



New Finance, The (4th Edition)

By Robert A Haugen

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The New Finance contains a comprehensive and organized collection of evidence and arguments that develop a persuasive case for an inefficient, complex and, at times, nearly chaotic stock market.

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Editorial Review

From the Back Cover

In this Third Edition, **Robert Haugen** focuses on the evidence, causes, and history of overreactive pricing in the stock market. He argues that, unlike the other social sciences, economic models aggregate from the assumed behaviors of individuals to predictions about market pricing. These models fail to capture the complexity of human interaction. In addition, Haugen argues that each interaction is entirely unique. The complexity and the uniqueness of interactions make it impossible to generalize from the preferences of individuals to meaningful conclusions about the structure and behavior of market prices. The logical conclusion: Both rational and behavioral economics should be reconsidered.

Bob Haugen is Professor Emeritus at the University of California, Irvine. He serves as Managing Partner to Haugen Custom Financial Systems, which licenses portfolio management software to pension funds, endowments, and institutional and high-net-worth money managers.

For further study on the author's unique approach to stock market analysis, read the entire Bob Haugen series, *The Inefficient Stock Market*, *What Pays Off and Why*, and *Beast on Wall Street*.

Visit www.prenhall.com/haugen for additional resources. Or go to www.newfinance.com.

About the Author

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This work makes the case for an *inefficient* stock market, where the complexity and uniqueness of investor interactions has important market pricing implications.

The efficient market's paradigm is at the unlikely extreme end of a spectrum of possible states. As such, the burden of proof falls on its advocates. It is their burden to deflect the stones and arrows flung at the paradigm

by the nonbelievers. It is their burden to reveal the inaccuracies of those who present evidence contending that the paradigm doesn't square with the facts.

Moreover, the case of market *efficiency* has been made many times by others. In fairness to the growing number of advocates for the *other side*, I present here, and in the two other books of this trilogy, *Beast on Wall Street: How Stock Volatility Devours Our Wealth* and *The Inefficient Stock Market: What Pays Off and Why*, a comprehensive and organized collection of the evidence and the arguments that constitute a strong and persuasive case for a complex and, at times, nearly chaotic stock market that *overreacts* to most things—in particular, to past records of success and failure on the part of business firms. It is a market that prices with great *imprecision*, with signals coming from the prices of other stocks as its *dominant driver*.

In the course of this work, I shall make a case for the following assertions:

- Players in today's stock market persistently make a fundamental mistake—overreacting to records of success and failure on the part of business firms. This mistake was also made in the distant past, only to be rectified. Stock investors began making the mistake once again in the late 1950s, and they continue to make it today. Those who recognize the mistake can build stock portfolios, or find mutual funds, that will subsequently outperform the market averages.
- Owing to the foregoing mistake, the stocks that can be expected to produce the highest returns in the future are the safest stocks. Risky stocks can be expected to produce the lowest returns!
- Because of agency problems in the investment business, the opportunity that is there *now* is likely to *remain* there in the future.
- Models in financial economics aggregate from assumed preferences to conclusions about market pricing. Game-theoretic models consider interactions among market participants, but given the preferences, wealth, information, and other aspects explicitly considered, responses to identical stimuli are presumed to be identical. *The New Finance* argues that each interaction must be considered as entirely *unique*, making aggregation, in any way, from the preferences and behaviors of interacting individuals to meaningful conclusions about the structure and behavior of market prices a meaningless exercise. Thus, both rational and behavioral economics need to be reconsidered.

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