Starting in the 1950's, Harry Markowitz and others in academia developed what later became modern portfolio theory (MPT). The thing was that the investment industry didn't really pick up on these novelties. That is, not until the first edition of this book in 1985 and the paper Determinants of Portfolio Performance the following year by Brinson et. al. After that the investment business was changed for ever. Mr Ellis, the most influential investment writer of the age, was for 30 years not only the managing partner of Greenwich Associated investment advisors to a huge number of financial organizations but also found time to teach at Harvard and Yale and to sit on a number of endowment boards.

The real gem in this book is the concept of the loser's game. Ellis offers the analogy of tennis and concludes that this sport could actually be two different types of games. Tennis played by amateurs is a loser's game as the outcome is determined by the mistakes of the loser. Professional tennis players make very few mistakes so it's a winner's game where the outcome is determined by the winner's initiatives. Professionals win points, amateurs lose points. Investments have according to Ellis turned into a loser's game. Most professional investment managers are extremely skilled and combined they have enough capital to almost become the market. This then makes it extremely hard for any one of them to regularly beat the market.

In a loser's game the one that makes the least strategic mistakes win. In Ellis analysis too many in the investment business focus on the nearly impossible task of beating the market but too few investment managers try to understand the needs of their clients. The conclusion is that focus should shift to setting up a clearly written investment policy with an asset allocation that truly caters to those needs. Asset mix is what counts and market timing, stock selection and changes in portfolio strategy should be downplayed.

Despite its importance this is a very short book. It's also a very likable book where you clearly feel that the author wants to help his readers to make better decisions. The concept of the loser's game is presented early and the consequences of this then follow when it comes to portfolio building, risk management, policy setting, performance measurement etc. All this in less than a hundred pages (which might be the reason for the impact in the investment industry).

To be honest the book feels quite a bit dated. MPT has dominated the investment arena for the last decades and its critics are getting louder. Two large stock market crashes the last ten years has not helped to boost the popularity of static asset mixes that is periodically rebalanced. Putting the area of behavioural finance aside and the challenge it post to modern portfolio theory, I think the most serious critique of Ellis conclusions is that they miss the time varying nature of expected returns of the different asset classes. Very few of the clients Ellis discusses really have 50 years long time horizons. For the next 5 to 10 years the expected returns of the equity market, of bonds of commodities etc. will due to the current valuation, the amount of overcrowding and the economic environment be vastly different from the long run averages.

This was very innovative work for its time. It's not anymore, but I would still recommend the book to anyone who wants to understand how the investment business got to where it is today. The thoughts in this book should be part of any market participant's tool box but the industry also has to move on from this – I'm not sure everybody in it has.

Mats Larsson, September 5, 2011