Book reviews

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Investment Beliefs: A Positive Approach to Institutional Investing. Kees Koedijk and Alfred Slager. Palgrave Macmillan, 2011, ISBN 978-0-230-28493-7, 187 pages. doi:10.1017/S1474747212000133

This book is of the moment. Recognising the causes and consequences of the global financial crisis, the authors seek to provide a way forward for institutional investing that eschews the dogmas of the past in favour of an adaptive approach to a changing environment. They note (p. 1) that 'investment strategies that seemed sound are now unhinged. Investment risks that were considered too improbable have occurred'. Most importantly, the authors aim to clarify what we know, and how that should inform pension fund investment decision-making. In this respect, the book is also a report from the frontiers of research and industry practice, integrating the latest in academic inquiry with documented instances of how leading institutions have made good on this knowledge and understanding. At the same time, the authors seek to provide an integrated approach to pension fund-investment management, linking a concern for fundamentals with the governance of the investment process. As such, this book is not only informative and to the point, it is also useful!

Overall, the authors are sceptical about the robustness of modern financial theory. Commenting on the plausibility of the Capital Asset Pricing Model and the Efficient Market Hypothesis, they suggest that these theoretical claims are much less reliable than advocates have hitherto conceded. While not disputing the value of theoretical models as reference points enabling discussion about how the world might work, they argue that 'pragmatic beliefs rather than hard theories guide us in our investment decisions'. This argument is justified by a realist perspective: financial markets are imperfect, financial data are noisy, it is hard to extract relevant information from price signals, and 'the predictive power of models for future returns is generally low'. Some readers will find these arguments and the underlying scepticism problematic: nonetheless, this book is informed by a great deal of experience at the interface between theory and practice. Their claims of credibility rest on their knowledge of institutional practice as well as the real-time costs and consequences of an over reliance on some models that were, in the end, distant from the action.

Throughout, the authors argue that we should take investment beliefs seriously. They do so on the assumption that beliefs inform decision-making and ultimately behaviour. They provide, throughout, examples of plausible and not-so-plausible investment beliefs including those founded upon evidence and those founded upon wishful-thinking. It might be supposed that there is an intimate relationship between knowledge and beliefs such that the former informs the latter and that the latter is only viable if justified by the former. However, the authors note that knowledge of the structure and performance of financial markets is imperfect and, worse, beliefs are about the future as much as they are based upon the past. To act on a set of beliefs is to suppose that the observed processes underwriting those beliefs will carry forward into the future in much the same way they were evident in the past. Inevitably, beliefs need to be adaptive to changing circumstances. As such, there is a premium on the institutional processes whereby beliefs are formed and revised.

Implied by their model of belief formation and adaptation is a form of Bayesian reasoning. However, this reader looked in vain for a statement to this effect and a more formal exposition of the process of belief formation and revision. Perhaps this is not as important as the readability of the book. Nonetheless, if Bayesian reasoning is the underlying model of decision-making behaviour it deserves to be recognised as such and consideration given to some of its shortcomings. Given their sensitivity to recent research on behavioural biases and anomalies, it is a bit surprising that their manifesto in favour of adaptive beliefs does not take into account (at least in the early stages of the book) behavioural predispositions that mitigate against effective and adaptive decision-making. It is widely recognised that many people are myopic, overemphasising recent events close to hand while not appreciating their significance against underlying patterns and processes. The authors of this book would wish that people took seriously these underlying patterns and processes when forming, calibrating, and revising beliefs.

At one level, Bayesian reasoning is entirely plausible and practical. At another level, however, the fact that few people are comfortable in this domain should give pause to anyone seeking to implement it into financial decision-making. Here, of course, the authors have a convincing counterclaim and answer: pension fund governance is an essential component in a comprehensive approach to informed investment decision-making. As such, the principles and procedures underpinning institutional governance ought to be conceived in ways that can make good on the promise of Bayesian reasoning. In this respect, their book is very ambitious. It is a manifesto for institutional design as well as individual reflexivity.

The authors believe that the global financial crisis has brought home the enormous costs of any theory-centred approach to investment management which is poorly equipped to adapt to the changing world around us. Ultimately, their focus on beliefs is a means by which those responsible for framing investment strategy interrogate the premises upon which strategy is formed.

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Securing Lifelong Retirement Income: Global Annuity Markets and Policy. Olivia S. Mitchell, John Piggott and Noriyuki Takayama, eds. Oxford University Press, 2011, ISBN 978-0-1995-9484-9, 231 pages. doi:10.1017/S1474747212000145

A crucial – and often overlooked – element of any retirement system is the mechanism by which accumulated savings are used to provide an income after retirement. Over the last 30 years, there has been a steady retreat away from defined benefit-type (DB) systems, which pay a defined income on retirement, towards defined contribution-type (DC) systems, which do not. As these DC systems mature, developing and structuring markets that provide retirement income is becoming increasingly important.

This volume provides a timely and elegant international summary of this issue. Rather than focusing on individual topics, the editors present individual chapters by specialists from 10 countries describing the current market in retirement income in each country. The selection of countries covers a broad spectrum of size, financial market development and pension system type. This book is essential reading for policy-makers trying to obtain an international context into which they can place their own retirement income market, and for academics who are looking for an introduction to retirement-income markets and the prominent researchers in this field.