REPLY

by Michael S. Young

Without going into an elaborate discussion of all the issues raised by Professor Ben-Horim in his Critique, let me say that we are not in disagreement with regard to the possible instabiilty or unpredictability of "beta" as a measure of risk or the occasional usefulness of marginal analysis. His argument is not wrong; we are simply talking about different things. He is delving into areas beyond the rudimentary presentation I made, and into regions of academic theory and research in which debate especially with regard to beta estimation and stability is currently raging.

In other areas of Professor Ben-Horim's comment he appears to have misinterpreted my intent or my English. For instance, I suggested that both betas *and* correlation coefficients be used to specify investment policy for holders of portfolios. In his discussion following the marginal contribution formula, he has lost sight of that which he earlier recognized. However, irrespective of the correlation coefficient restriction in the model, those who wish to try the computation will quickly discover that successive additions of an asset whose beta is lower than that of the portfolio to which it is added will not consume the entire portfolio but will reach a point of equilibrium unless constrained earlier by physical limitations.

Perhaps I got a little ahead of myself when I said that the choice of the periodicity of wealth relatives is a "matter of convenience, accuracy, and availability." Obviously, the geometric mean does not depend upon the intermediate wealth relatives but other computations such as the variance clearly do. In a paper addressed to a wide, generally non-academic audience, there is never the opportunity to go into all the minute details of proof.

Professor Ben-Horim's closing paragraph gives me reason to believe that the myth that diversification is enforced by specifying maximum percentages of a portfolio that should be invested in various assets will persist. Specifying percentages or quotes will *never* ensure diversification. Professor Ben-Horim and doubtless many others are guilty of this misunderstanding.

My article was intended to stimulate further discussion of advanced analytical techniques that might be applied to real estate. As a profession, real estate lags decades behind finance and economics. I had hoped that some institutional holder of real estate assets such as the insurance companies who maintain real estate portfolios for pension funds would submit or subject their portfolio to the kind of analysis necessary to substantiate or refute the proposition that real estate assets behave like common stock assets in such a way that useful comparisons could be made. Unfortunately no one has taken up the challenge.

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