**FEN-MAY-2018**

"Stock Market Short-Termism’s Impact

[MARK J. ROE](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=16052&partid=22912&did=384415&eid=382381), Harvard Law School, Email: [mroe@law.harvard.edu](mailto:mroe@law.harvard.edu)

Stock-market driven short-termism is crippling the American economy, according to legal, judicial, and media analyses. Firms are forgoing the R&D they need, sharply cutting capital expenditures, and buying back their own stock so feverishly that they starve themselves of cash. The stock market is the primary cause: corporate directors and senior executives cannot manage for the long-term when their shareholders furiously trade their company’s stock, they cannot make long-term investments when stockholders demand to see profits on this quarter’s financial statements, they cannot even strategize about the long-term when shareholder activists demand immediate results, and they cannot keep the cash to invest in their future when stock market pressure drains away that cash in stock buybacks.

This doomsday version of the stock-market-driven short-termism argument embeds economy-wide predictions that have not been well-examined and that could tell us how severe these problems are: if the scenario is correct and strong, we should first see sharp increases in stock trading in recent decades and more frequent activist interventions, and these increases should be accompanied by:  
  
(1) economy-wide R&D spending declining,   
  
(2) cash bleeding out from the corporate sector, and   
  
(3) sharply declining investment spending in the U.S., where large firms depend on stock markets and where activists are important, as compared with advanced economies that do not depend as much on stock markets.   
  
These baseline predictions flow directly from the short-termist critique of stock markets and corporate America. They are the central negative consequences of stock-market driven short-termism and they justify corporate law policies that seek to prevent these outcomes.   
  
But none of these predicted outcomes can be found in the data. Corporate R&D is not declining, corporate cash is not bleeding out, and the developed nations with neither American-style quarterly-oriented stock markets nor aggressive activist investors are not investing any more in capital equipment than the U.S. Hence, the stock-market-driven short-termist argument needs to be reconsidered, recalibrated, and, quite plausibly, rejected.

["Eclipse of the Public Corporation or Eclipse of the Public Markets?"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3176244&partid=22912&did=384415&eid=382381" \t "_blank)   
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The authors look back at Michael Jensen's 1989 article “The Eclipse of the Public Corporation.” They find some of his predictions have been borne out but other important ones, not. Jensen concluded that the publicly held corporation was in decline and had outlived its usefulness in many sectors. He argued that agency costs made public corporations an inefficient form of organization and that new private organizational forms promoted by private equity firms would likely replace the public firm. The number of public firms in the U.S. has declined significantly but there are still many hugely profitable and successful public companies. U.S. public markets are still well‐suited for firms with mostly tangible assets. So, what we are really witnessing is an eclipse not of public corporations, but of the public markets as the place where young firms with mostly intangible capital seek their funding. This is especially true when the usefulness of the intangible assets has yet to be proven. Sometimes the market is extremely optimistic about some intangible assets, but otherwise firms with unproven intangible assets may be better off funding themselves privately. This evolution has a downside: investors limited to public markets are cut off from investing in high intangible‐asset firms. Additionally, as fewer firms remain publicly listed, fewer firms will be transparent to society.

["Fiduciary Duties of Corporate Directors in Uncertain Times"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3176245&partid=22912&did=384415&eid=382381" \t "_blank) [Journal of Applied Corporate Finance, Vol. 30, Issue 1, pp. 17-22, 2018](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/PIP_Journal.cfm?pip_jrnl=97175&partid=22912&did=384415&eid=382381)

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Confronting new political uncertainties, heightened challenges, and asserted “best practices,” directors may wonder whether their fiduciary duties have changed. The authors synthesize the latest decisions of the Delaware courts on the standards of conduct for directors and the standards by which their conduct is reviewed. While directors should expect uncertainty to be a fact of corporate life, neither the fiduciary duties of directors nor the protections afforded them have changed. Disinterested and independent directors, acting in good faith to make decisions they deem in the best interests of the corporation, continue to have broad protections under the business judgment rule. This legal framework enables and encourages active directors to make hard choices when they need to do so. The paper includes flowcharts illustrating how the standards of judicial review apply to various categories of business decisions that directors may have to make. It concludes with practical suggestions for directors and General Counsels to establish business judgment rule protection for board decisions or, where applicable, withstand more stringent standards of review.

["Financial Flexibility and Opportunity Capture: Bridging the Gap between Finance and Strategy"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3176246&partid=22912&did=384415&eid=382381" \t "_blank)   
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Logically, the practice of corporate finance and corporate strategy should be closely coordinated, but in reality there remains a massive gap between the two. This can lead strategically oriented firms to de‐emphasize or even discard NPV. Neither financial theory nor competitive strategy has been very open to the economic value of investment opportunity capture. Strategy must recognize that financial flexibility provides powerful advantages and financial theory must evaluate entire strategic programs rather than discrete, stand‐alone projects. Necessarily, the financial discussion of cost of capital and capital structure has to change. The authors offer two specific concepts to bridge the Gap between Finance and Strategy:. 1) Reserve Financial Capacity is the annual sum of Free Cash Flow, Financing Flexibility and Cash Reserves over the period envisioned for strategy execution. Individual projects must belong to strategic programs in the sense that they either: 1) keep the base business running; 2) preserve an existing competitive position; or 3) form part of a program to enhance advantage or fashion a strategic breakout. 2) Strategically Sustainable Cost of Capital is the true, blended cost of capital required to complete an entire capital program. These concepts provide financial rigor to firms with well‐defined strategies and allow managements to wield Financial Flexibility as a strategic weapon, creating options on unique buying opportunities, such as at the bottom of industry cycles.

["Size, Age, and the Performance Life Cycle of Hedge Funds"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3169312&partid=22912&did=384412&eid=375674) Free Download

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Using an event time approach, we show that diseconomies of scale significantly contribute to performance declines with age in the hedge fund industry. Small funds outperform large funds and are more likely to maintain good performance. In addition, the contribution of the management fee to managers’ total compensation grows with fund size, suggesting decreasing incentives to improve performance. Lastly, declining performance is not significantly related to various fund and family-level characteristics. Overall, our results suggest that age effects on performance are largely driven by fund growth, and performance persistence is achievable when funds maintain a small size.

["When Does Cap-Weighting Outperform? Factor-Based Explanations"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3172498&partid=22912&did=384412&eid=375674) Free Download

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Equity mutual fund performance can be partially explained by commonly-followed equity market factors, and the proposition that fund managers in the aggregate have more equally-weighted positions that the capitalization weighted market. Currently, the aggregate mutual fund’s active return is positively associated with the performance of pure Momentum, Small Size, and Profitability factors, and negatively associated with the performance of pure Value and

[Margin Requirements for Non-Cleared Derivatives"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3168751&partid=22912&did=384256&eid=220917) Free Download

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The advent of mandatory daily initial and variation margin requirements for non-cleared over-the-counter derivatives transactions has raised many questions regarding the methodology which should be used for computing these margin requirements. Regulatory guidelines require initial margin levels for non-cleared contracts to cover a 99% loss quantile of the netting set over a horizon of 10 days, as opposed to 3 to 5 days for cleared OTC contracts. We discuss the rationale behind this and other features of the proposed framework for bilateral margin requirements and advocate an approach which better reflects the actual exposure during closeout in case of the default of a counter party.   
  
We argue that the liquidation horizon should depend on the size of the position relative to the market depth of the asset. This may be achieved by specifying a minimum liquidation horizon for each asset class, associated with an asset-specific size threshold, and scaling the liquidation horizon linearly with position size beyond this threshold. Adopting such a size-dependent liquidation horizon leads to a liquidity-sensitive initial margin, which penalizes large concentrated positions without requiring any ‘liquidity add-on’.  
  
We also argue that the IM calculation needs to account for the fact that market participants hedge their exposures to the defaulted counter party once default has been confirmed. As a result, IM should not be based on the exposure of initial position over the entire liquidation horizon but on the exposure over the initial period required to set up the hedge, plus the exposure to the hedged position over the remainder of the liquidation horizon.   
  
Based on these remarks, we propose a “four-step approach” for the calculation of IM for over-the-counter derivatives transactions. We argue that this approach yields a more realistic assessment of closeout risk for non-cleared transactions and leads to an outcome which is in general quite different from the risk exposure of the netting set over the liquidation horizon.

["Do Properly Anticipated Prices Fluctuate Randomly? Evidence from VIX Futures Markets"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3174507&partid=22912&did=384246&eid=214827) Fee Download   
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The VIX index is not traded on the spot market. Hence, in contrast to other futures markets, the VIX futures contract and spot index are not linked by a no-arbitrage condition. We examine (a) whether predictability in the VIX index carries over to the futures market, and (b) whether there is independent time series predictability in VIX futures prices. The answer to both questions is no. Samuelson (1965) was right: VIX futures prices properly anticipate predictability in volatility, and are themselves unpredictable.

["The Economics of Instability: An Abstract of an Excerpt"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3163792&partid=22912&did=384133&eid=87371) Free Download   
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Email: [Veneroso@bloomberg.net](mailto:Veneroso@bloomberg.net)

The dominant postwar tradition in economics assumes the utility maximization of economic agents drives markets toward stable equilibrium positions. In such a world there should be no endogenous asset bubbles and untenable levels of private indebtedness. But there are.  
  
There is a competing alternative view that assumes an endogenous behavioral propensity for markets to embark on disequilibrium paths. Sometimes these departures are dangerously far reaching. Three great interwar economists set out most of the economic theory that explains this natural tendency for markets to propagate financial fragility: Joseph Schumpeter, Irving Fisher, and John Maynard Keynes. In the postwar period, Hyman Minsky carried this tradition forward. Early on he set out a “financial instability hypothesis” based on the thinking of these three predecessors. Later on, he introduced two additional dynamic processes that intensify financial market disequilibria: principal–agent distortions and mounting moral hazard. The emergence of a behavioral finance literature has provided empirical support to the theory of endogenous financial instability. Work by Vernon Smith explains further how disequilibrium paths go to asset bubble extremes.  
  
The following paper provides a compressed account of this tradition of endogenous financial market instability.

[Repo Markets Across the Atlantic: Similar but Unalike"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3165720&partid=22912&did=384067&eid=37256) Free Download

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This paper sketches the key differences in the EU and the U.S. repo markets to inform the policy recommendations for harmonization and standardization of rules governing repo contracts put forward by the international financial fora and standard setters. In so doing, it examines three main aspects of the repo markets. First, it highlights the differences in the legal framework governing repo markets, such as legal construction of repo contracts, special insolvency treatment, and legal treatment of the reuse of collateral. Second, it discusses the composition, structure, and organization of the repo markets, such as differences in the composition of repo participants, the maturity of repos and the composition of the underlying collateral in repo contracts. Finally, it investigates the differences in the issues related to the market infrastructure of repo markets such as differences in the clearing and collateral management stages. The main finding of this paper is that in spite of significant efforts to standardize and harmonize repo markets as well as their applicable legal framework in the past, there remains significant differences across the Atlantic. Such differences in the legal framework, composition, structure, and organization of repo markets and repo markets infrastructure would require differential and more nuanced approach to regulating repo markets than what is pursued by the current international financial standard setters

[Co-Impact: Crowding Effects in Institutional Trading Activity"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3168684&partid=22912&did=384043&eid=20815) Free Download

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This paper is devoted to the important yet unexplored subject of crowding effects on market impact, that we call co-impact. Our analysis is based on a large database of metaorders by institutional investors in the U.S. equity market. We find that the market chiefly reacts to the net order flow of ongoing metaorders, without individually distinguishing them. The joint co-impact of multiple contemporaneous metaorders depends on the total number of metaorders and their mutual sign correlation. Using a simple heuristic model calibrated on data, we reproduce very well the different regimes of the empirical market impact curves as a function of volume fraction Φ: square-root for large Φ, linear for intermediate Φ, and a finite intercept *I\_0* when *Φ to 0*. The value of *I\_0* grows with the sign correlation coefficient. Our study sheds light on an apparent paradox: How can a non-linear impact law survive in the presence of a large number of simultaneously executed metaorders?

[Smart Derivative Contracts (Detaching Transactions from Counterparty Credit Risk: Specification, Parametrisation, Valuation)"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3163074&partid=22912&did=383858&eid=1516076) Free Download

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In this note we describe a smart derivative contract with a fully deterministic termination to remove many of the inefficiencies in collateralized OTC transactions. The automatic termination procedure embedded in the smart contracts replaces the counterparty default by an option right of the counterparty.  
  
The application of smart contracts to cure issues in xVAs has been described before, see Morini et. al. (2015, 2017).  
  
However, a direct implementation of an OTC derivative as a smart contract may come with its own issues:  
  
\* If the smart contract is implemented on a crypto-currency blockchain it will introduce a currency conversion risk.  
  
\* If the smart contract has an automatic termination in case of insufficient wallet amounts, the contract essentially contains a bilateral American option. Both counterparts can willingly terminate the contract by emptying the wallet. This would render the contract useless.  
  
In this note we will fully describe the terms of a smart contract to replace a collateralized OTC transaction. We introduce a penalty payment to modify the American option right in the contract. The penalty and the excess amount in the wallet can be seen as a combination of default fund contribution and initial margin, inducing a per-contract termination probability.  
  
Hence, each contract come with its own termination probability (corresponding to the default probability). Based on this, ratings could be assigned on a per-contract basis.  
  
Such smart contracts are also interesting with respect to the mathematical theory of systemic risk, since each contract represents an individual counterparty, increasing the numbers of individual counterparties in the whole system and possibly justifying the application of mean filed theory (compared to a setup with a large central counterpart (CCP)).

["Detection of False Investment Strategies Using Unsupervised Learning Methods"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3167017&partid=22912&did=383857&eid=1516014) Free Download

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Email: [mjlewis@cims.nyu.edu](mailto:mjlewis@cims.nyu.edu)

Most investment strategies uncovered by practitioners and academics are false. This partially explains the high rate of failure, especially among quantitative hedge funds (smart beta, factor investing, stat-arb, CTAs, etc.) In this paper we examine why false positives are so prevalent in finance, why researchers fail (in many cases purposely) to detect them, and why firms are able to monetize their scheme. Beyond merely pointing to this industrywide problem, we offer a practical solution. We hope that the machine learning tools presented in this paper will help financial academic journals filter out false positives, and bring up the retraction rate to reasonable levels. The SEC, FINRA and other regulatory agencies worldwide could use these tools to take a more active role in curving this rampant financial fraud.

["Information, and the Regulation of Inefficient Markets"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3172536&partid=22912&did=383857&eid=1516014" \t "_blank) Free Download   
The Political Economy of Financial Regulation, Emilios Avgouleas and David C. Donald, eds. (Cambridge University Press, 2018, Forthcoming)  
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We are at the close of an era that has treated market efficiency with something bordering on religious wonder. When securities markets are understood as environments in which rational behaviour causes prices perfectly to reflect available information, regulators should hesitate to interfere beyond ensuring the disclosure of material information. Markets become the best diviners of truth and justice. However, as generally known and here recounted, work in the areas of market microstructure, behavioural psychology and financial economics have shown that there is little efficient mystery – but much complexity – in how securities market prices are formed.   
  
This chapter of The Political Economy of Financial Regulation (forthcoming from Cambridge University Press) draws two conclusions from the waning belief in market efficiency: First, the entire market environment, particularly complex market infrastructure, should be examined for imbedded unfairness of the kind that led to the creation of the Investors Exchange (IEX). Detailed information about key market infrastructure should be disclosed. Second, the public should no longer be conditioned to share the viewpoint of market participants by daily feeds of ‘sporting event’ information, reporting ‘winners’ and ‘losers’ and ‘scores’ from the daily competition of traders. Rather, not entirely unlike public information about other activities (such as smoking) that contain hazard, information relevant to ordinary people should be made available, such as value changes in major pension funds, changes in median employee income, labour’s share of corporate profits, expected reductions of jobs or research expected from proposed mergers or takeovers, or changes in percentage of workers receiving full health care benefits at a given listed company.

["Symposium Article: The Myth of the Ideal Investor"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3165630&partid=22912&did=383837&eid=1508802) Free Download

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Email: [defontenay@law.duke.edu](mailto:defontenay@law.duke.edu)

Critiques of specific investor behavior often assume an ideal investor against which all others should be compared. This ideal investor figures prominently in the heated debates over the impact of investor time horizons on firm value. In much of the commentary, the ideal is a long-term investor that actively monitors management, but the specifics are typically left vague. That is no coincidence. The various characteristics that we might wish for in such an investor cannot peacefully coexist in practice. If the ideal investor remains illusory, which of the real-world investor types should we champion instead? The answer, I argue, is none. The corporate finance ecosystem evolves at such a rapid pace that interventions specifically designed to encourage particular types of investors are increasingly likely to be ineffective or even counterproductive: we are destined to place our bets on the wrong horse, time and again. To illustrate the difficulty, this Article briefly sketches the evolution of three types of shareholders frequently advanced as exemplars based on their time horizons: major mutual fund groups, activist hedge funds, and private equity funds. Based on their behavior to date, there is little support for policies aimed either at favoring or penalizing such investors’ participation in the capital markets generally, and corporate governance specifically.

["Business Groups and Firm-Specific Stock Returns"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3167489&partid=22912&did=383836&eid=1507808) Free Download

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In lower income economies, stocks co-move more and business groups are more prevalent. This study connects these two findings by showing that business group affiliated firms’ stock returns exhibit less firm-specific volatility than do the returns of unaffiliated firms. We use shocks to global commodity prices to hold the characteristics of shocks constant across firms. We show that commodity shocks move group affiliates’ shares significantly less than unaffiliated firms’ shares in the same industry and economy. Identification follows from difference-in-difference tests exploiting control block transactions and matching with firms subject to control block bids that failed for exogenous reasons.

[Fiduciary Duties in Financial Regulation"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3149577&partid=22912&did=383125&eid=867947) Free Download

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This chapter explores the application of fiduciary duties to regulated financial firms and financial services. At first blush, the need for such a chapter might strike some as surprising in that fiduciary duties and systems of financial regulation can be conceptualized as governing distinctive and non-overlapping spheres: Fiduciary duties police private activity through open-ended, judicially defined standards imposed on an ex post basis, whereas financial regulations set largely mandatory, ex ante obligations for regulated entities under supervisory systems established in legislation and implemented through expert administrative agencies. Yet, as we document in this chapter, fiduciary duties often do overlap with systems of financial regulation. In many regulatory contexts, fiduciary duties arise as a complement to, or sometimes substitute for, other mechanisms of financial regulation. Moreover, the interactions between fiduciary duties and systems of financial regulation generate a host of recurring and challenging interpretative issues.  
  
Our motivation in writing this chapter is to explore the reasons why fiduciary duties arise so frequently in the field of financial regulation, and then to provide a structured account of how the principles of fiduciary duties interact with the more rule-based legal requirements that characterize financial regulation. As grist for this undertaking we focus on a set of roughly two dozen judicial decisions and administrative rulings to illustrate our claims.

[Global Market Inefficiencies"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3002573&partid=22912&did=382781&eid=613151) Free Download

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We use point-in-time accounting data to estimate monthly out-of-sample fair values of over 25,000 stocks from 36 countries with a novel methodology. A simple trading strategy based on deviations from fair value yields statistically and economically significant risk-adjusted returns in most regions, especially the Asia Pacific. Differences in the signal’s monthly alphas of 40-70 basis points between emerging and developed markets contrast with findings of prior research about the relative efficiency of these two market types. Globally, pre-transaction-cost alphas, which are unrelated to known anomalies, are positively related to trading costs, but exceed country-specific institutional trading costs. Thus, global equity markets are inefficient, but are relatively less efficient in counties with quantifiable market frictions, particularly trading costs, that deter arbitrageurs.

[Forward Guidance"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3163298&partid=22912&did=382444&eid=350324) Fee Download   
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We assess the power of forward guidance—promises about future interest rates—as a monetary tool in a liquidity trap using a quantitative incomplete-markets model. Our results suggest the effects of forward guidance are negligible. A commitment to keep future nominal interest rates low for a few quarters—although macro indicators suggest otherwise—has only trivial effects on current output and employment. We explain theoretically why in complete markets models forward guidance is powerful—generating a “forward guidance puzzle”—and why this puzzle disappears in our model. We also clarify theoretically ambiguous conclusions from previous research about the effectiveness of forward guidance in incomplete and complete markets models.

["Crowdsourcing Economic Forecasts"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3160795&partid=22912&did=382444&eid=350324) Free Download

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Email: [daftamar@live.unc.edu](mailto:daftamar@live.unc.edu)

Economic forecasts are often disseminated via a survey of professionals (i.e. “Consensus”). In this paper we compare and contrast the Consensus with a crowdsourced alternative wherein anyone may submit a forecast. We focus on U.S. Nonfarm Payrolls and find that, on average, Consensus is more accurate, but the best crowdsourced forecasters are superior to the best Consensus forecasters. Moreover, Consensus tends to be more accurate over short horizons, while Crowdsourced are more accurate over longer horizons. Lastly, when the Consensus is uncertain and herds together, the Crowdsourced forecasts appears to be more accurate.

[Granularity and (Downside) Risk in Equity Markets"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3156654&partid=22912&did=382111&eid=88152) Free Download

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Email: [steve.raymond@unc.edu](mailto:steve.raymond@unc.edu)

The U.S. equities market price process is largely driven by the information set and actions of large institutional investors, not individual retail investors. Using quarterly 13-F holdings, we construct the Herfindahl-Hirschman Index (HHI) of institutional investor concentration as a measure of granularity. Our contributions are both empirical and theoretical. We provide a comprehensive study of how granularity affects: (1) the cross-section of returns, (2) conditional variances across stocks and (3) downside risk. We find that constructing a low-HHI minus high-HHI portfolio produces an annualized return of 5.6%. Using an approach advocated by Koijen and Yogo, we document that the cross-section of HHI portfolios can be explained by a conditional asset pricing model involving heterogeneous investor demands driven by time-varying beliefs over asset characteristics. We document the adverse impact that investor ownership concentration has on both conditional volatility, and critically, a robust set of downside risk measures at both the portfolio and the firm level.

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[Buy Low, Sell High? Do Private Equity Fund Managers Have Market Abilities?"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3169155&partid=22912&did=381943&eid=1819293) Free Download   
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When investors commit capital to a private equity fund, the money is not immediately invested but is called by the fund manager throughout an investment period of up to five years. This business model allows private equity fund managers to invest the committed capital at their own discretion, which gives them the flexibility to time the markets. Based on 5,366 private equity deals, which are benchmarked against around 11,000 transaction market multiples and 170,000 trading market multiples, we find evidence that on average private equity funds are able to add value by timing the markets. Throughout the holding period, private equity funds achieve on average a 0.5 EBITDA market multiple expansion. Market timing ability is not captured by performance measures such as the PME, yet it is a potential source of returns for investors.

[Long Horizon Predictability: A Cautionary Tale"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3142575&partid=22912&did=381202&eid=1049047) Free Download

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Long-horizon return regressions have effectively small sample sizes. Using overlapping long-horizon returns provides only marginal benefit. Adjustments for overlapping observations have greatly overstated t-statistics. The evidence from regressions at multiple horizons is often misinterpreted. As a result, there is much less statistical evidence of long-horizon return predictability than implied by existing research, casting doubt over claims about forecasts based on stock market valuations and factor timing.

[Hedge Fund Manager Skills and Style-Shifting"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3123660&partid=22912&did=381088&eid=961232) Free Download

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We document that a significant portion (6.8% per quarter) of hedge funds shift their investment styles. Majority style-shifting funds switch to different categories rather than to different styles in the same category. We examine two competing hypotheses: skill-driven versus style-chasing. Our empirical results are consistent with the skill-driven hypothesis. We show that style-shifting funds’ new styles significantly outperform their old styles following, but not prior to, their shifts. Moreover, style-shifting funds earn significantly positive returns in excess of their new style benchmark. As a result, style-shifting funds deliver significantly higher returns than they would have had they not shifted styles.

[The Equity Risk Premium in 2018"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3151162&partid=22912&did=380369&eid=280772) Free Download

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We analyze the history of the equity risk premium from surveys of U.S. Chief Financial Officers (CFOs) conducted every quarter from June 2000 to December 2017. The risk premium is the expected 10-year S&P 500 return relative to a 10-year U.S. Treasury bond yield. The average risk premium is 4.42% and is somewhat higher than the average observed over the past 18 years. We also provide results on the risk premium disagreement among respondents as well as asymmetry or skewness of risk premium estimates. We also link our risk premium results to survey-based measures of the weighted average cost of capital and investment hurdle rates. The hurdle rates are significantly higher than the cost of capital implied by the market risk premium estimates.

[Stress Testing Banks: Whence and Whither?"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3154350&partid=22912&did=380028&eid=23808) Free Download   
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This paper provides a brief overview of the recent practice of stress testing banking institutions, focusing on capital adequacy. We argue that stress testing has been successfully used to mitigate bank opacity; quantify systemic risk under extreme but plausible stress; keep the participants mindful of severely adverse shocks, thereby mitigating “disaster myopia” and concomitant financial instability; and improve the data collection and analytical capabilities of financial institutions. Our paper then reviews several critiques of stress testing made by policymakers and academics. We also propose several modifications of the current stress testing practice, such as the fusion of liquidity and capital adequacy stress testing, expansion of granular data availability, and explicit modeling of sectors inextricably connected to banking as well as the feedback mechanisms from these sectors. Addressing these issues is likely to keep stress testing highly relevant for promoting financial stability in the future.

[Interest Rate Caps: The Theory and the Practice"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3155971&partid=22912&did=380008&eid=11173) Free Download   
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Ceilings on lending rates remain a widely used policy tool that is intended to lower the overall cost of credit or protect consumers from exorbitant rates. Interest rate caps come in many forms and scopes and, according to their rationale, ceilings can affect a small segment or the overall market. Over the past years, many countries have introduced new or tightened existing restrictions, while only a few have removed or eased them. This paper takes stock of recent developments in interest rates caps globally and classifies them according to a novel taxonomy. The paper also presents six case studies of different types of interest rate caps. The case studies indicate that while some forms of interest rate caps can indeed reduce lending rates and help to limit predatory practices by formal lenders, interest rate caps often have substantial unintended side-effects. These side-effects include increases in non-interest fees and commissions, reduced price transparency, lower credit supply and loan approval rates for small and risky borrowers, lower number of institutions and reduced branch density, as well as adverse impacts on bank profitability. Given these potential negative consequences of interest rate caps, the paper discusses alternatives to reduce the cost of credit.

[The Theory and Practice of Corporate Risk Management: Evidence from the Field"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3143797&partid=22912&did=380011&eid=6261) Free Download

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We survey more than 1,100 risk managers from around the world on their risk management policies, goals, and perceptions. We find evidence consistent with some of the traditional theories of risk management, but not with all. We then analyze the reasons beyond “why” or “why not” firms hedge. We find that almost 90% of the risk managers in non-financial firms hedge to increase expected cash flows. We also find that 70%-80% of the risk managers say that they hedge to smooth earnings or to satisfy shareholders’ expectations. Our analysis also suggests that regulatory changes (e.g., Dodd-Frank Act of 2010) and new accounting rules put in place to increase market stability might discourage corporate hedging. Finally, we provide comprehensive evidence about hedging in the context of six forms of risk: interest rate, foreign exchange, commodity, energy, credit, and geopolitical risk. Among other things, we find that operational hedging is more common than hedging with financial contracts in all risk areas except foreign exchange.

[A New Perspective on Performance Persistence: Evidence Using Portfolio Holdings"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3151114&partid=22912&did=379521&eid=1285747) Fee Download   
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We investigate the existence and sources of performance persistence for Australian equity funds, using monthly portfolio holdings data. We find significant persistence among outperforming rather than underperforming funds, which is primarily related to security selection skill, and is associated with growth‐orientated funds. Meanwhile, the relation between persistence and momentum is secondary and nuanced. Further, persistence largely derives from existing holdings, while subsequent active trading contributes only moderately positive returns for both outperforming and underperforming funds. We also find that persistence fades beyond 6 months and vanishes after 24 months. Our findings differ from those for U.S. equity funds and previous Australian studies, implying that persistence may vary with market context and its identification may depend on data availability.

[Money Illusion in Asset Pricing"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3148311&partid=22912&did=379361&eid=1193329) Free Download

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A form of “money illusion” in financial markets may cause investors to think that news should correspond to a dollar change in price rather than a percentage change in price, leading to return underreaction for high-priced stocks and overreaction for low-priced stocks. Consistent with a simple model of money illusion, we find that total volatility, idiosyncratic volatility, and absolute market beta are significantly higher for stocks with low share prices, controlling for size. To identify a causal effect of price, we show that volatility increases sharply following stock splits and drops following reverse stock splits. The economic magnitudes are large: money illusion can explain a significant portion of the “leverage effect” puzzle, in which volatility is negatively related to past returns, as well as the volatility-size and beta-size relations in the data. We also show that money illusion biases investor reactions to news that is itself reported in nominal rather than real units. Investors react to nominal earnings per share surprises, after controlling for the earnings surprise scaled by share price. The reaction to the nominal earnings surprise reverses in the long run, consistent with correction of mispricing.

[How Skilled are Security Analysts?"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3147238&partid=22912&did=379233&eid=1007941) Free Download

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Techniques developed to control for false discoveries identify a majority of security analysts as skilled. We model the cross-section of analyst recommendation performance as a mixture of multiple skill distributions. Analysts exhibit heterogeneous skill--some are high-type, and some are low-type. On average, the recommendations of both types exhibit positive abnormal returns. The probability of being a high-type analyst is positively related to analyst tenure and negatively related to the percentage of the analyst's recommendations that are buy recommendations, consistent with the latter capturing agency problems. A majority of research firms are also identified as skilled.