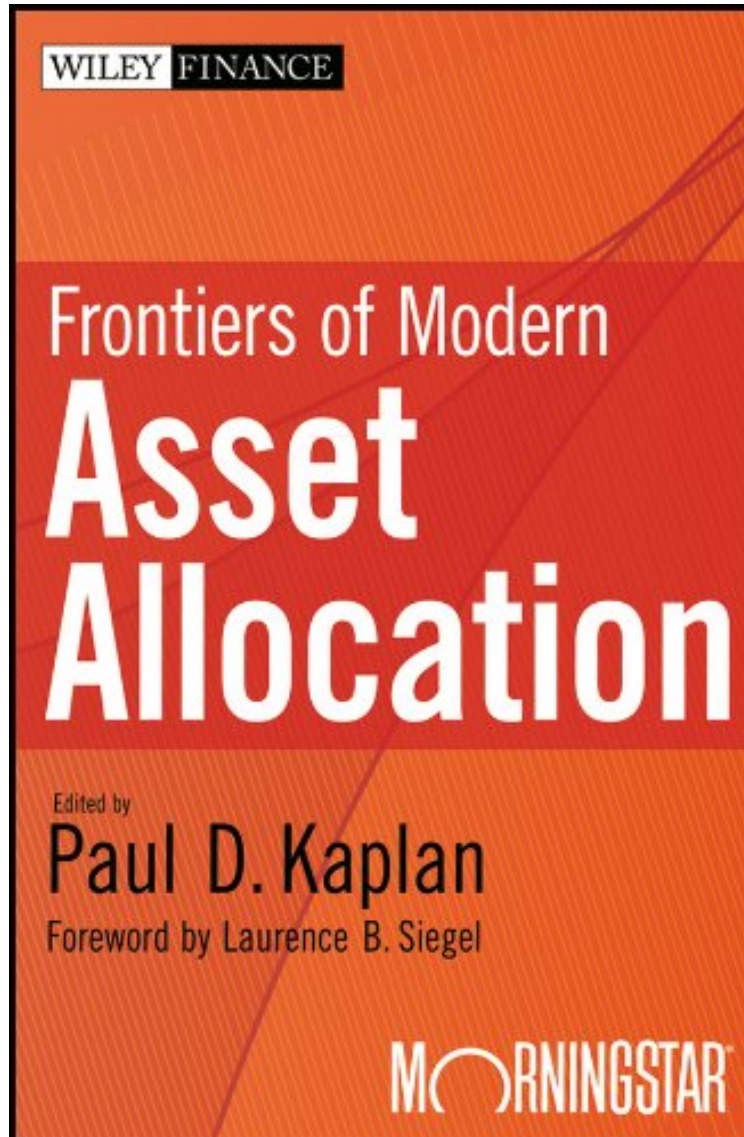


(Ebook pdf) Frontiers of Modern Asset Allocation (Wiley Finance)

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**From Wiley : Frontiers of Modern Asset Allocation (Wiley Finance)** before purchasing it in order to gage whether or not it would be worth my time, and all praised Frontiers of Modern Asset Allocation (Wiley Finance):

0 of 0 people found the following review helpful. This is a fabulous book for those interested in the ...By StuartThis is a fabulous book for those interested in the details of quantitative analysis of investor and market behavior. While fascinating, I can not state that there was anything inherent that prompted me to change my direction.11 of 11 people found the following review helpful. A Thorough and Candid Assessment of the Power and Limits of Quantitative AnalysisBy Robert Martorana"Historical statistics should not be blindly fed into an optimizer."This quote summarizes

the spirit of this book by Paul D. Kaplan, Ph.D. the Director of Quantitative Analysis at Morningstar. I published a full review of this book here on [...] on February 8, 2012: [...]Below are some excerpts from this review. The book covers a wide range of topics that span two decades of Kaplan's research. The 27 chapters are organized in four sections: 1. Equities (index construction, small-stock betas, etc.) 2. Fixed income, Real Estate, and Alternatives 3. Crashes and Fat Tails 4. Doing Asset Allocation

Markowitz and Optimization I found Kaplan at his best when discussing asset allocation, the fourth section of the book. He begins with a brief overview of Modern Portfolio Theory, which was based on the 1952 paper by Harry Markowitz. This pioneering work on asset allocation, uncertainty, and diversification led to Modern Portfolio Theory (MPT), and to the efficient frontier, which shows the trade-off between risk and return as a series of optimal portfolios. MPT also led to portfolio optimization, also called Mean Variance Optimization (MVO), and to the "fish hook" charts that adorn many client presentations.

The Limitations of Mean Variance Optimization Anyone who has worked with portfolio optimization knows that the results are extremely sensitive to the inputs. This leads to "estimation errors," a wonderful euphemism for what could be an investment catastrophe. Consequently, Kaplan emphasizes the importance of the assumptions for expected returns, standard deviation, and the correlation of asset classes. He repeatedly notes that optimizers are extremely sensitive to these assumptions. Kaplan also cautions against cutting our asset class slices too thin: If the asset classes are too similar, high correlations cause the correlation matrix to become "ill-conditioned," and small moves along the efficient frontier result in large changes in asset allocation. Kaplan's work suggests that optimization has limits when used for thin slices of the same wedge, as when stocks are divided into categories such as micro-cap, small-cap, mid-cap, large-cap, and mega-cap.

Markowitz 2.0 In chapter 26, Kaplan addresses four key problems with the original Markowitz model, and he offers solutions to each. Kaplan and co-author Sam Savage of Stanford University dub this "Markowitz 2.0," and Harry Markowitz himself approves this nomenclature in an interview (364). Kaplan's discussion of the limitations is unusual, since he actually offers specific solutions. Most critics of Mean Variance Optimization and Modern Portfolio Theory do not go this far, and Kaplan is on solid ground with each of his suggestions.

The Bottom Line The most critical takeaway I would offer potential readers is this: Paul Kaplan is not only eminently capable and rigorous, but he has intellectual humility and integrity--I trust his judgment and his conclusions.

2 of 3 people found the following review helpful. An innovative thinker By investingbythebooks Paul Kaplan is one of the more innovative thinkers in finance. After leaving Northwestern University Kaplan has spent over two decades at Ibbotson Associates and later Morningstar - after they bought Ibbotson - currently as the research director for Morningstar Europe. Kaplan's thinking spans over almost any topic in finance apart from perhaps individual security selection. Kaplan's eclectic thinking is on full display in this book that collects a number of the author's best papers grouped under a number of headlines. It's impossible to cover all the topics in the book. However, a few papers stand out. One is "The Long and Short Commodity Indexes" where the author presents a convincing argument that commodity futures' indexes' should be constructed as long-short-indexes instead of normal long-only-indexes. With a rule based trend following long-short strategy the index can reap the benefits of markets that are both in backwardation and in contango. A few texts cover fundamental indexes. One pleasant feature in this book is that a number of papers on the same topic often are rounded up by a debate. A discussion between Kaplan and Robert Arnott of Research Affiliates ends the topic of fundamental indexes. Consensus is reached on that these might be effective strategies as they combine a value reweighting of the index constituents with a flexibility to increase or decrease the bet that is taken versus a market cap weighted index depending on the grade of over- or undervaluation, but they do not represent a new way to define the equity market per se. Arguably, the most important paper in the book is Markowitz 2.0 (also discussed by Harry Markowitz and Sam Savage with Kaplan as the moderator). The topic is what could be done to update and improve the mean variance optimization framework. The improvements include using the geometric mean of returns, risk measures that better account for the fat tails, using scenario analysis to understand the time varying nature of correlations etc.

My favourite paper however is another one. In fact, it might be one of my favourite papers all time. How often have you heard that asset allocation determine 90 percent of the returns in asset management? In the paper "Does Asset-Allocation Policy Explain 40 Percent, 90 Percent, or 100 Percent of Performance?" Kaplan addresses the fact that most people misunderstand the classic 1986 paper by Brinson et. al. There are actually three questions with three very different answers. The first question is how much of the variability of returns across time in the average fund is ascribed to asset allocation as opposed to security selection? The answer is that asset allocation accounts for 90 percent of the variability in the returns from one year to another for asset managers in general. This is the question Brinson et. al. answered. The second question is how much of the variation between different funds that is explained by asset allocation in a specific year. This is the question most people think Brinson et. al. answered. In Kaplans study the answer is 40 percent and hence security selection accounts for the main difference between competitors a specific year. Finally, the question could be what percent of the returns for the average fund that is explained by asset allocation. As alpha is zero for all participants in the market the answer is obviously 100 percent.

Based on the papers above this is clearly a book that deserves the highest rating. The problem is that some texts are unique and cutting edge, others are fairly plain. Some texts are highly mathematical while others are very short and simple. The book isn't coherent enough. I highly recommend reading the top five or so of these papers. They are clearly in the forefront of the

thinking in asset allocation. If you can't get them in another way, buy the book. This is a review by eqtbooks.com

Innovative approaches to putting asset allocation into practice Building on more than 15 years of asset-allocation research, Paul D. Kaplan, who led the development of the methodologies behind the Morningstar Rating(TM) and the Morningstar Style Box(TM), tackles key challenges investor professionals face when putting asset-allocation theory into practice. This book addresses common issues such as: How should asset classes be defined? Should equities be divided into asset classes based on investment style, geography, or other factors? Should asset classes be represented by market-cap-weighted indexes or should other principles, such as fundamental weights, be used? How do actively managed funds fit into asset-class mixes? Kaplan also interviews industry luminaries who have greatly influenced the evolution of asset allocation, including Harry Markowitz, Roger Ibbotson, and the late Benoit Mandelbrot. Throughout the book, Kaplan explains allocation theory, creates new strategies, and corrects common misconceptions, offering original insights and analysis. He includes three appendices that put theory into action with technical details for new asset-allocation frameworks, including the next generation of portfolio construction tools, which Kaplan dubs "Markowitz 2.0."

From the Inside Flap Paul D. Kaplan has been right in the middle of these developments. First as a researcher for Ibbotson Associates and now for Morningstar, Dr. Kaplan has published dozens of articles and research papers over the past fifteen years that dig deeply into analyzing the moving parts of portfolio creation. In addition to pushing the asset-allocation debate forward with his research, Dr. Kaplan has helped develop products and tools for institutions, financial advisors, and individual investors that have made it practical to put the concepts of asset allocation into everyday use. In *Frontiers of Modern Asset Allocation*, Dr. Kaplan brings together twenty-seven of his best articles and interviews. He divides the book into four parts—Equities; Fixed Income, Real Estate, and Alternatives; Crashes and Fat Tails; and Doing Asset Allocation—examining everything from how asset classes should be defined to whether they should be represented by market value—weighted indexes or other principles. The book also includes interviews with industry luminaries who have greatly influenced the evolution of asset allocation, including Markowitz, Roger Ibbotson, and the late Benot Mandelbrot. *Frontiers of Modern Asset Allocation* is essential reading for institutional investors, wealth managers, financial planners, and academics. It includes three appendices that put theory into action with technical details for new asset-allocation frameworks, including the next generation of portfolio construction tools, which Dr. Kaplan dubs "Markowitz 2.0," in honor of the father of Modern Portfolio Theory.

From the Back Cover Praise for *Frontiers of Modern Asset Allocation* "This is a book where theory meets practice and results in innovation. Some of Paul's research challenges commonly used asset-allocation methodologies and offers investors interesting alternatives. A most interesting read." —Bruno Solnik, Professor of finance, Hong Kong University of Science and Technology and HEC Paris "The foundations of MPT, though solid, are desperately in need of updating to reflect modern market dynamics. Paul does exactly that while taking time to shatter myths along the way. Read this book and you will have in your possession modern tools masterfully applied to asset allocation relevant to today's investors." —Rodney N. Sullivan, CFA, Editor, *Financial Analysts Journal*, CFA Institute "This book by Paul Kaplan is a most unusual, and worthwhile, mix of practitioner wisdom and academic rigour, topped with some excellent interviews and debates; highly recommended." —Dr. Steve Satchell, Fellow, Trinity College, University of Cambridge "Paul Kaplan's state-of-the-art research on asset allocation has been instrumental in resolving many of the issues that face practitioners. In *Frontiers of Modern Asset Allocation*, Paul brings much of his work together to walk the reader through the evolution of asset allocation toward a better understanding of its state in today's markets." —Brian Singer, CFA, Head of Global Macro Strategies, William Blair Company, LLC "The breadth and depth of the articles in this book suggest that Paul Kaplan has been thinking about markets for about as long as markets have existed." —From the Foreword by Laurence B. Siegel

In 1952, the economist Harry Markowitz introduced a now-commonplace concept: investors can construct an "efficient portfolio" by investing in diverse securities combined to maximize expected returns while minimizing expected volatility. Markowitz revolutionized investing. Ever since, the idea of asset allocation has been the bedrock of constructing portfolios. The pursuit of finding a portfolio's sweet spot—the optimal area where various asset classes work in conjunction to provide the most returns for the least risk—has given rise to an incredible body of research and range of products.

About the Author Paul D. Kaplan is quantitative research director at Morningstar Europe and is responsible for the quantitative methodologies behind Morningstar's fund analysis, indexes, advisor tools, and other services. Dr. Kaplan conducts research on investment style analysis, performance and risk measurement, asset allocation, retirement-income planning, portfolio construction, index methodologies, and alternative investments. He led the development of quantitative methodologies behind the Morningstar Rating for funds (Morningstar's star rating), the Morningstar Style Box, and the Morningstar family of indexes. Many of Dr. Kaplan's research papers have been published in professional books and publications such as the *Financial Analysts Journal*, the *Journal of Portfolio Management*, the *Journal of Wealth Management*, the *Journal of Investing*, the *Journal of Performance Measurement*, the *Journal of Indexes*, and the *Handbook of Equity Style Management*. He

received the 2008 Graham and Dodd Award and won a Graham and Dodd Award of Excellence in 2000.