**FEN OCTOBER 2017**

["Financialization in Commodity Markets"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3038778&partid=22912&did=356599&eid=536139) [FRB of Chicago Working Paper No. WP-2017-15](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/PIP_Journal.cfm?pip_jrnl=700068&partid=22912&did=356599&eid=536139), [V. V. CHARI](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=2788611&partid=22912&did=356599&eid=536139), University of Minnesota  
[LAWRENCE J. CHRISTIANO](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=54302&partid=22912&did=356599&eid=536139), Northwestern University, Federal Reserve Bank of Cleveland, Federal Reserve Bank of Chicago, Federal Reserve Bank of Minneapolis, National Bureau of Economic Research (NBER), Email: [l-christiano@northwestern.edu](mailto:l-christiano@northwestern.edu)

The financialization view is that increased trading in commodity futures markets is associated with increases in the growth rate and volatility of commodity spot prices. This view gained credence because in the 2000s trading volume increased sharply and many commodity prices rose and became more volatile. Using a large panel dataset we constructed, which includes commodities with and without futures markets, we find no empirical link between increased futures market trading and changes in price behavior. Our data sheds light on the economic role of futures markets. The conventional view is that futures markets provide one-way insurance by allowing outsiders, traders with no direct interest in a commodity, to insure insiders, traders with a direct interest. The data are not consistent with the conventional view and we argue that they point to an alternative mutual insurance view, in which all participants insure each other. We formalize this view in a model and show that it is consistent with key features of the data.

["The Bright Side of Fair Value Accounting: Evidence from Private Company Valuation"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3040396&partid=22912&did=356978&eid=859984) Free Download

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[KELVIN LAW](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=824286&partid=22912&did=356978&eid=859984), Nanyang Technological University (NTU), Email: [law.kelvin.kf@gmail.com](mailto:law.kelvin.kf@gmail.com)

Using proprietary quarterly reports from a large sample of private equity managers, we examine how fair value accounting standards influence the valuations of private companies. We find that after fair value implementation, fund managers are more likely to update the valuations of portfolio companies and lower the magnitude of upward valuation across all quarters. Valuation error is also smaller and less volatile after the implementation, especially among outperforming and mature companies. Our findings show that fair value accounting improves the quality of individual valuations to investors, even when these valuations are subjective and unverifiable.

["Reconsidering Returns"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3039507&partid=22912&did=356972&eid=854949) Free Download

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[DAVID H. SOLOMON](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=1356481&partid=22912&did=356972&eid=854949), Boston College - Carroll School of Management  
Email: [david.solomon@bc.edu](mailto:david.solomon@bc.edu)

While returns are central throughout academic finance, we show that data on returns for most assets is difficult to obtain and investors display confusion about what performance measure they are shown. Major market indices are price indices without dividend reinvestment, as they pre-date the academic consensus in favor of returns from the mid 20th century. This leads to predictable drops when their constituent stocks go ex-dividend, which markets fail to price. On index ex-days newspaper articles about financial markets are more negative, and betas on Fama-French portfolios track market price changes more than market dividends leading to predictable future market returns. Investors discontinuously reward mutual funds with inflows if they “beat the S&P 500,” by comparing the price-only index with the fund's change in net asset value (another non-return measure).

["Carry Trades and Tail Risk: Evidence from Commodity Markets"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3035453&partid=22912&did=356631&eid=556064)

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In this paper I document that carry trades in commodity markets are subject to potential large and infrequent losses, that is, tail risk. Also, I show that shocks to carry trades and volatility have persistent tail-specific effects which last from four to twelve weeks ahead. The main empirical results are consistent with existing theoretical models in which carry traders are subject to limited risk capacity and liquidity constraints. In this respect, I provide evidence that money managers, index traders, and more generally non-commercial traders, tend to unwind their net-long futures positions when exposed to deteriorating aggregate financial conditions and increasing market uncertainty. Methodologically, I make use of panel quantile regressions with non-additive fixed effects, which allow to identify the tail-specific effect of carry on the conditional distribution of commodity futures excess returns.

["Misconceptions About Nudges"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3033101&partid=22912&did=356741&eid=681459) Free Download

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Email: [csunstei@law.harvard.edu](mailto:csunstei@law.harvard.edu)

Some people believe that nudges are an insult to human agency; that nudges are based on excessive trust in government; that nudges are covert; that nudges are manipulative; that nudges exploit behavioral biases; that nudges depend on a belief that human beings are irrational; and that nudges work only at the margins and cannot accomplish much. These are misconceptions. Nudges always respect, and often promote, human agency; because nudges insist on preserving freedom of choice, they do not put excessive trust in government; nudges are generally transparent rather than covert or forms of manipulation; many nudges are educative, and even when they are not, they tend to make life simpler and more navigable; and some nudges have quite large impacts.

["How Do Banks and Households Manage Interest Rate Risk? Evidence from the Swiss Mortgage Market"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3043072&partid=22912&did=357570&eid=1290194) , [CESifo Working Paper Series No. 6649](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/PIP_Journal.cfm?pip_jrnl=254971&partid=22912&did=357570&eid=1290194)

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[CATHERINE KOCH](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=795564&partid=22912&did=357570&eid=1290194), Bank for International Settlements (BIS), Email: [catherine.koch@bis.org](mailto:catherine.koch@bis.org)

We exploit a unique data set that features both un-intermediated mortgage requests and independent offers from multiple banks for each request. We show that households typically are not prudent risk managers but prioritize the minimization of current mortgage payments over the risk of possible hikes in future mortgage payments. We also provide evidence that banks do influence the contracted mortgage rate fixation periods, trading off their own exposure to interest rate risk against the borrowers’ affordability and credit risk. Our results challenge the implicit assumption of the existing mortgage choice literature whereby fixation periods are determined entirely by households

["The Impact of Ownership Concentration and Shareholder Identity on Dividend Payout Probabilities: New Evidence from the German Stock Market"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3040884&partid=22912&did=357346&eid=1186568) , Corporate Ownership & Control / Volume 15, Issue 1.

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[JOACHIM ROJAHN](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=2589960&partid=22912&did=357346&eid=1186568), FOM University of Applied Sciences - ESSEN

Numerous studies analyze the impact of ownership concentration and shareholder identity on dividend payout probabilities. In this paper, we seek to provide additional information about the importance different ownership proxies have for dividend payments. Because the importance of those proxies varies with the classification techniques applied, we use both traditional and machine learning techniques. We examine the dividend payout behavior of German issuers, which is considered rather flexible in terms of its distribution frequencies and dividend yields compared to international practice. Our sample period covers the years 2007 to 2014. Despite considerable differences in the classification techniques applied, we find that previous years’ dividend payments, corporate profitability and firm size are consistently the most important firm-specific determinants of dividend payout probabilities. Only the largest shareholders with equity stakes that are either between 25% and 50% or above 50% rank among the most important variables. The impact is non-linear. When controlling for shareholders’ identities, we find that both financial institutional and managerial ownership are especially important. Taking the location of institutional investors into account, only foreign financial investors influence payout probabilities.

["Accrual Duration"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3043973&partid=22912&did=357848&eid=1571037) Free Download

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Accrual duration can be defined as the length of time between an accrual and its associated cash flow. This paper argues that accrual duration is a key factor in understanding the discretion in accruals. The function of accruals is to shift the recognition of associated cash flows across time, usually working in pairs of opening/closing accruals. By design, one side of the accrual pair shifts the recognition of the associated cash flow away from the period in which it occurs by recording an accrual with the same magnitude but the opposite sign in the same period. Thus, such zero-duration accruals are non-discretionary because the timing and magnitude of the associated cash flow pin down the timing and the magnitude of the concurrent accrual. The other side of the accrual pair shifts the recognition of the associated cash flow into some other time period(s), which involves using forward-looking estimates over the duration of the accrual, and therefore some discretion. In addition, accruals that have longer duration are more discretionary because longer horizons of estimation allow more discretion with respect to their timing and magnitude. Summarizing, accrual duration and accrual discretion are inextricably linked by the fundamentals o

["Financial Alchemists and Financial Shamans"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3042154&partid=22912&did=357842&eid=1565183) Forthcoming, Behavioral & Brain Sciences

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Professional money management appears to require little skill, yet its practitioners command astronomical salaries. Singh’s theory of shamanism provides one possible explanation: Financial professionals are the shamans of the global economy. They cultivate the perception of superhuman traits, maintain grueling initiation rituals, and rely on esoteric divination rituals. An anthropological view of markets can usefully supplement economic and psychological approaches.

["Diagnostic Expectations and Stock Returns"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3042437&partid=22912&did=357842&eid=1565183) Fee Download   
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We revisit La Porta’s (1996) finding that returns on stocks with the most optimistic analyst long term earnings growth forecasts are substantially lower than those for stocks with the most pessimistic forecasts. We document that this finding still holds, and present several further facts about the joint dynamics of fundamentals, expectations, and returns for these portfolios. We explain these facts using a new model of belief formation based on a portable formalization of the representativeness heuristic. In this model, analysts forecast future fundamentals from the history of earnings growth, but they over-react to news by exaggerating the probability of states that have become objectively more likely. Intuitively, fast earnings growth predicts future Googles but not as many as analysts believe. We test predictions that distinguish this mechanism from both Bayesian learning and adaptive expectations, and find supportive evidence. A calibration of the model offers a satisfactory account of the key patterns in fundamentals, expectations, and returns.

[Phase Transition in Global Financial Markets: Empirical Evidence, Risk Measure, and Portfolio Selection"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3044222&partid=22912&did=357841&eid=1560943)

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In this paper, we aim to examine the phase transition phenomenon in the financial market. To avoid specific coroperation risk, we focus on market indexes. And we found evidence to support two-phase behavior in twenty one global market indexes daily return rate data. The order parameter we use is the daily swing denoted by &#963. We separate the index data in each market into two groups based on their daily swing. If the daily swing is less than a threshold, we put the data into the 'less' group. Otherwise, the data is put into the 'large' group. We use Hartigan's Dip test to quantitatively examine whether the conditional distribution of the return rate follows a single-peak or a double-peak distribution. The empirical results show that, for the 'large' group data, there exists a threshold value σ c . For σ < σ c , the conditional distribution accepts the null hypothesis of single-peak distribution (single-peak phase). For σ < σ c , the conditional distribution rejects this hypothesis (double-peak phase). With these pieces of evidence, we believe that the phase transition phenomenon is a global phenomenon. Relevant issues and implications are also discussed. Quantitative phase transition risk measure is defined with stopping time methods. Double-peak process is modelled by a mixture of Weiner process and jump diffusion, and optimal asset allocation policy in this case depends on investors attitudes. The reference point effect can also give an explanation for some investment patterns in financial bubbles or crashes. Causes for phase transition can be group polarization, herding, and the intrinsic positive feedback nature of financial market.

["Good Banks, Bad Banks"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3044006&partid=22912&did=357836&eid=1555309)

[RICHARD CHRISTOPHER WHALEN](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=986130&partid=22912&did=357836&eid=1555309), Economic Advisory Committee of FINRA, Indiana State University - Networks Financial Institute, Association of Private Enterprise Education (APEE), National Association of Business Economists (NABE), Email: [chris@rcwhalen.com](mailto:chris@rcwhalen.com)

This paper examines the factors which contribute to banks being perceived as being “good” or “bad” in terms of their impact on the political economy and society as a whole. We first review some of the historical antecedents for public approbation against banks, then consider how changes in ownership affect bank behavior, then examine the financial performance of different sized banks, and then finally discuss the particular examples of off-balance sheet transactions and incomplete sales as indicia of cheating by “bad banks.” We conclude with a discussion of financial conflicts as prohibited by the Volcker Rule and the larger question of corruption and crony capitalism between the largest banks, elected officials and their regulators.

["The Role of Mental Accounting in Household Spending and Investing Decisions"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3051415&partid=22912&did=359310&eid=1210687)   
Forthcoming in C. Chaffin (Ed.), Client Psychology. New York: Wiley.

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This chapter reviews recent advances in the literature on mental accounting - the process by which people group expenses into categories, assign funds to these categories, determine budgets, and perform elements of cost-benefit analyses. We focus in particular on mental accounting within the context of consumer financial decision-making and highlight some of the notable work in this growing area.

[Stock Market Charts You Never Saw"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3050736&partid=22912&did=359303&eid=1202649)

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Investors have seen countless charts of US stock market performance which start in 1926 and end near the present. But US trading long predates 1926, and the foreshortened perspective that results from a focus on post-1926 data can be misleading. To compound the problem, visual and arithmetic frailties, as catalogued in behavioral finance, make it difficult for investors to draw appropriate inferences from long-term records of performance. As a partial corrective, this paper displays a novel set of charts, with some rooted in the 19th rather than the 20th century, and others ending well before the present. The goal is to challenge shibboleths about the expected outcomes of buy-and-hold stock market investing, and to raise questions about the expected performance of stocks versus bonds over long periods.

[Does Skin-In-The-Game Discipline Risk Management? Evidence from Mortgage Insurance"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3049639&partid=22912&did=358994&eid=907764) Free Download

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Many mortgage reform proposals suggest replacing Fannie Mae and Freddie Mac (the GSEs) with private entities. A common assumption underlying these proposals is that unlike the GSEs, private insurers will properly manage risk and set fair prices. Inconsistent with this assumption, this paper presents evidence that private insurers less effectively managed home price risks during the 2000-2006 housing boom than the GSEs did. Mortgage origination data reveal that the GSEs were selecting loans with increasingly higher percentages of down payments, or lower loan to value ratios (LTVs), in boom areas than in other areas. These lower LTVs in boom areas reduced the GSEs’ exposure to overheated markets. Furthermore, the decline of LTVs in boom areas stems entirely from the segment insured by the GSEs only, and none of the decline stems from the segment where private mortgage insurers take the first loss position. Private insurers also did not lower their exposure to home price risks along other dimensions, including the percentage of high LTV GSE loans they insured and the percentage of insured mortgage balance. My results highlight that post-crisis reform of the mortgage insurance industry should carefully consider additional factors besides moral hazard induced by the government guarantees, such as mortgage insurers’ future home price assumptions and the industry organization of the mortgage origination chain.

["Does the Stock Market Reflect Downward Sloping Demand Curves? Repercussions of Institutional Ownership"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3049682&partid=22912&did=358983&eid=895524) Free Download

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This paper provides evidence of the price pressure hypothesis in the aggregate, daily stock market return. Over the past decade, events that convey no new information about fundamentals, but entail large transfers of money, predict the daily stock market return. This predictability has a direct relation to institutional ownership. The rise in institutional ownership has led to a common ownership phenomenon. Common ownership is the conduit dispersing price pressure across securities. Three examinations - of dividend payouts, ETF fund flows, and merger effective dates - affirm the price pressure hypothesis and show that as institutional ownership rises, the daily stock market return becomes predictable.

["Notes on Fano Ratio and Portfolio Optimization"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3050140&partid=22912&did=358983&eid=895524" \t "_blank) , Journal of Risk & Control (Forthcoming)

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We discuss - in what is intended to be a pedagogical fashion - generalized "mean-to-risk" ratios for portfolio optimization. The Sharpe ratio is only one example of such generalized "mean-to-risk" ratios. Another example is what we term the Fano ratio (which, unlike the Sharpe ratio, is independent of the time horizon). Thus, for long-only portfolios optimizing the Fano ratio generally results in a more diversified and less skewed portfolio (compared with optimizing the Sharpe ratio). We give an explicit algorithm for such optimization. We also discuss (Fano-ratio-inspired) long-short strategies that outperform those based on optimizing the Sharpe ratio in our backtests.

["Is the Price Right? Swing Pricing and Investor Redemptions"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3051483&partid=22912&did=359572&eid=1500007)  CURIOUS, THIS SWING PRICING!  
[BIS Working Paper No. 664](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/PIP_Journal.cfm?pip_jrnl=685688&partid=22912&did=359572&eid=1500007)

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Email: [Jochen.schanz@bis.org](mailto:Jochen.schanz@bis.org), How effective are available policy tools in managing liquidity risks in the mutual fund industry? We assess one such tool - swing pricing - which allows funds to adjust their settlement price in response to large net flows. Our empirical analysis exploits the fact that swing pricing is available to Luxembourg funds, but not yet to U.S. funds. We show that swing pricing dampens outflows in reaction to weak fund performance, but has a limited effect during stress episodes. Furthermore, swing pricing supports fund returns, while raising accounting volatility, and may lead to lower cash buffers.