Journal Of Investment Management, Vol. 18, No. 4, (2020), pp. 130–131
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BOOK REVIEW

Mark Kritzman, Senior Editor

THE ASCENT OF MARKET EFFICIENCY: *FINANCE THAT CANNOT BE PROVEN*

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(*Reviewed by Joe Sherman*)

The Ascent of Market Efficiency explores how the efficient market hypothesis is used as a theoretical basis for most quantitative research in finance, despite an overwhelming lack of empirical evidence to support it. The author dives into how the field of financial economics came to be, the changing balance of a "data-method-theory" triad, and the social aspect of research. I would recommend this book to anyone interested in finance, with an emphasis on learning how quantitative research established its footing in the industry.

One of the main arguments in the book is that the rise of financial economists was, in large part, due to the efficient market hypothesis because it lends a strong sense of scientific rigor to their work. However, the author questions why a theory that implies that asset prices are impossible to predict became the foundation of the study of financial markets. The author argues that understanding the rise of market efficiency as a theory of market behavior requires insight into the research process that is filled with trust and tight-knit networks. In the analysis, data rises to the top of the data-method-theory triad and becomes the driver of new research.

Throughout the book, the author continually analyzes the balance of power among the "theory, data, and method" triad which, he argues, are the building blocks of knowledge production. Theory is the basis of all research, but the author mentions a paper on asset-pricing theory (Richard Roll) that sets the stage for data's rise within the triad. Roll claims that the CAPM is untestable, as we do not have a complete dataset on all assets historically, such as human capital and other non-tradeable assets. He argues that more information is needed than just the expected return and risk of an asset. This paper opened the door to the idea that data can shape theory, which was quite controversial at the time.

On the social side of research, the author focuses on the continued rise of co-authorship, and how partnerships and teams formed in unique ways. Instead of seeking out new collaborations with academics who were experts in specific areas, financial economists tended to work with the same team repeatedly. Trust in longstanding partners takes precedent over expanding

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one's network to collaborate with other researchers who may be an expert in the specific field of interest. It is intriguing that tight social networks prevailed even in the field of data analysis, where methods and data are widely available and frequently shared. The book investigates this further by looking at authors who received recognition via awards and publications in leading journals. The likelihood of winning an award aligns with membership in a small, sustained network. It leads to a feedback loop: Those who are successful become even more successful over time.

Another interesting point the author makes throughout the book is that certain academics believed "quantification" was almost a weakness. If a paper uses too many advanced techniques and is filled with data, it may be seen as a ploy to win over skeptical audiences. I found this view to be fascinating, given how heavily financial economics relies on data today. It ties into another point the author makes about how research is presented to gain trust; graphs and tables are viewed as ways to shape the data in an untrustworthy way, where equations and theory are viewed as more trustworthy methods of research delivery. The author looks further into financial economics and makes an argument that it is not overutilizing graphs, while tables and equations tend to prevail.

The book paints a fascinating view of the rise of financial economics and the social aspect of its development. With the rise of new quantitative methods and big data, trust is more important than ever.

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