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BOOK REVIEW

Mark Kritzman, Senior Editor

BOND PORTFOLIO INVESTING AND RISK MANAGEMENT

By Vineer Bhansali, McGraw Hill, 2011

(*Reviewed by Sébastien Page, CFA*)

There are similarities between the extreme sport of mixed martial art and investment management. Both activities are zero-sum games (for every winner there is a loser), and both require participants to combine technique with a capacity to take risks. In "Bond Portfolio Investing and Risk Management," Bhansali combines academic and technical knowledge, with the real-world experience of a risk taker. Ultimately, this book is about managing risk to win at the investment game. In the author's words, "Lest it may sound that risk management leaves no room for investment, (…) effective risk management actually helps focus on the proper opportunities."

Like a jujitsu expert, Bhansali masters a variety of approaches to bond investing. He first covers the building blocks—forwards, repos, swaps. Then he takes the reader on a fascinating journey through bond land. We learn about structural trades (the toolkit for the alpha-generating bond manager), macroeconomic models, tail risk management, index replication, and bonds in an asset allocation context. True to his practitioner DNA, Bhansali uses Bloomberg screens to illustrate the concepts he describes. Interested readers will be able to load the same screens and play with the assumptions without having to write a single line of code. The author limits the use of equations and focuses on intuition and applications. (He also recently published a more mathematical book with Mark Wise, entitled "Fixed Income Finance: A Quantitative Approach," McGraw Hill, 2010.)

The key concept illustrated throughout the book is that *excess yield comes from implicitly selling an option*. The author does a terrific job at explaining how to move away from the linear assumptions that plague conventional investment thinking. Selling out-of-money options might look attractive on the surface—for example in terms of Sharpe ratio, which is a linear measure—but the important questions are whether the option is currently attractively valued, and whether other hedges can be used to offset most of the risk (or *all* of the risk in the case of pure arbitrage trades, which, the author reminds us, are rare). Throughout the book Bhansali warns of lunches that appear to be free, while at the same time offering invaluable insights into how to find very cheap and tasty lunches in bond markets.

Bhansali shows that to win, one must understand models and theories, but most importantly one must look beyond them and *think differently*. This book will help bond investors—and investors in all asset classes—think differently. Insights range from sound theoretical foundations, such as how to manage risk through risk factor analysis, to the real-world pitfalls of quantitative models, such as how past data and normal distributions can be extremely misleading. The author reconciles qualitative with quantitative analysis to achieve superior investment results. For example, he warns: "using history to forecast volatilities and correlations is fraught with disaster," but adds "empirical betas are handy in calibrating our forward-looking views so that we are not completely arbitrary in our forecasts."

I highly recommend this book to anyone interested in learning how to bridge theory and practice to win in markets—not just in bond markets but also across asset classes. Bhansali introduces a different and better way of managing risk, and he does not shy away from the important "nuts and bolts" details of implementation. Read this book and benefit from its treasure of practical insights. Like a jujitsu investor, you will sharpen your technique, and you will get better at deciding when and how to take risks.