

## Recommended Books on Finance for Finance 321 Students

### 1. Against the Gods: The Remarkable Story of Risk by Peter L. Bernstein

This fascinating book describes man's efforts to understand, measure and cope with risk. The author notes that the mastery of risk is "the revolutionary idea that defines the boundary between modern times and the past." Within our era, it also separates the cultures where economic development and political progress have occurred, and those where they have yet to advance. I was fortunate to meet Peter Bernstein at the American Risk and Insurance Association meeting where this work won the award for the best book on risk published that year, and now have a signed copy of his work. This book is destined to become a classic as it combines a remarkable story with outstanding writing. If you can only read one book on my list, I would encourage you to enjoy this one.

### 2. The New Financial Order: Risk in the 21<sup>st</sup> Century by Robert J. Shiller

This book proposes a major transformation in risk sharing in society, with many innovative ideas about how to handle risk. One interesting concept is basing financial transactions on an inflation indexed unit so that rents, salaries, loan repayments and investment income are all paid in inflation adjusted units, removing inflation risk. Many of the innovations are based on global risk information databases (GRIDs) that would provide the underlying indices for all manner of risk trading, from income in a particular occupation to the GNP of a nation.

Shiller proposes several ideas for a new financial order, including insurance for livelihoods and home values, inequality insurance and responsible intergenerational social security. He reviews several significant historical financial innovations: money, modern stock markets, futures markets and life insurance and draws conclusions from the strategies that made these innovations successful. This book is a good explanation of the role risk plays in society and potential methods for reducing risk even further by adopting new risk sharing instruments.

### 3. When Genius Failed: The Rise and Fall of Long-Term Capital Management by Roger Lowenstein

Any well-rounded list of business books will include some success stories and some failures, to help us learn both what works and what doesn't. This book describes one of the most remarkable financial failures of recent times. The cause of this failure was an over-reliance on financial models. Success often breeds hubris, and the more remarkable that success is, the more overconfident the decision-makers tend to become. If you remember this story, and the dangers of over leveraging and overconfidence, then you will be less likely to suffer a similar debacle.

### 4. Buffet: The Making of an American Capitalist by Roger Lowenstein

Now for a success story, again authored by Roger Lowenstein. This is an excellent book describing how Warren Buffet became the richest person in America simply by investing in value stocks (or other securities) and using market timing. His life contradicts the Efficient Market Hypothesis, so widely accepted in finance. He became a follower of Benjamin Graham

in graduate school and started by studying financial reports to find stocks that were undervalued by the market, generally by having cash or other valuable resources that was worth more than the stock was selling for. He bought and held until the market value increased, and often continued to hold. He did not use leverage and was very patient with his investments.

At first he ran a partnership for some friends and family. He dissolved the partnership in 1969, when he felt the market was overvalued and he could not find many attractive stocks. At this point he bought Berkshire Hathaway and used the cash this firm generated to buy National Indemnity, primarily to get hold of its cash flow. He then used these funds for other significant investments in undervalued securities. He later continued to make successful investments in other insurers, including GEICO and General Reinsurance. He kept to his strategy, invested only in companies whose business he understood (thus avoiding the technology bubble of the 1990s) and kept close control over expenses. His ability to beat the market without relying on a large staff of analysts or massive computer databases demonstrates the opportunity that the financial market creates for any dedicated investor.

#### 5. Good to Great: Why Some Companies Make the Leap ... and Others Don't by Jimmy Collins

This book provides dozens of examples of success stories, and a list of characteristics that separates companies that have become great from the rest of the pack. His findings of the most important characteristics are somewhat surprising:

1. Having a leader who is humble, but professional, and not high profile
2. Putting the right team together, and getting rid of the people who don't fit
3. Maintaining unwavering faith in the selected strategy, along with a willingness to confront the facts
4. Selecting a simple concept and focusing on what you can be the best in the world at
5. Developing a culture of discipline
6. Being willing to apply carefully selected technologies
7. Staying focused on the strategy until it becomes successful

These factors can help you to identify companies that have the potential to become great, or to develop strategies to make your own organization great.

#### 6. Pipe Dreams: Greed, Ego, and the Death of Enron by Robert Bryce

As long as we are going to learn from the failures of others, we might as well study one of the most gigantic failures of recent years, Enron. This book provides some helpful insights into the failure that rocked the financial world, destroyed the reputation of a previously respected accounting firm, and derailed trading in energy derivatives. The lesson is simple. If a new division in a company appears to be extremely profitable, the leaders of the company can either make the effort to learn exactly how that aspect of the company works or it can decide to pass along that segment of the business to some other entity that has a better understanding of those operations. The management of a company cannot simply accept that business and allow it to

become the dominant force within the organization, without understanding it enough to establish reasonable controls. This is an important lesson, and one that all industries need to take to heart.

#### 7. A Random Walk Down Wall Street by Burton G. Malkiel

If you haven't already read this one, it is about time. This work provides, in very readable terms, the basic underpinnings of modern financial theory. The advice doled out in this book is useful for individual, as well as institutional, investors. Investment strategies are described and debunked, bonds, equities and derivatives explained, and practical investment advice is widely, and wisely, dispensed. The underlying premise of the book is the Efficient Capital Market theory, which has been the widely accepted tenet in modern finance, until recently challenged by behavioral finance theory. This book is both entertaining and informative, a rarity in the field of finance.

#### 8. Irrational Exuberance by Robert J. Shiller

This book expounds on the 1996 comment by Alan Greenspan to make the case that the stock market was in a speculative bubble. Fortuitously published in March 2000, at the very height of the major stock indices, the book presents the case that stock prices were excessive. The book starts with a graph of the inflation adjusted price earnings ratio of the S&P 500 from 1880-2000, which shows peaks in 1901, 1929 and 1966, and a record level for 2000. Another graph illustrates a negative relationship between the price-earnings ratio and subsequent returns. The book builds a case to support the thesis that the stock market was overpriced.

This book attacks a commonly held belief that the stock market outperforms all other investments over a 10-30 year time horizon. Shiller reports results of surveys he has conducted that demonstrate how many investors feel this is true. He then shows that investments made at the peak of past markets do not outperform short-term bonds.

Although you may not find this book to be especially well written, as it combines a rather dry discussion of some high level academic work on the subject with less well supported work and even some unsupported beliefs of the author, the success of the book is most likely based on its title and the timing of its publication. It is also an effective counterpoint to the widely accepted financial theories detailed by Malkiel, and provides an important lesson for investors.

#### 9. Liar's Poker by Michael Lewis

Michael Lewis is an outstanding writer, with such popular non finance books as *Blind Side* (on football) and *Moneyball* (on baseball). In this, his first work, he details the inside of Wall Street trading during the 1980s based on his personal experiences. It is not a pretty picture, but understanding how the game is played is important for anyone participating in financial markets. This is not a book for anyone who is offended by locker room language and antics. Some of the characters he discusses show up in other books on this list (*When Genius Failed*).

10. No list should stop at nine. Help me round out this list by suggesting your own personal favorite.