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## BOOK REVIEW

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Mark Kritzman, Senior Editor

**PORTFOLIO CONSTRUCTION, MEASUREMENT, AND EFFICIENCY ESSAYS IN HONOR OF JACK TREYNOR**

*John B. Guerard*  
(Reviewed by  
*Savannah Smith*)

John B. Guerard, Jr. has compiled an impressive collection of essays focusing on and inspired by the seminal research of Jack Treynor (1930–2016) in his latest book, *Portfolio Construction, Measurement, and Efficiency*. Comprised of 19 chapters contributed by over 30 esteemed authors, this book not only provides a thorough exploration of Treynor’s role in the creation of the Capital Asset Pricing Model (CAPM), but the influence of said model on modern financial economics.

The book begins with three articles dedicated to Jack Treynor,

each offering a unique perspective on the man himself, as well as his roles as both an academic and a practitioner. While the chapters following primarily seek to build on Treynor’s research, a touching article by Andrew W. Lo shines light on Treynor’s unique and formative upbringing. Raised in Council Bluffs, Iowa, Treynor was an exceptional and inventive student, a football player, a debate team member, and later, a soldier. Lo also discloses perhaps the two most surprising revelations of this entire book: firstly, that the original musings of the Capital Asset Pricing Model took place while Treynor was on *vacation*. Secondly, that Treynor wrote an award winning play on the Kennedy assassination.

The chapters that follow cover a variety of research topics and investment perspectives ranging from market timing

to sentiment-induced share returns. Though the subject matter differs from essay to essay, each focuses on research areas that interested Treynor throughout his lifetime and works to apply current methodologies.

The first chapter of this book addresses several aspects of risk, return, and performance measurement—as well as the people who pioneered the original research (Harry Markowitz, Bill Sharpe, Jan Mossin, and Jack Treynor). It provides an in-depth review of portfolio theory, capital market equilibrium, some of the fundamental risk models. The subsequent chapters (2–7) continue to build on that research and propose new applications across security selection, transaction costs, and optimization.

Chapter 8 of this book, written by Bernell K. Stone, takes an

interesting turn and presents the use of an alternative return forecast assessment framework. Stone challenges the conventional methodologies for portfolio performance assessment, stating that these models are fraught with measurement and specification problems. He then provides a thorough explanation of his proposed methods for improvement, which touches upon multivariate regression with control matching, variable weighting, and an in-depth implementation of the eight-variable return forecast model of Bloch, Guerard, Markowitz, Todd, and Xu (1993).

Another section of note is chapter 13, contributed by Richard A. Brealey, Ian A. Cooper, and Evi Kaplanis. The authors investigate the relationships between investor sentiment and deviations of share prices from fundamental values. Using a sample of upstream oil stocks, for which a large part of the fundamental value is observable, they seek to demonstrate that sentiment predicts returns.

The final chapter of this book reflects on a series of “bean jar” experiments that Treynor conducted while teaching at the University of Southern California and the article he published in the *Financial Analysts Journal* titled “Market Efficiency and Bean of Jar Experiment.”<sup>1</sup> In the first experiment, Treynor asked his students to independently estimate the number of beans contained in a jar. In the second experiment, Treynor presented his students with the same task, but provided information on the jar (size, materials, amount of air at the top). To his surprise, the students with more information had larger errors than those who did not. The FAJ article explored these results and their implications for potential shared errors in the stock market. Treynor remarked that investors may be persuaded to give up their independent information and rely on common sources of information instead—which could do damage to market efficiency. Chapter 19 of this book explores that notion, and examines the

differences (both in strategy and performance) between contrarian funds and herding funds.

I highly recommend this book to anyone interested in pursuing an in-depth understanding of modern portfolio theory, and specifically research pioneered by Jack Treynor. *Portfolio Construction, Measurement, and Efficiency* does a superior job in presenting a comprehensive history of portfolio risk and return as well as the most current methodologies. In this book contains a journey, from the origins of portfolio risk measurement to methods applied by a new generations of investors. These essays represent the powerful and lasting impact of Jack Treynor’s independently inventive mind on modern finance.

#### Note

- <sup>1</sup> Treynor, J. (1987). “Market Efficiency and Bean of Jar Experiment,” *Financial Analyst* **43**, 50–53.