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KEYNOTE SPEAKERS

FACTOR PREMIUMS AND INVESTMENT STRATEGIES

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ABSTRACT

The number of asset pricing factors has grown in the last two decades from a handful to hundreds if not thousands. In this talk, Professor French will discuss this proliferation and explore how researchers and investors might winnow the set to something useful.

ASSET PRICE BOOMS AND MACROECONOMIC POLICY: A RISK-SHIFTING APPROACH

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ABSTRACT

This paper uses a risk-shifting model to analyze policy responses to asset price booms. We show risk shifting leads to inefficient asset and credit booms in which asset prices can exceed fundamentals. However, the inefficiencies associated with risk shifting arise independently of whether the asset is a bubble. Given evidence of risk-shifting, policymakers may not need to determine if assets are bubbles to justify intervention. We then show that some of the main candidate interventions against asset booms have ambiguous welfare implications: Tighter monetary policy can mitigate some inefficiencies but at a cost, while leverage restrictions may raise asset prices and lead to more leveraged speculation rather than less. Policy responses are more effective when they disproportionately discourage riskier investments.

*We thank Robert Barsky, Marco Bassetto, John Conlon, Huberto Ennis, Tomoyuki Nakajima, Toan Phan, Alp Simsek, and Sanjay Singh, the editor, and three anonymous referees for their comments, as well as audiences at various conferences and seminars. The views here do not represent those of the Federal Reserve Bank of Chicago or the Federal Reserve System.

WELFARE COSTS OF IDIOSYNCRATIC AND AGGREGATE CONSUMPTION SHOCKS

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ABSTRACT

I estimate welfare benefits of eliminating idiosyncratic consumption shocks unrelated to the business cycle as 47.3% of household utility and benefits of eliminating idiosyncratic shocks related to the business cycle as 3.4% of utility. Estimates of the former substantially exceed earlier ones because I distinguish between idiosyncratic shocks related/unrelated to the business cycle, estimate the negative skewness of shocks, target moments of idiosyncratic shocks from household-level CEX data, and target market moments. Benefits of eliminating aggregate shocks are 7.7% of utility. Policy should focus on insuring idiosyncratic shocks unrelated to the business cycle, such as the death of a household's prime wage earner and job layoffs not necessarily related to recessions.

PLENARY SPEAKERS

VALUE INVESTING: WHO, WHAT AND WHY?

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ABSTRACT

Value investors are investors who, using fundamental analysis, allocate their capital to undervalued securities/assets or to securities/assets with the highest potential upside. As a result, value investing is all about active portfolio management, about stock picking. Value investing was developed in the early 30's at Columbia University by Ben Graham who showed an approach and a way to find and buy stocks that trade significantly below intrinsic value. Despite the success that value investors like Warren Buffett have had and plenty of evidence that markets are not efficient in the short run, value investing has not found many supporters at the University level as only a handful of universities have in the curriculum any courses on value investing. So, university graduates finish their schooling without having taken or having understood what value investing is all about.

SYMPOSIASTS

CAPITAL RETURNS AFTER A TERMS OF TRADE SHOCK

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Abstract

The aim of this paper is to study the effect of a terms of trade (ToT) shock on the return on capital (ROC). Standard dynamic stochastic general equilibrium models fail to portray significant ROC responses after a specific exogenous shock. I extend the theoretical importable-exportable model from Schmitt-Grohé and Uribe (2017) by introducing internal habit persistence preferences in consumption as well as in labor-supply and adding capital adjustment costs. These modifications allow to produce substantial volatility in the price of capital and lead to considerable ROC responses after a ToT shock. A model application suggests that the initial ROC response to a 1% positive ToT shock is usually negative, since the price of capital at the beginning of a time period increases by different amounts, depending on the degree of economic activity. This finding stands in stark contrast to some results from an empirical SVAR model applied to 22 economies.

Keywords: Open economy macroeconomics, terms of trade, capital return, SVAR model, DSGE model

JEL Classification: F41, F44, F62, F65, G12

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MERGER-DRIVEN LISTING DYNAMICS

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Abstract

To accurately gauge the flow of firms into and retained by stock exchanges, we add targets of public acquirers to the listing count. For the U.S., this merger-adjustment rivals IPOs in its impact on listing dynamics, and it eliminates the dramatic post-1996 listing decline and subsequent international listing gap. We also show that listing peaks are surprisingly common internationally, but with a different impact of our merger-adjustment. While the U.S. post-peak decline reflects mergers between public firms, declines elsewhere tend to move assets out of public markets-pointing to a relative U.S. listing advantage.

Keywords: M&A; IPO; merger; public listing; listing gap

JEl classification: G15, G34

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*An earlier version of this paper was entitled \The merger-adjusted U.S. listing gap" (2020). We are grateful for the comments and suggestions of Sanjai Bhagat, Eric de Bodt, Ing-Haw Cheng, Jean-Gabriel Cousin, Joan Farre-Mensa (discussant), Andrey Golubov, Tanakorn Makaew, Vojislav Maksimovic (discussant), Jay Ritter, Ali Sanati, Felipe Severino, Keke Song (discussant), Karin Thorburn, and Adam Winegar (discussant). We also thank the seminar participants the Norwegian School of Economics, the Tuck School of Business at Dartmouth, and conference participants at the 2020 Australasian Finance and Banking Conference, the 2020 Finance Organizations and Markets Conference, the 2020 Nordic Finance Network PhD Workshop, and the 2021 Midwest Finance Association Annual Meeting. This project has received partial _nancial support from Tuck's Lindenauer Forum for Governance Research and from the Norwegian Research Council (NRC #273678\Incentives, Access to Capital, and Innovation").

PROCESSING OF FINANCIAL ASSET RETURNS TO NEUTRALIZE BIAS IN JUMP-DETECTION STATISTICS

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Abstract

Financial price series are widely regarded as following jump-diffusion processes, with jumps predominantly viewed as market corrections induced by the release of economic news. Various quantitative techniques, such as the BNS and the ABD methods, have been developed to detect jumps. Financial price series are also governed by trading constraints, such as tick size and bid-offer spreads, which restrain price records to specific increments and arguably curb trading activity. These trading constraints are often referred to as microstructure noise in the literature. It is evidenced that microstructure noise creates significant biases in jump detection test results, potentially leading to erratic and unreliable detection rates. This research presents an original financial data processing methodology, which effectively neutralizes the effect of microstructure noise, and yields consistent jump detection results across a wide range of detection methods and data sampling frequencies. Comprehensive jump detection tests on simulated and real financial data are produced to support this methodology.

Keywords: Jump detection, BNS, ABD, jump-diffusion, realized variation, bi-power variation, microstructure noise, volatility, financial series.

JEL Classification: G15, G17, C4, C5, C8

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PRODUCTION NETWORK: DUALITY OF ASSET PRICING, AND SYSTEMIC RISK

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Abstract

FISD data set from 1994 to 2016 shows that the corporate yield spread increased by about 150 basis points. By merging three different data sets, I empirically show that the U.S. production network changed from the mid-1990s. I document these changes in six main stylized facts. The production network becomes more connected and asymmetric. There is a higher concentration on the demand and supply side of the firm, and firms sell a larger share of their products to other firms. The upstream firms have a 20.6 basis points higher spread compare to downstream _rms. The reduced-form model with IV shows how the U.S. production network affects the systemic and idiosyncratic risk of the firms from 1994 to 2016. The more connected network explains between 84.4 to 124.82 basis points increase in the spread. The increase in relying more on the top customer increases the spread by 18.7 bp. The production network changes can explain the upward trend in the corporate yield spread from 1994 to 2016.

Keywords: Production Network, Asset Pricing, Systemic Risk

JEL Classification:

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FIRE-SALE RISK AND CREDIT

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Abstract

This paper examines whether the risk of future collateral fire sales affects lending decisions. We study US mortgage applications and exploit exogenous variation in foreclosure frictions for identification. Lenders are less likely to approve mortgages when anticipated losses due to uncoordinated collateral liquidations are high, and when there is elevated risk of joint collateral liquidation. The results suggest that _re-sale risk has implications for credit allocation, and that lenders' collective origination decisions mitigate fire-sale exposures ex-post. However, we also find the effects to be significantly weaker in periods in which _re-sale risk is less salient for lenders.

Keywords: fire sales, credit supply, foreclosure laws, creditor concentration, joint liquidation risk, collateral

JEL Classification: G21; G11;

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DO STOCK PRICES CO-MOVEWITH FUNDAMENTAL VALUES?

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Abstract:

This report re-examines the apparent increase in speculation in stock prices, documented in Curtis (2012), by investigating the association between stock prices and estimated fundamental values of US financial-services firms. Earlier research in this area has found that stock prices and fundamental values of non-financial firms appear to comove in historical periods up until about 1996 (Lee, Meyers & Swaminathan, 1999; Curtis, 2012), but not in more recent periods (Curtis, 2012). Financial-services firms provide a promising setting to study the association between stock prices and fundamental values, as their valuations are expected to be less speculative given their more predictable performance and use of fair value accounting. I examine the period from 1975 to 2018 and find evidence for co-movement between market and fundamental values over the entire period, but with structural changes in the association over time (around the years 1994 and 2007). These structural changes are accompanied by changes in future returns predictability by the fundamentals-to-price ratio. The inferences are consistent across various specifications of fundamental valuation models.

Keywords: Fundamental analysis, market efficiency, residual income valuation, co-movement.

JEL Classification:

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DARK POOLS AND PRICE DISCOVERY IN LIMIT ORDER MARKETS

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Abstract

This paper examines how the introduction of a dark pool impacts price discovery, market quality, and aggregate welfare of traders. I use a four-period model where rational and risk-neutral agents choose the order type and the venue and obtain the equilibrium numerically. The comparative statics on the order submission probability suggests a U-shaped order migration to the dark pool. The overall effect of dark trading on market quality and aggregate welfare was found to be positive but limited in size and depended on market conditions. I find mixed results for the process of price discovery. Depending on the immediacy need of traders, price discovery may change due to the presence of the dark venue.

Keywords: Dark Pools, Price Discovery, Order Markets

JEL Classification:

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HETEROGENEOUS CSR APPROACHES

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Abstract

Theoretical CSR literature argues that firms approach CSR via either strategic CSR, CSR as-insurance or corporate greenwashing. Where empirical CSR literature primarily analyses CSR in general, we show that it is precisely the heterogeneity in CSR approaches that shapes the societal contribution and financial performance of firms. Using a novel method which segregates the promised to realised CSR performance of firms, we find that firms approach strategic CSR, CSR-as-insurance and corporate greenwashing respectively 50%, 24% and 26% of the time for a global sample. By comparing the societal contribution and financial performance of firms, we show that contributing to societal welfare through strategic CSR enhances profitability, whereas corporate greenwashing simultaneously deteriorates societal welfare and firm value.

Keywords: Strategic CSR, CSR-as-insurance, corporate greenwashing, societal contribution, financial performance, clustering

JEL Classification: M14, Q56, G15

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FIRM CHARACTERISTICS AND STOCK PRICE LEVELS: A LONG-TERM DISCOUNT RATE PERSPECTIVE

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Abstract

We study how firm characteristics are correlated with stock price levels by measuring the long-term discount rates (defined as the internal rate of return) of anomaly portfolios over a long horizon. We develop a simple, non-parametric methodology to estimate the long-term equity discount rate from ex-post realized payouts and prices. Our estimates show that the cross-sectional patterns in the long-term discount rates can be substantially different from that of the average short-term holding period returns; and appealing to mean reversion in anomaly premia does not reconcile the wedge between the two for a group of prominent anomalies. We argue that the long-term discount rate is a better measure of firm's equity financing cost than the premium from a dynamically-rebalanced trading strategy; and we demonstrate with a representative example that structural models that interpret the spreads in the latter as the differences in the former could generate counterfactual patterns in the long-term discount rates. Our empirical exercise uncovers numerous new stylized facts regarding firms' equity financing cost; and these findings could shed new light on the mechanisms underlying various asset pricing anomalies, and advance our understanding about the determinants of stock price levels.

Keywords: Firm Characteristics, Stock Price, Long-Term Discount Rate

JEL Classification: G12

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We thank the seminar participants at University of Rochester June 7, 2021

FAMOUS FIRMS, EARNINGS CLUSTERS AND THE STOCKMARKET

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Abstract

We show that much of the market premium for the year occurs on a handful of days, identifiable well in advance, on which several of the market's most famous, high-media attention firms simultaneously announce earnings after the market close. Puzzlingly, the market surges occur during the 24 hours prior to the earnings announcements, from close to close. Since there is no overlap between the price increase period and the information revelation, the high returns do not appear to represent a risk premium, and our tests seem to rule out information-leakage explanations. Deepening the puzzle, the market delivers high returns only prior to post-close earnings-announcement clusters, not in advance of clusters that occur in the pre-open period. In addition to being economically large and easily tradeable, the effect is statistically significant, and the results hold consistently throughout our sample. We argue that the best explanation for our findings is that of Miller (1977) as extended by Hong and Stein (2007): when over a short "attention" period difference of opinion combines with short-sale constraints, prices will rise as optimists buy while pessimists cannot sell.

Keywords: Earnings Announcing Cluster, Pre-announcement Drift, Equity Premium, Disagreement Theory

JEL Classification: G12, G14

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BANK CULTURE AND ENFORCEMENT ACTIONS

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Abstract

We examine the way and extent to which corporate culture influences bank misconduct. Consistent with the risk-taking culture in banks, we show strong and robust evidence that banks with a growth-oriented culture are more likely to receive enforcement actions whereas banks with a safety-oriented culture are less likely to receive enforcement actions. Our findings survive a battery of robustness checks to look-ahead bias, measurement errors and omitted variable bias. Using state-level bank branching deregulation following the Interstate Banking and Branching Efficiency act (IBBEA) as exogenous shocks to the competitive environment in the banking system, we find evidence supporting a causal effect of corporate culture on misconduct in banks.

Keywords: risk culture, bank stability, text analysis, regulatory risk

JEL Classification: G21, M14

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CRYPTOCURRENCY FACTOR PORTFOLIOS: PERFORMANCE, DECOMPOSITION AND PRICING MODELS

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Abstract

The empirical distributions of cryptocurrency returns are highly non-normal, casting doubt on the performance metrics. So we apply almost stochastic dominance (ASD), which does not require any assumption about the return distribution, to examine cryptocurrency factor portfolios. Using portfolios based on factors that can be constructed from available market information, we find 13 factor portfolios that dominate our four benchmarks. The long-only strategy contributes more to this dominance than does the short-only strategy. We test whether returns on the 13 dominant factor portfolios can be explained by a coin market three-factor model. This model has limited success, and its performance is significantly improved by the inclusion of a mispricing factor.

Keywords: Cryptocurrencies, Asset Pricing, Almost Stochastic Dominance, Mispricing

JEL Classification: G11, G12

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FUND FLOWS AND PERFORMANCE UNDER DYNAMIC UNOBSERVABLE MANAGING ABILITY

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Abstract

We introduce continuous-time rational models of dynamic unobservable fund manager abilities with risk-neutral or risk-averse investors. Investors forever face time nonmonotonic ability-tracking problems. Consequently, precision of inferred abilities and inferred abilities' sensitivities to fund returns' innovation shocks are time nonmonotonic, inducing steady-state, time-nonmonotonic flow-performance sensitivities. Our empirical evidence of nonmonotonic flow-performance sensitivities supports our theoretical framework, showing that our model explains real-world flowperformance sensitivities. Current models lack both positive and normative explanatory powers as they explain only monotonic flow-performance sensitivities. We also offer insights to help resolve ongoing disputes of whether empirical flow-performance relations are linear or convex.

Keywords: Active fund management, Fund flows, Fund performance, Alpha,Dynamic unobservable manager abilities, Learning, Nonlinear filtering

JEL Classification: G11, G14, G23

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INFORMATION, INSIDER TRADING, EXECUTIVE RELOAD STOCK OPTIONS, INCENTIVES, AND REGULATION

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Abstract

We introduce a theoretical model of executives with insider information who receive executive stock options (ESOs) as incentives and optimize their "outside wealth" portfolios. We show that insider information nullifies ESO incentivizing, misaligning executives' and shareholders' interests. We offer realigning methods: granting executives with reload stock options (RSOs) while imposing a blackout trading period. Effective blackouts keep executives incentivized without over-restricting, i.e., reducing executives' welfare below that of outsiders. We introduce RSO pricing for insider executives and offer policy implications: reestablishing the currently "out of favor" RSOs, allowing firms, not regulators, to set effective blackouts on securities they issue.

Keywords: Executive Stock Options, Insider Information, Constrained Portfolio Optimization,Non-Hedgeable, Non-Transferable, Reload, Enlarged Filtration

JEL Classification: G11, G13, C02, C61

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Corporate Finance and Governance Conference, and The Australasian Finance and Banking Conference.

ONE GLOBAL VILLAGE?
COMPETITION IN THE INTERNATIONAL ACTIVE FUND MANAGEMENT INDUSTRY

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Abstract

We introduce an international active fund management industry model in which competing managers, each having heterogeneous incentives (effort productivities, costs) for searching domestic versus foreign investment opportunities. In equilibrium, incentive heterogeneity leads to a novel prediction: increasing foreign competitiveness, which improves (worsens) domestic manager incentives, induces an increase (decrease) of both domestic performance and size. Empirically, we find that 30 global markets' performance and size, on average, decrease with U.S. concentration. This evidence is consistent with our theoretical predictions but is inconsistent with extrapolation of single-country (implying homogeneous incentives) equilibria to one "global village" [e.g., Feldman, Saxena, and Xu (2020)].

Keywords: Active management, Mutual funds, Global fund markets, Global village,Effort, Performance, Market concentration, Competition, Herfindahl-Hirschman index, Industry size, Alpha

JEL Classification: G10, G15, G20, L10

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READING THE NEWS: TELLING SUPPLY FROM DEMAND IN COMMODITY MARKETS

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Abstract

We build novel indexes of commodity price developments by simulating news-reading. Our proposed computer-based, narrative approach is flexible, unified and spans the global commodity market, including energy, industrial and precious metals, and agricultural commodities. Empirical evidence and human readings of news articles indicate that our indexes capture commodity-price supply and demand components. Index-peaks track the post-crisis collapse of commodity markets, other market-specific developments, as well as the recent COVID-19 crisis. The richness of news content allows us to decompose the supply and demand indexes into a number of key determinants that shaped commodity markets since the beginning of the 21st century, including business cycle effects, geopolitical risk, natural disasters, and climate change considerations. Preliminary results reveal that the nature of commodity price movements matters for portfolio diversification decisions and has a differential impact on stock market volatility.

Keywords: commodities, textual analysis, news.

JEL classification codes: Q02, Q11, Q31, Q41, C19.

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…, AND THE DIMINISHING SCIENTIFIC IMPACT OF NEW RESEARCH IN FINANCE

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Abstract

We examine the relative scientific impact of new research in finance and find it declined steadily during the period 2002-2019, more than 60 percent cumulatively, reaching the lowest level in four decades. Additional results using the Gini coefficient of the citations support this conclusion. Comparisons to other disciplines show that the proliferation of finance research that advance the field only marginally since 2002is not typical across research fields. Our findings support the necessity to remove the obstacles hindering innovative research and scientific progress in finance that many prolific researchers and editors of leading journals indicate.

Keywords: Knowledge progression in finance; Innovative research in finance; Impact of finance research; Epistemology

JEL Classification: G00, I23

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LAW OF ONE PRICE VIOLATION IN PARENT SUBSIDIARY PRICE RELATIONS

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Abstract

We present evidence of a persistent violation of the law of one price in one of the most liquid capital markets in the world. Using a hand collected dataset which corrects for the data errors in SDC, we find evidence that the value of the parent's ownership in the subsidiary exceeds the parent firm's total market value across time and industry. The persistence of this excess valuation is contrary to the conclusions of prior studies on this topic. Furthermore, we find that the returns associated with the excess subsidiary valuations perform opposite to what an efficient capital market predicts. Contrary to what efficient capital markets would suggest, this price aberration is persistent in liquid securities affording investors the opportunity to profit by taking advantage of the price discrepancy.

Keywords: Price Violations, Parent Subsidiary Price Relations, Liquidity, Capital Markets

JEL Classifications:

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SELECTING OPTIMAL PORTFOLIO BASED ON CUSTOMER SOLVENCY IN GENERALIZED FEED FORWARD NETWORKS AND SUPPORT VECTOR MACHINES HYBRIDS

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Abstract

In this paper, using financial data from 1411 companies from the loan department of a Greek commercial bank, we evaluate the performance of 70 Generalized Feed Forward (GFF) and 14 Support Vector Machines models (SVMs) of plain and hybrid form to define the optimal classifier in portfolio selection based on customer solvency. According to our results, the GFF dominate the SVMs that have a relatively excellent classification, in terms of precision and independency in the financial data.

Keywords: Genetic Algorithms, Generalized Feed Forward, Hybrid Networks, Support Vector Machines, Hedge Management, customer financial solvency Portfolio Optimization

JEL Classification:

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WHO TAMES THE LIONS? EVIDENCE FROM KOREAN CHAEBOLS

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Abstract

This study examines the forces that can make the owners of business groups act in the interest of the shareholders of the individual firms and thus maintain the value of the group firms. Utilizing a unique dataset from South Korea for the period 1993-2007, we first examine whether the firms that are part of a business group perform at a lower level than firms that are not. The results of this initial analysis confirm that group firms face serious agency problems and consequently underperform when compared to nongroup firms. We next investigate which forces are able to influence the behavior of business group owners. The findings indicate that foreign institutional ownership, media attention, regulation and extensive analyst coverage help to curtail the greed of corporate group owners and mitigate the negative effect that group affiliation has on a firm's performance.

Keywords: Business groups, firm financial performance, foreign institutional investors, regulatory change, media attention, number of analysts following.

JEL Classification: G32, G34, M10

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