

Schwager, Jack D. – Market Sense and Nonsense

John Wiley & Sons, 2013, [Finance] Grade ★★ ★

I was excited when I first heard about this book. This is for two reasons. A new book from Jack Schwager is always something to look forward to. He has done the Investment Management industry tremendous service through his educational and entertaining in-depth interviews with knowledgeable, passionate money managers. These interviews make it obvious to me, that the market is not efficient if you have a well thought-out investment philosophy, a coherent process, strong work ethics and discipline. Second, the book's title made me genuinely curious. The market is flooded with industry-specific aphorisms or "market truths", some more commonsensical than others, although together far too often contradictory and quite commonly derived from the "good old days". How do they stand up to a reality test in today's highly competitive market? Few are more appropriate for this kind of analysis than Schwager.

The essence of the book is 55 "Investment Misconceptions" where Schwager tells us what reality is. Some stated misconceptions are quite obvious to the experienced investor, e.g. "The average investor can benefit from listening to the recommendations made by financial experts" and others are truly intriguing, e.g. "The diversification benefits beyond 10 holdings are minimal" (hint, if you consider worst-case out comes instead of averages, a portfolio of say 20 holdings usually provides substantial additional risk-reduction benefits). Schwager's "reality-testing" is usually not empirical in an academic sense: rather, it is based on his long experience in analyzing investment managers and their portfolios. But the discussions on the misconceptions are usually straightforward and logical. I doubt an experienced investor would disagree with the conclusions.

The underlying idea behind the book's theme - to analyze "market truths" and either confirm or falsify them - is brilliant. However, to be honest, I don't think the outcome of the book is on par with the idea. I wish Schwager had spent more time with this book, focused more on researching trickier "market truths", e.g. "never catch a falling knife" and analyzed them in greater detail and in a more quantitative way. For example, instead of just listing and discussing hidden risks, he could have tried to quantify their

importance and occurrence. It is a bit sad because I believe Schwager, with his potential, had a golden opportunity to write a new Investment Classic with this great idea and missed it. An advanced study of market truths based on market realities and long-term price action instead of theories from academia based on artificial assumptions is still very much in demand. I cannot help being annoyed in my suspicion that Schwager needed to meet a strict deadline or something similar.

The setup of the book is somewhat ad-hoc, too. It consists of three parts: 1) Markets, return and risk, 2) Hedge Funds as an Investment, and 3) Portfolio Matters. The second part doesn't fully fit with the book's theme and too much time is spent on the basics of hedge funds, their origin and their differences from mutual funds. The part on hedge funds does have its merits, especially the more advanced chapters, and it could very well have made a book on its own. More focus on the stated purpose would have enhanced my impression of the book.

If I have been too harsh in my critique, it is because of my high expectations of a favorite author. There are several chapters that caught my attention, e.g. I quickly reread the part on Portfolio Matters. I really appreciate Schwager's thoughts on portfolio rebalancing; they are counterintuitive and probably performance enhancing. Also, almost anyone can learn from Schwager how to evaluate a portfolio manager including assessing his performance and risk taking. The chapter on "Track Record Pitfalls" (hidden risks are far too seldom discussed!) was instructive, as well as the chapter on "The Tyranny of Past Returns". Further, Schwager's discussion on sector and hedge fund selection based on past performance is among my preferred readings in this book - a good example of where I believe market convention and "alpha-reality" often differ.

Schwager summarizes his book with 32 Investment Observations. There is lots of market wisdom here to assimilate. Despite some objections to this book, I still regard Schwager to be one of the most able professionals in our industry. I will read his next book, too.

Michael Persson, March 29, 2013