Preface

A book that deals with investing should contain warnings to readers about what to expect from its author. Here is mine: I am not a financial analyst, economic statistician, or financial economist. To be sure, I am interested in all of those areas, as anyone trained in economics would be, but primarily my research has specialized in the history of economic thought and institutional economic history. Consequently, for most of my career I have focused on issues such as Adam Smith’s theory of the natural rate of wages and the effect the public finance methods of the American colonies during the revolution had on the framing of the US Constitution. This background did little to prepare me to write this book, except to give me a healthy respect for the thinking of pre-modern economists and to help me recognize good thinking when I saw it.

Three factors influenced me to write this book. First, as often happens at small liberal arts colleges, in fall 1999 it became necessary for me to teach the course in corporate finance in the economics department here at St. Mary’s College. I had taken finance as an undergraduate and worked for two years at Standard & Poor’s writing about the financial details of major corporations and was always interested in the subject. Through the rigor of mastering the details of the course and presenting them to a group of very capable students, I gained a basic understanding of and appreciation for the ideas behind modern financial economics. Second, in spring 2000, St. Mary’s selected me for the honor of being the first holder of the G. Thomas and Martha Myers Yeager Endowed Chair. Thomas Yeager earned the money with which the chair was endowed as an investment advisor. Perhaps, I thought, I can return the honor having an endowed chair gives by doing some type of research in financial markets.

In the following year, I got a chance to do just that through the third influence. A former colleague at St. Mary’s, Blu Putnam, returned to the area to set up Bayesian Edge Technology and Solutions, a web-based investment research and advisory firm specializing in applying Bayesian statistics to financial markets. He asked me to write brief articles for his web page that might illuminate his approach and suggested I look into Irving Fisher’s investment strategy, given the notoriety of Fisher’s financial losses in the 1920s (see Chapter 5). I started with Fisher’s earlier works and found, as described in Chapter 2, that he had been very modern in his advocacy of statistics as a method for analyzing financial markets. I wondered whether
other economists of that era had been interested in statistical approaches to investigating financial markets, and a project was born.

Am I the right person to take on this project? Well, I seem to be the only one to have volunteered. And I have had help. In addition to Blu Putnam who read early drafts of the manuscript, Sykes Willford, Jose Quintana, and Erik Norland all read portions of its text and were especially helpful in improving the quality of my explanations of the issues between Bayesians and frequentists. While they are not responsible for any errors the book may contain, I greatly value their assistance.

Throughout this book I describe the ideas and contributions of a large number of economists and a few statisticians and investment analysts. Where possible, I have given some background information on each of them, trying at a minimum to give the years during which they lived. In some instances, even that minimum was unattainable, as some of the thinkers whose works make up this book have fallen into obscurity. In selecting the persons to study in this book, I used the following process. Some of them, such as Veblen and Keynes, I knew from previous study to have been interested in finance, and Fisher was an obvious choice. The names and works of the less prominent economists in the study, I found partly from references in other works but mainly through searches in the JSTOR database of periodicals in economics, finance, and statistics. At times I have felt like the drunkard whose movements typify the term ‘random walk’, lurching through all of these sources in search of articles and books on probability theory and statistical methods as applied to finance. Accordingly, I have subtitled the book ‘A Random Walk in the History of Economic Thought’. As an exploratory effort in the history of financial economics, it will contain gaps and errors which I hope others will help me remedy. In this regard, I am especially grateful to the two reviewers for Edward Elgar Publishing for their constructive suggestions, which greatly improved the quality and content of Chapters 1, 2, and 9.