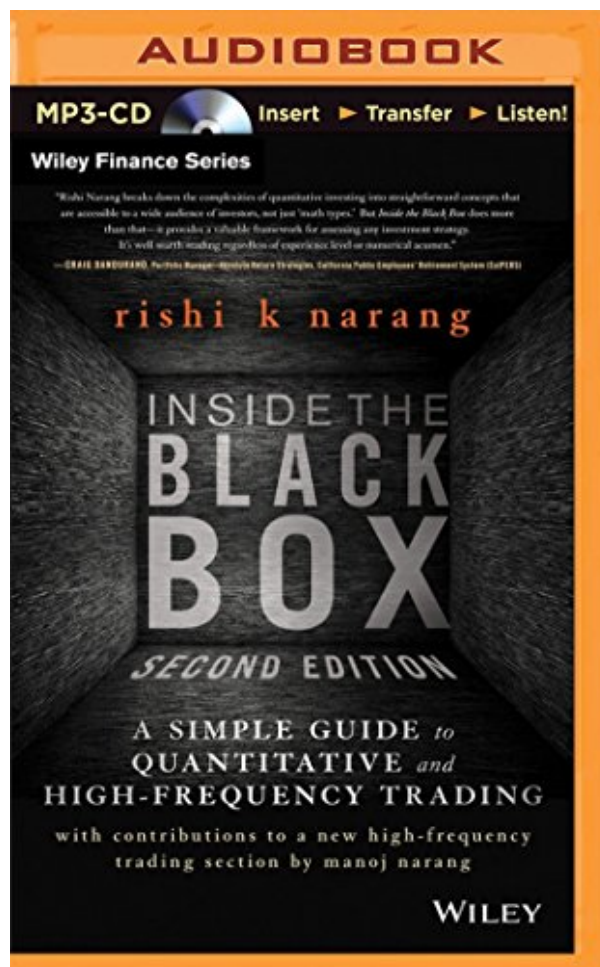


INSIDE THE BLACK BOX: THE SIMPLE TRUTH ABOUT QUANTITATIVE TRADING

BY RISHI K. NARANG



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rishi k narang

INSIDE THE
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BOX**

SECOND EDITION

A SIMPLE GUIDE *to*
QUANTITATIVE *and*
HIGH-FREQUENCY TRADING

with contributions to a new high-frequency
trading section by manoj narang

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"Quantitative trading, like all investment strategies, gets more complex yet more interesting the deeper you dig into it. Rishi deftly peels back the layers, walking readers through each building block and their combination, then providing useful chapters on evaluating model-based approaches and finally a new section surveying high-frequency trading. Anyone approaching the space will learn something from this clear, thorough, and readable book."

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"To look at the man, you would never know that Rishi could write so clearly and effectively about something as complex as quantitative trading and investment. But he does and does it brilliantly. And, even if you already own the first edition, you should buy this one, too. The new material on high speed trading is worth the price of admission, and you will have a chance, especially in Chapter 16, to see Rishi at his incisive and high spirited best. If you don't laugh out loud, you have no soul."

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From the Inside Flap

Whether you call it quant, algo, or black box trading, it all adds up to the same thing: systematic trading performed by computers.

While some decry it as dangerously detached from human control, and a driver of excessive volatility in the markets, others see quantitative trading as a welcome departure from the unruly passions and cognitive biases that inform human investment decision making.

Say what you will about quant trading, the fact is, overall, quant funds consistently outperform the markets—which may be why so many smart investors are keen to avail themselves of that black box magic.

Unfortunately, much remains obscure about quantitative trading, thanks in great part to the extreme guardedness of quants when it comes to the details of how their systems work. But, as quant-trader and master explainer Rishi Narang deftly shows in this updated edition of his bestselling guide, quantitative trading is much easier to understand and take advantage of than you think.

Designed to make quantitative trading comprehensible to even the most math- or technophobic investor, this book takes you on a guided tour inside the black box. In plain English, Mr. Narang turns the lights up on what the quants are up to, once and for all lifting the veil of mystery surrounding quantitative trading and quantitative trading strategies.

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Then, with the help of numerous real-world examples and lively anecdotes, he clearly explains:

- The most common quant system structures
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- Current and future trends in quant trading and the role it will play in the years ahead

A book that lifts the lid on black box trading, making it transparent, intuitively sensible, and readily understandable, *Inside the Black Box* is a must-read for institutional investors, asset managers, investment advisors, pension fund managers, and all savvy investors looking to gain an edge in today's turbulent financial markets.

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Quantitative trading strategies?known to many as “black boxes”?have gained a reputation of being difficult to explain and even harder to understand. While there is a certain level of complexity to this approach, with the right guidance, you can successfully overcome potential obstacles and begin to excel in this arena.

That’s why expert fund manager Rishi Narang has created Inside the Black Box. In a straightforward, nontechnical style?supplemented by real-world examples and informative anecdotes?this reliable resource takes you on a detailed tour through the black box. It skillfully sheds light upon the work that “quants” do, lifting the veil of mystery around quantitative trading and allowing anyone interested in doing so to understand quants and their strategies.

Divided into three comprehensive parts, Inside the Black Box opens with an accessible introduction to the discipline of quantitative trading and quickly moves on to demonstrate that what many call a black box is in fact transparent, intuitively sensible, and readily understandable. Along the way, it also explains how quant strategies can fit into your portfolio and why they are so important.

Whether you’re an institutional investor or high-networth individual, the lessons learned here will help you gain an edge in today’s turbulent market. Some of the tough questions answered include:

- How do quants capture alpha?
- What is the difference between theory-driven systems and data-mining strategies?
- How do quants model risk?
- What can be learned about investing in general from quantitative trading?
- And much more.

Given both the difficulty of the market environment over the past few years and the negativity surrounding hedge funds in general and quant funds in particular, there has never been a better time to become more familiar with what quantitative trading is really about. With the help of the framework found here, you can gain a firm understanding of quant strategies, discern which are more likely to succeed, and ascertain how to use specific strategies in a portfolio, to help improve the performance of your investment process.

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Most helpful customer reviews

56 of 57 people found the following review helpful.

Even better when supplemented with other books

By Newbie Algo Trader

This book gives an excellent overview of how algo trading works. Though the author would not give specific strategies, readers can get example algorithmic strategies from "Algorithmic Trading: Winning Strategies and Their Rationale" by Ernest Chan. Chan's book has mean reversion strategies and momentum strategies. If you want a trend following algorithm, you can look up "Following the Trend: Diversified Managed Futures Trading" by Andreas Clenow. If you are not afraid of learning the "R" language, you can try machine learning algorithms for stock trading in "Data Mining with R: Learning with Case Studies" by Luis Torgo. Happy Algo trading!

25 of 26 people found the following review helpful.

What's under the hood

By D. DeMers

In my opinion, this book plays a valuable role in the discussion of quantitative trading.

It is not a how-to handbook, although wannabe quants would be well served by reading it.

Anyone who is not a quant but is considering investing with a quantitative manager owes their clients a duty of understanding the potential investment,

and "Inside the Black Box" does an excellent job of laying out the important issues.

It can help a quant manager understand how to effectively describe his or her process to investors,

and can help an investor understand how to probe for the right level of detail when evaluating a manager.

As a systematic manager, I would want my investors to have read this book.

I know Rishi well, and have been through his due diligence process, which is famous for its depth and focus. The many years of deep review of many systematic managers shows its results in that he has distilled the best practices into the right (in my opinion) abstractions.

This new edition has added quite a bit of material on "high frequency trading", a topic of some importance and controversy.

He (assisted by his brother, who has deep insight into the HFT world) lays out the key issues.

I may disagree with him on interpretation, opinion and consequences, but the material here contributes to the debate.

Some minor quibbles are just a matter of the right level of inclusion and detail.

For example, in Chapter 5 (Transaction costs) there is no discussion of adverse selection and opportunity cost,

nor much advice on how to actually measure and model market impact.

But one could write a full book on transaction cost, and indeed, such books exist.

I recently read Mauboussin's book "The Success Equation", which provides a good explanation of the problem of distinguishing skill from luck.

In my opinion, Rishi could have added additional value by discussing how one can get a more accurate estimate of manager skill for a quant manager than for most discretionary managers.

This is a valuable book though it will not train you to become a successful quant.

You will understand the concepts underlying investing and how quants leverage computational power in order to develop a scientifically driven investment process.

If you invest in hedge funds, you may learn how to improve your due diligence by focusing on the meaningful issues underlying success for systematic managers.

19 of 22 people found the following review helpful.

Highly thought-provoking and pleasurable

By Rasheed Sabar

This book is both thought-provoking and pleasurable to read. I run a quant trading operation and the book made me reflect on the performance drivers for our strategies, for other quant strategies, and for hedge fund strategies in general.

I found the following particularly insightful: (1) observations on the relationship of value trades to carry strategies; (2) discussion of order types and market microstructure; (3) conceptualization of August of 2007; (4) process for evaluating quant managers and their process; (5) brilliant taxonomy of alphas.

It's not a book one reads to mine for strategy ideas. It's a book one reads to understand the quant space. Required reading for our new hires and summer interns.

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"In this updated edition, Rishi again provides an insightful taxonomy of a wide range of systematic trading strategies in liquid instruments. Without the extensive use of complex formulae, this book offers intuitive explanations of some of the choices faced by quants in constructing trading systems, and is a valuable read

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—ROSS GARON, Managing Director, Quantitative Strategies, SAC Capital Advisors, LP

"Rishi takes a complicated subject and distills it down to its essentials using non-technical language and numerous concrete examples to bring concepts alive. Inside the Black Box provides readers with a valuable framework to understand the various components of quant strategies and insights on how to evaluate and interview quant managers. Inside the Black Box is a useful reference guide for any institutional allocator to quant strategies."

—DAREN SMITH, CFA, CAIA, FSA, Managing Director, Manager Selection & Portfolio Construction, University of Toronto Asset Management

"If a car were a black box, Rishi would be the gentle voice of the navigation system. Not the one driving, but if you want to know where everyone is going: just listen."

—HAROLD de BOER, CEO, Transtrend

"Rishi presents a thorough overview of quant trading in an easy-to-read format, free of much of the hype and hysteria that has recently surrounded computerized trading. The book clearly categorizes the different types of strategies, explaining in plain English the basic ideas behind how and when they work. Most importantly, it dispels the popular notion that all quants are the same, exposing the diversity of the types of skills and thinking that are involved in quant trading and related disciplines. An excellent read for anyone who wants to understand what the field is all about."

—Shakil Ahmed, PhD, Global Head of Market Making, Citi Equities

"To look at the man, you would never know that Rishi could write so clearly and effectively about something as complex as quantitative trading and investment. But he does and does it brilliantly. And, even if you already own the first edition, you should buy this one, too. The new material on high speed trading is worth the price of admission, and you will have a chance, especially in Chapter 16, to see Rishi at his incisive and high spirited best. If you don't laugh out loud, you have no soul."

—Galen Burghardt, Director of Research, Newedge

"Quant managers will find their meetings with investors to be smoother if the investors have read this book. And even more so if the manager him or herself has read and understood it."

—David DeMers, Portfolio Manager, SAC Capital Advisors, LP

"In this second edition of Inside the Black Box Rishi highlights role of quant trading in recent financial crises with clear language and without using any complex equations. In chapter 11 he addresses common quant myths. He leads us effortlessly through the quant trading processes and makes it very easy to comprehend, as he himself is a quant trader."

—Pankaj N. Patel, Global Head of Quantitative Equity Research, Credit Suisse

"Something that every trader should aspire to, whether his eventual trading box is black or translucent. In brief, this book is not just for those who want to know what quants do (though it does an excellent job of describing their role in the investment community) but for everyone whose trading is informed by more than dart throwing or gut reactions. ... The text is highly readable. No math is required, only, I would suggest, an interest in scientific inquiry and a curiosity about the world that the mathematical elite inhabit. Inside the Black Box is an enlightening and potentially enriching read."

—Investing.com

From the Inside Flap

Whether you call it quant, algo, or black box trading, it all adds up to the same thing: systematic trading performed by computers.

While some decry it as dangerously detached from human control, and a driver of excessive volatility in the markets, others see quantitative trading as a welcome departure from the unruly passions and cognitive biases that inform human investment decision making.

Say what you will about quant trading, the fact is, overall, quant funds consistently outperform the markets—which may be why so many smart investors are keen to avail themselves of that black box magic.

Unfortunately, much remains obscure about quantitative trading, thanks in great part to the extreme guardedness of quants when it comes to the details of how their systems work. But, as quant-trader and master explainer Rishi Narang deftly shows in this updated edition of his bestselling guide, quantitative trading is much easier to understand and take advantage of than you think.

Designed to make quantitative trading comprehensible to even the most math- or technophobic investor, this book takes you on a guided tour inside the black box. In plain English, Mr. Narang turns the lights up on what the quants are up to, once and for all lifting the veil of mystery surrounding quantitative trading and quantitative trading strategies.

Following a concise introduction to quantitative trading principles and general practices, Mr. Narang cuts to the chase with a detailed inventory of the contents of a typical black box system, explaining, in non-technical terms, what each one is and how it fits together with the others.

Then, with the help of numerous real-world examples and lively anecdotes, he clearly explains:

- The most common quant system structures
- How quants capture alpha
- The level of discretion in quant trading
- High-frequency trading and the infrastructure that supports it
- Execution algorithms and how they work
- How quants model risk and how to know if a particular model really works
- The important difference between theory-driven systems vs. data-mining strategies
- How to evaluate quant managers and their strategies
- How quant strategies can fit into an overall portfolio strategy—and why they're so important
- Current and future trends in quant trading and the role it will play in the years ahead

A book that lifts the lid on black box trading, making it transparent, intuitively sensible, and readily understandable, *Inside the Black Box* is a must-read for institutional investors, asset managers, investment advisors, pension fund managers, and all savvy investors looking to gain an edge in today's turbulent financial markets.

From the Back Cover

High Praise for *Inside the Black Box*

"Rishi provides a comprehensive overview of quantitative investing that should prove useful both to those allocating money to quant strategies and those interested in becoming quants themselves. Rishi's experience as a well-respected quant Fund of Funds manager and his solid relationships with many practitioners provide ample useful material for his work."

—PETER MULLER, founder, PDT Partners

"Quantitative trading, like all investment strategies, gets more complex yet more interesting the deeper you dig into it. Rishi deftly peels back the layers, walking readers through each building block and their combination, then providing useful chapters on evaluating model-based approaches and finally a new section surveying high-frequency trading. Anyone approaching the space will learn something from this clear, thorough, and readable book."

—ALEKSANDER WEILER, CFA, Senior Portfolio Manager, Public Market Investments, Canada Pension Plan Investment Board

"Rishi continues to demystify even more quantitative trading areas in this excellent new edition. Significant updates include several new chapters that shine much-needed light on high-speed and high-frequency trading. This book continues to be a must-read for anyone interested in quantitative trading."

—STEVE EVANS, Managing Director of Quantitative Trading, Tudor Investment Corporation

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Sometimes, checking out *Inside The Black Box: The Simple Truth About Quantitative Trading By Rishi K. Narang* is extremely boring and also it will certainly take long period of time beginning with getting guide as well as begin reading. Nevertheless, in modern age, you could take the developing modern technology by making use of the net. By internet, you can see this page and also start to hunt for the book *Inside The Black Box: The Simple Truth About Quantitative Trading By Rishi K. Narang* that is needed. Wondering this *Inside The Black Box: The Simple Truth About Quantitative Trading By Rishi K. Narang* is the one that you require, you can choose downloading and install. Have you comprehended how to get it?