### Contents

**Preface** xi

**Introduction: The Birth of the Quant** 1  
- Characterizing the Quant 3  
- Active versus Passive Investing 6

**CHAPTER 1**  
**Desperately Seeking Alpha** 11  
- The Beginnings of the Modern Alpha Era 16  
- Important History of Investment Management 18  
- Methods of Alpha Searching 20

**CHAPTER 2**  
**Risky Business** 27  
- Experienced versus Exposed Risk 28  
- The Black Swan: A Minor ELE Event—Are Quants to Blame? 34  
- Active versus Passive Risk 38  
- Other Risk Measures: VAR, C-VAR, and ETL 49  
- Summary 52

**CHAPTER 3**  
**Beta Is Not “Sharpe” Enough** 55  
- Back to Beta 64  
- Beta and Volatility 65  
- The Way to a Better Beta: Introducing the g-Factor 67  
- Tracking Error: The Deviant Differential Measure 75  
- Summary 77

**CHAPTER 4**  
**Mr. Graham, I Give You Intelligence** 79  
- Fama-French Equation 81  
- The Graham Formula 89
CONTENTS

Factors for Use in Quant Models 90
Momentum: Increasing Investor Interest 96
Volatility as a Factor in Alpha Models 113

CHAPTER 5
Modeling Pitfalls and Perils 123
Data Availability, Look-Ahead, and Survivorship Biases 124
Building Models You Can Trust 127
Scenario, Out-of-Sample, and Shock Testing 131
Data Snooping and Mining 139
Statistical Significance and Other Fascinations 140
Choosing an Investment Philosophy 148
Growth, Value, Quality 149
Investment Consultant as Dutch Uncle 152
Where Are the Relative Growth Managers? 154

CHAPTER 6
Testing the Graham Crackers . . . er, Factors 159
The First Tests: Sorting 160
Time-Series Plots 173
The Next Tests: Scenario Analysis 182

CHAPTER 7
Building Models from Factors 193
Surviving Factors 194
Weighting the Factors 197
The Art versus Science of Modeling 200
Time Series of Returns 210
Other Conditional Information 215
The Final Model 217
Other Methods of Measuring Performance: Attribution Analysis via Brinson and Risk Decomposition 220
Regression of the Graham Factors with Forward Returns 228

CHAPTER 8
Building Portfolios from Models 233
The Deming Way: Benchmarking Your Portfolio 235
Portfolio Construction Issues 247
Using an Online Broker: Fidelity, E*Trade,
TD Ameritrade, Schwab, Interactive Brokers, and TradeStation 249
### Contents

Working with a Professional Investment Management System: Bloomberg, Clarifi, and FactSet 251

**CHAPTER 9**

**Arguments: The Antidementia Bacterium** 255
- The Colossal Nonfailure of Asset Allocation 256
- The Stock Market as a Class of Systems 258
- Stochastic Portfolio Theory: An Introduction 266
- Portfolio Optimization: The Layman’s Perspective 276
- Tax-Efficient Optimization 282
- Summary 282

**CHAPTER 10**

**Past and Future View** 285
- Why Did Global Contagion and Meltdown Occur? 292
- Fallout of Crises 297
- The Rise of the Multinational State-Owned Enterprises 301
- The Emerged Markets 310
- The Future Quant 311

**Notes** 317

**Acknowledgments** 325

**About the Author** 327

**Index** 329