invariably lack the sophistication to understand the risks they are inheriting.

While *Traders, Guns & Money* is generally informative and good humoured, occasionally one cannot help but despair at Das's seemingly bleak view of the derivatives industry and ask why he has chosen to stay within a field he so often pillories for its greed and dishonesty.

In one memorable section, Das recounts a time early in his career when he was given the task of showing new trainees around his bank's dealing room. Here Das writes how he described that salespeople were those that "lie to clients", traders were those that "lie to risk-managers", risk managers were those that "lie to management" and clients were those that are "lying mainly to themselves".

Stories of this kind are littered throughout *Traders, Guns & Money* and there is no literally no-one within the financial industry that escapes Das's ire. His refrain that "lies – both beautiful and true – are still the currency of trading" says much about his attitude towards the financial markets.

Despite its occasional grimness, there is no doubt that *Traders, Guns & Money* is a fascinating and compelling insight into the world of derivatives. Unlike other texts on the subject that are often dry or simply incomprehensible, Das has managed to use his considerable, wit, intelligence and experience to produce a book that will no doubt provoke many more spirited debates and discussions on the mysterious world of derivatives. J

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# Portfolio management and investment strategy

Two new books cover some of the same topics but as **M. SCOTT DONALD** reports, the results are mixed.

***Pioneering Portfolio Management***
by David F. Swensen
(Free Press, 2000)

***Multi-Asset Class Investment Strategy***
by Guy Fraser-Sampson
(John Wiley and Sons, 2006)

Disillusioned by equity market volatility and uninspired by the hard work of grinding returns out of fixed income markets, many investors have turned in the past five years to alternative assets.

For many, their inspiration is David Swensen and his team at the Yale Endowment; their guidebook, *Pioneering Portfolio Management*. Swensen's work in creating a peerless investment track record and then documenting some of the principles and beliefs behind that achievement deserve praise. He makes both seem easy.

*Pioneering Portfolio Management* reads like a modern Benjamin Graham. There are no clever tricks, no sure-fire, get-rich-quick strategies. Instead there are solid, common-sense prescriptions illustrated with well-chosen examples and careful language. His readers soon realise what they are in for. The scene is set by the opening chapters, one on the history of Yale endowment, the other on the nature of an endowment's financial objectives.

This is no mere window-dressing. Swensen is making an important point – these things matter. Again and again his illustrative examples highlight the importance of understanding what and where things came from in order to recognise their true import. And if you don't understand what you are trying to achieve and why, "risk management" becomes mere cant.

For all his reputation as a "prophet" (not his words) of the virtues of alternative assets, Swensen nevertheless dutifully covers modern finance theory and traditional asset classes thoughtfully. Markowitz, Tobin and Sharpe share the lectern with Keynes, Schumpeter and Shiller, the iconoclasts.

Investment in alternative assets is presented in the same measured, common-sense way. His clear-sightedness also untangles many of the conflicts and dysfunctions in institutional investing, whether they are fee-charging practices, soft dollars or decision-making sclerosis.

If *Pioneering Investment Management* has a short-suit it is in his treatment of the international arena. That's easy to identify from Australia, where a global perspective comes naturally from the reality to see beyond the limits of a market accounting for perhaps 2% of the world's investment opportunities. His examples outside the US are fewer and less compelling than US-sourced examples and his treatment of currency risk is cursory. Perhaps that gives him something to work on for a second edition.

*Multi-Asset Class Strategy* covers some of the same ground as *Pioneering* ▶

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► *Investment Management*, but from the perspective of UK pension funds rather than US endowments. Its author, Guy Fraser-Sampson, takes to his task with obvious gusto.

In writing *Multi-Asset Class Strategy*, Fraser-Sampson has clearly been inspired by Swensen. However for all its verve and ambition, *Multi-Asset Class Strategy* is unsatisfying. Fraser Sampson's often strident tone contrasts with Swensen's careful, unadorned prose. The shortcomings he perceives in the way the UK pension industry approaches its core task of earning investment returns to fund pension obligations are well deserved. Fraser-Sampson recognises this but his entire quest may soon seem quixotic, as both trustee boards and their consultants adapt to the more exacting standards of the Pensions Regulator, the challenge of DC-style plans and the rise of managed account (master trust) platforms.

*There are no clever tricks, no sure-fire, get-rich-quick strategies. Instead there are solid, common-sense prescriptions illustrated with well-chosen examples and careful language.*

More telling are the mathematical errors in Fraser-Sampson's arguments, errors that undermine the legitimacy of some of his key assertions. It means that the alternative approach to investing that he proposes rests on an unstable foundation. In a text so critical of prevailing approaches (Fraser-Sampson uses the epithets: "intellectual cowardice", "blind prejudice", and "unthinking", amongst others, to prevailing approaches), such epithets are more than a little ironic. J

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# Predicting corporate failure

There have been consistent warnings from world bankers that rising debt levels on both a corporate and consumer level are potential red flags to corporate failure. But what the market requires is more science and less opinion in predicting failure. **MARK UEBERGANG** reports.

Amidst a climate of unprecedented financial leverage and rising interest rates, the finance sector is scrutinising the performance of corporate borrowers more closely than ever before. As nervous lenders pore over financial statements looking for any sign of financial distress, the search continues for an accurate means of identifying failure before it occurs.

While insolvency expert Mark Korda jovially swears by the "Aquarium Method", whereby the financial wellbeing of a firm is related inversely to the size and opulence of the fish tank in reception, others prefer a more systematic approach.

Models aimed at predicting corporate failure began to emerge around the time of the Great Depression – probably in response to a sharp rise in the incidence of default.

Today, analysts have a suite of sophisticated techniques from which to choose. Yet, despite the availability of modern alternatives, the Grandfather of predictive models, the "Z-Score", has remained popular among financial analysts.

Details of the Z-Score were published in 1968 by Edward Altman, a professor at New York University. The concept was both simple and intuitive. Altman assembled a sample group of failed firms and a group of similar firms which had not failed. By observing subtle differences in the financial ratios between failed and non-failed firms, Altman was able to construct a general formula for assessing financial health.

To "bench test" Altman's Z-Score we compiled a group of ASX listed firms that had experienced an "insolvency event" such as the appointment of a receiver or voluntary administrator. We established 84 such cases since

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