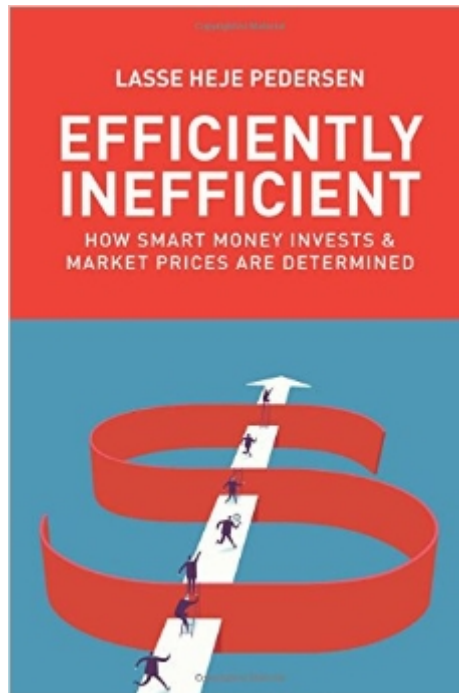


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# Efficiently Inefficient: How Smart Money Invests And Market Prices Are Determined



## Synopsis

Efficiently Inefficient describes the key trading strategies used by hedge funds and demystifies the secret world of active investing. Leading financial economist Lasse Heje Pedersen combines the latest research with real-world examples and interviews with top hedge fund managers to show how certain trading strategies make money--and why they sometimes don't. Pedersen views markets as neither perfectly efficient nor completely inefficient. Rather, they are inefficient enough that money managers can be compensated for their costs through the profits of their trading strategies and efficient enough that the profits after costs do not encourage additional active investing.

Understanding how to trade in this efficiently inefficient market provides a new, engaging way to learn finance. Pedersen analyzes how the market price of stocks and bonds can differ from the model price, leading to new perspectives on the relationship between trading results and finance theory. He explores several different areas in depth--fundamental tools for investment management, equity strategies, macro strategies, and arbitrage strategies--and he looks at such diverse topics as portfolio choice, risk management, equity valuation, and yield curve logic. The book's strategies are illuminated further by interviews with leading hedge fund managers: Lee Ainslie, Cliff Asness, Jim Chanos, Ken Griffin, David Harding, John Paulson, Myron Scholes, and George Soros. Efficiently Inefficient effectively demonstrates how financial markets really work. Free problem sets are available online at <http://www.lhpedersen.com>

## Book Information

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## Customer Reviews

Efficiently Inefficient breaks down the primary ways by which hedge funds (and conventional money

managers) attempt to generate positive returns for their investors. It provides an overview of the hedge fund industry by going into the mechanics of the industry and then follows with detailed descriptions of the different strategies employed. Immediately after the Table of Contents, the author provides the gist of the book in three simple tables. These tables provide a very efficient overview of the main topics in each section of the book. In a nutshell the book could be outlined as:

**Part I** This section has five chapters which provide an overview of the theoretical aspects of investing. It covers an overview of the hedge fund industry in chapter one followed by a brief explanation of the "greek" alphabet of performance measurement in chapter two. The remaining chapters discuss issues in back-testing, perspectives on risk management followed by discussion of trading costs and leverage.

**Part II** Part II of the book discusses the three primary equity strategies which the author has broken down as Discretionary Equity Trading, Dedicated Short Bias and Quantitative Equity Investing. This book outlines the theoretical principles of each of these primary strategies and ends each respective chapter with an interview with a respected practitioner of the strategy. Discretionary Equity investing is what would probably be familiar to most investors. It is the Graham & Dodd realm of investing. The next chapter on Dedicated Short bias gets into the thesis, details and complications of short selling and ends with an interview with noted short seller James Chanos. The final chapter in this section gets into Quantitative Equity investing.

This text is an unusual hybrid of a description of hedge fund investment styles, investor interviews and a finance textbook. The book's promise is to be a mix of Antti Ilmanen's Expected Returns (an AQR colleague) and Jack Swager's "wizard-series". Efficiently Inefficient doesn't fully live up to this standard but I still like it. This hybrid approach isn't surprising given the author's parallel and impressive career path. Pedersen is a finance professor at both NYU and Copenhagen Business School and has written several important papers earning him the title of best European economist under 40. Further he's on the editorial board of The Journal of Finance and a research associate at NBER. For most of us this would be more than enough but this is only half the story. The author is also a principal on AQR's asset management team and as such an important part of one of the world's largest hedge funds. This has no doubt given him easier access to the many investors to interview in this book. At least Pedersen has turned 43 by now so even he can't have it all. The introductory section on the nuts and bolts of hedge funds (called Active Investment in the typical modest hedge fund style) discusses topics like risk management, back testing, trading, performance measurement etc. I found the notion of several different types of liquidity premiums very interesting and now and then the author presented a

nugget I hadnâ™t thought of but mostly this section gives the foundation for the rest of the book by describing the general character of âœsmart moneyâ• and the activities that hedge funds perform.

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