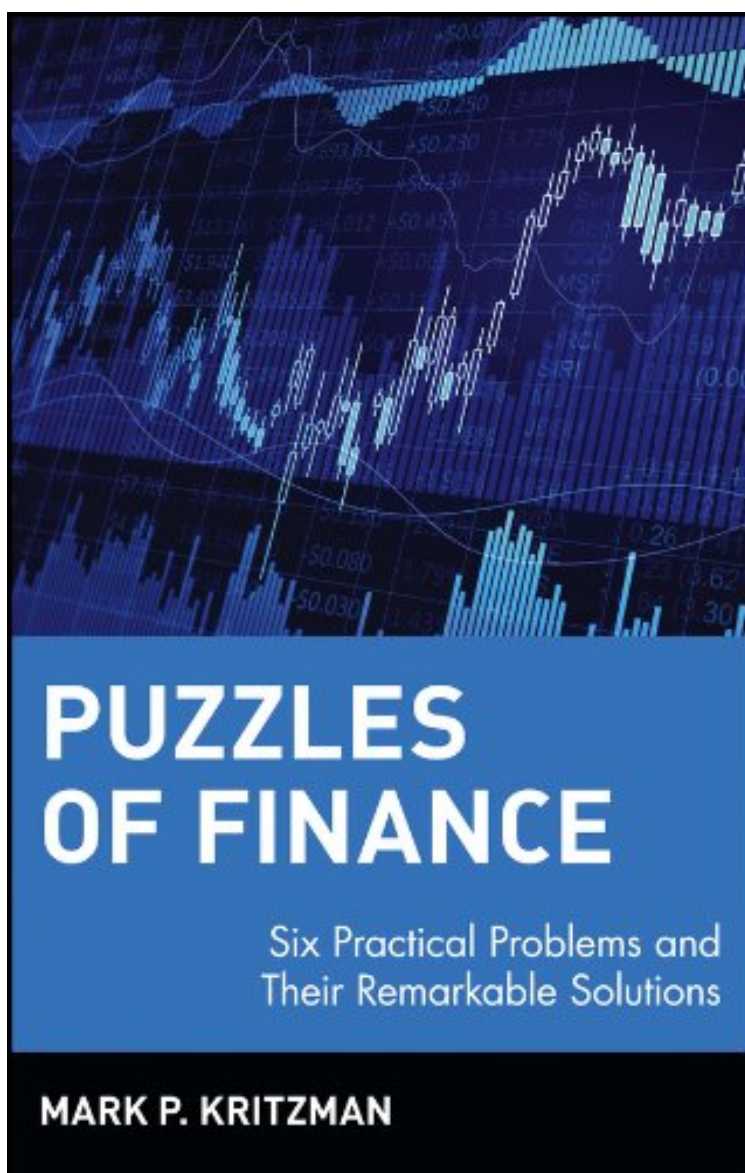


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Puzzles of Finance: Six Practical Problems and Their Remarkable Solutions (Wiley Investment)

Mark P. Kritzman

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Mark P. Kritzman : Puzzles of Finance: Six Practical Problems and Their Remarkable Solutions (Wiley Investment) before purchasing it in order to gage whether or not it would be worth my time, and all praised Puzzles of Finance: Six Practical Problems and Their Remarkable Solutions (Wiley Investment):

16 of 21 people found the following review helpful. Entertaining..By Professor Joseph L. McCauley This small, entertaining monograph can be read superficially in a sitting and provides food for thought. It would be interesting and useful for econophysicists to try to find alternative solutions to several of the first five puzzles not based on either expected utility or 'equilibrium' arguments. Kritzman prefaces the book by stating that he will not address either the equity premium or dividend puzzle because these two problems depend on agents' psychology. He addresses instead 6 puzzles that he calls purely logical and mathematical. However, he contradicts himself in that several of the solutions depend on utility functions and therefore on agents' psychology. His background is that of money manager. Siegel's Paradox is based on the fact that the average of a random variable differs from the inverse of the average of the same variable. He applies this to exchange rates with the question whether the difference is economically relevant. In Likelihood of Loss the nonuniqueness of likelihood of loss is discussed. The result is used to criticize the idea of using social security funds to place bets in the stock market. Lognormal returns, which are incorrect especially for large returns, are assumed throughout the book. In Time Diversification he addresses the interesting question whether agents should be more risk-tolerant with long rather than short time horizons. The conventional wisdom assumes the former, but he discusses a solution by Samuelson that contradicts this viewpoint. Samuelson's solution is, of course, based on an expected utility, which is arbitrary. Why the Expected Return is Not to be Expected. Kritzman argues that the expected return has less than 50% probability of occurring. Half the Stocks All the Time or All the Stocks Half the Time? Should an agent switch or balance? The balanced strategy has lower risk. Again, expected utility is referred to, but this time after the fact. The Irrelevance of the Expected Return for Option Valuation. This chapter extols the use of the riskless return in the delta hedge strategy, an idea much beloved of theorists and ignored by traders. In this chapter, I am irritated that everyone under the sun (including Einstein and Wiener) gets credit for the background necessary for the Black-Scholes equation while Osborne, who introduced the lognormal distribution into finance in 1958, is completely ignored. The main point, however, is that the famous (anti-) arbitrage argument leading to a riskless hedge is wrong on two counts {1}, another example of how the economists' 'equilibrium' idea does not apply to reality. As we point out in our new stochastic theory of returns, volatility and option pricing, why would a trader go to the trouble to construct a complicated hedge that must be updated continually only to get the same return he'd get by letting his money rest in a CD or money market fund? Clearly, such a trader would not be intelligent. Credit is given incorrectly to Einstein for his solution of a heat transfer problem whereas in reality all that was/is needed in order to solve the Black-Scholes equation (after a simple transformation) is the Green function for the diffusion equation written down by Einstein, Bachelier and others. Also repeated is the irritating claim that CAPM is an 'equilibrium' model, which it patently is not {1}. References 1. J. L. McCauley and Gemunu H. Gunaratne, An Empirical Model for Volatility of Returns and Option Pricing, submitted (2002).

5 of 11 people found the following review helpful. Of limited interest By Tim Josling The puzzles in the book are of little practical value. If you have much previous reading in finance you would already be aware of these issues. You may also find the tone of the book annoying - "look how clever I am". Like most of finance, the math is not very interesting in itself, nor is it very accurate in describing the real world e.g. the Black-Scholes option pricing model. If you are reasonably good at math and know little or nothing about finance you may enjoy the book. Otherwise a standard text on investment management would be better.

0 of 10 people found the following review helpful. Not very practicable in spite of the title By Tim Josling This is not a very useful book, in my opinion. The puzzles can be interesting for some people, but I found it quite dull. Some people may find them clever and 'neat' but I don't think most people will be pleased by the book. Some of the puzzles are 'old hat' to anyone who has done much reading on finance eg option pricing.

". . . shining clarity and enviable originality" --Peter L. Bernstein, author of *Against the Gods* "Mark Kritzman presents the reader with an entertaining way of learning some serious finance." --Harry Markowitz, Nobel Prize Recipient, 1990, Economic Sciences President, Harry Markowitz Company Six challenging questions . . . six entertaining solutions, profound yet straightforward, and relevant to the everyday challenge of investing and investment management. *Puzzles of Finance* takes on today's most persistently challenging financial questions and, through clever examples and just plain logic, helps you move beyond those questions to arrive at a deeper understanding of finance and the daily management of money. From Siegel's Paradox ("Is it possible to profit from asymmetry of exchange rate changes?") to questions of option value ("Why is the value of an option unaffected by the underlying asset's expected return?"), *Puzzles of Finance* goes beyond vague theoretical suppositions to supply practical, concrete solutions that investors and money managers can benefit from every day. While the intellectually curious will be drawn to *Puzzles of Finance*, it is the day-to-day finance professional who will derive the most benefit from this remarkable book. In clear, concise language-with more than a touch of humor-renowned author and financial professional Mark Kritzman simplifies six of today's most perplexing financial riddles. Along the way, he presents a finance primer as practical as it is profound, as illuminating as it is entertaining. Kritzman artfully explores the relationship of such seemingly disparate fields as botany and thermodynamics to options. These proofs propel *Puzzles of Finance* forward with the pace of a novel. An easy-to-understand primer on financial concepts and quantitative methods combined with a technical glossary ensures that no concept is misunderstood. The result is an unprecedented

book that will change the way you view finance and investing. When you invest your time in reading *Puzzles of Finance*, you will uncover some of the most probing and insightful lessons in financial literature today. For updates on new and bestselling Wiley Finance books: wiley.com/wbns Critical Praise for *Puzzles of Finance* ". . . an extraordinary combination of the elements of finance, commonsense wisdom, sparkling humor, shining clarity, and enviable originality. This is a potent blend by any standard of measurement. Long time Kritzman watchers, however, would anticipate nothing less." --Peter L. Bernstein, Author, *Against the Gods* "A modest, lively, clever, little book. Kritzman's puzzles range from party tidbits to the profound, and each is presented with a bit of history, a lot of insight, and just the right measure of wit. While he may not have intended it to be more than a collection of interesting conundrums, Kritzman has actually created a wonderful introduction to finance for the uninitiated with challenges for even the most sophisticated." --Stephen A. Ross, Franco Modigliani Professor of Finance and Economics, Sloan School, MIT; Co-Chairman, Roll and Ross Asset Management Corp. "Some people do crosswords. Mark Kritzman does financial puzzles and his explications amuse and instruct. Financial theory has never been this much fun."-Jack R. Meyer, President, Harvard Management Company "Puzzles of Finance should be a joy to finance mavens and even their friends! Perhaps all students of the field should be required to solve these six puzzles; they go to the heart of the intuitions for essential contributions, such as the pricing of options, the meaning of efficient diversification, and the definition of risk." --Kenneth A. Froot, Andre R. Jakurski Professor of Business Administration and Director of Research, Harvard

"Kritzman's new book shows again that he is not only a talented asset manager but also a gifted teacher who knows how to simplify even the most complex issues." (*Risk*, January 2001)From the Inside Flap"Mark Kritzman presents the reader with an entertaining way of learning some serious finance." -Harry Markowitz Nobel Prize Recipient, 1990, Economic Sciences President, Harry Markowitz Company Six challenging questions ... six entertaining solutions, profound yet straightforward, and relevant to the everyday challenge of investing and investment management. *Puzzles of Finance* takes on today's most persistently challenging financial questions and, through clever examples and just plain logic, helps you move beyond those questions to arrive at a deeper understanding of finance and the daily management of money. From Siegel's Paradox ("Is it possible to profit from asymmetry of exchange rate changes?") to questions of option value ("Why is the value of an option unaffected by the underlying asset's expected return?"), *Puzzles of Finance* goes beyond vague theoretical suppositions to supply practical, concrete solutions that investors and money managers can benefit from every day. While the intellectually curious will be drawn to *Puzzles of Finance*, it is the day-to-day finance professional who will derive the most benefit from this remarkable book. In clear, concise language-with more than a touch of humor-renowned author and financial professional Mark Kritzman simplifies six of today's most perplexing financial riddles. Along the way, he presents a finance primer as practical as it is profound, as illuminating as it is entertaining. Kritzman artfully explores the relationship of such seemingly disparate fields as botany and thermodynamics to options. These proofs propel *Puzzles of Finance* forward with the pace of a novel. An easy-to-understand primer on financial concepts and quantitative methods combined with a technical glossary ensures that no concept is misunderstood. The result is an unprecedented book that will change the way you view finance and investing. When you invest your time in reading *Puzzles of Finance*, you will uncover some of the most probing and insightful lessons in financial literature today.From the Back Cover". . . shining clarity and enviable originality." -Peter L. Bernstein, author of *Against the Gods* Critical Praise for PUZZLES OF FINANCE "An extraordinary combination of the elements of finance, commonsense wisdom, sparkling humor, shining clarity, and enviable originality. This is a potent blend by any standard of measurement. Longtime Kritzman watchers, however, would anticipate nothing less." - Peter L. Bernstein, author, *Against the Gods* "A modest, lively, clever little book. Kritzman's puzzles range from party tidbits to the profound, and each is presented with a bit of history, a lot of insight, and just the right measure of wit. While he may not have intended it to be more than a collection of interesting conundrums, Kritzman has actually created a wonderful introduction to finance for the uninitiated with challenges for even the most sophisticated." - Stephen A. Ross, Franco Modigliani Professor of Finance and Economics, Sloan School, MIT; Co-Chairman, Roll and Ross Asset Management Corp. "Mark Kritzman presents the reader with an entertaining way of learning some serious finance." -Harry Markowitz, Nobel Prize Recipient, 1990, Economic Sciences President, Harry Markowitz Company