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*"Risk is an inescapable feature of investing, and risk, more than anything else, is what this fine book is all about."*

—Peter L. Bernstein

# The Portable Financial Analyst

*What Practitioners Need to Know*

Second Edition

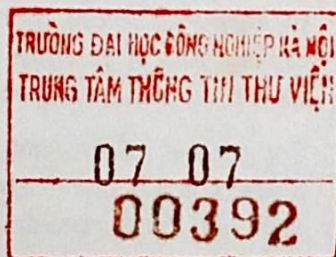
MARK P. KRITZMAN



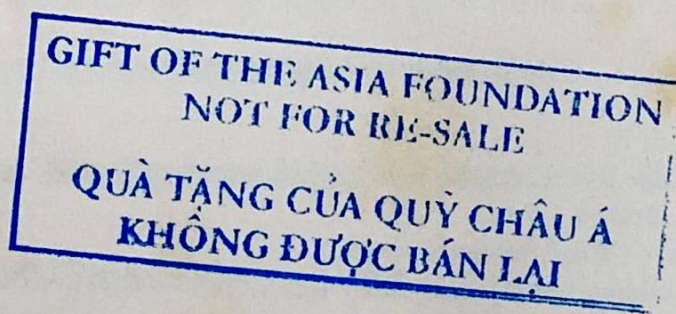
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your mind after you have made an investment, at a moment of your own choosing, would be extremely costly or even impossible under such conditions. You would hesitate a long time before buying an asset with these constraints, and even then you would demand high compensation for taking the risk that matters could take a turn for the worse without any opportunity for you to get out. Or perhaps more attractive investments might come along after you have committed your money to this illiquid situation. Let's face it: Many individuals in the investment management profession take a lot longer to reach a decision about which house to buy for their family, and how much to pay for it, than they spend before committing millions of dollars of client money in stocks like General Electric or Microsoft.

Financial markets are a kind of magic elixir providing you with the opportunity to change your mind after you have made a commitment. You may have to pay a price for that reversibility—a price you will never know in advance—but the trade-off for that risk is in sustaining your flexibility instead of locking yourself up in what might be a much greater risk over the indefinite future. In more technical terms, whatever the present value of the expected future cash flows from your investment might be, you can realize them in the markets at your discretion without having to wait through the future to cash out.

That is the picture from the perspective of an investor who wants to sell an asset, but someone else is always at the other side of every market transaction. If, as I have just pointed out, sellers are realizing the present value of future cash flows today, buyers are doing the opposite. They are using today's cash—or instant purchasing power—to purchase a stream of cash flows expected to arrive in the future. In short, *financial markets are a time machine that allows selling investors to compress the future into the present while allowing buying investors to stretch the present into the future.*

But there are no free lunches and no sure things. Through all of this wonderful magic lurks uncertainty. We do not know what the future holds, we never have known, and we never shall know. As Frank Sinatra used to phrase it, "That's life!" Everyone reading these words will nod their heads in agreement. But few people reading these words will *behave* as though the future is unknown. Consider what "the future is unknown" really means: that surprise is endemic, an inescapable feature of daily life. There would be no such thing as surprise if we knew the future.

Yet humans have never learned how to live with surprise, which is just another way of saying they persist in believing they know what lies ahead. The most vivid proof of that assertion is in stock markets, where volatility seems to be a permanent feature—sometimes more, sometimes less, but always present. These sharp and often discontinuous price movements in either direction are clear evidence that surprise takes us by surprise. If we



really accepted our ignorance of the future, the frequent arrival of the unexpected would not shake us up as much as it does. The very word "unexpected" shows we had a view of what the future would bring even though we admit we do not know what the future will bring. The eternal conflict between what we expect and what actually does happen is encapsulated in that important little word, risk.

The many wisdoms in this book focus primarily on that conflict. Mark Kritzman's objective is to show you how you can deal with the harsh reality that we do not know what the outcomes of our decisions will be. Risk is an inescapable feature of investing, and risk, more than anything else, is what this fine book is all about.

PETER L. BERNSTEIN