FEN SEPTEMBER 2017

["Is 'Being Green' Rewarded in the Market? An Empirical Investigation of Decarbonization Risk and Stock Returns"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3020304&partid=22912&did=353440&eid=1052129), International Association for Energy Economics (IAEE) Energy Forum, Special Issue 2017.

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[KI YOUNG PARK](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=1228461&partid=22912&did=353440&eid=1052129), Yonsei University, Email: kypark@yonsei.ac.kr
[ASHBY H. B. MONK](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=638380&partid=22912&did=353440&eid=1052129), Stanford University - Global Projects Center, mail: amonk@stanford.edu

While investors are increasingly prioritizing climate finance and looking for investment opportunities of “yield with impact,” they seem still reluctant. It is mainly because they need more clear understanding on the return-risk relationship related to investing for a clean energy economy. To shed more light on the market evaluation of decarbonization, this study empirically investigates the relationship among firm-level decarbonization, financial characteristics, and stock returns by analyzing 75,638 observations of 739 U.S. firms during the period of January 2005 to December 2015. The main research questions include: (1) what types of firms are more likely to take decarbonization actions; (2) whether carbon-efficient firms’ stocks are likely to outperform carbon-intensive firms’ stocks; (3) and if so, whether these excess returns on decarbonization are from a pure alpha or market compensation from bearing additional risk.

We define firm-level carbon intensity as the actual amount of greenhouse gas (GHG) divided by company revenue, construct EMI (“efficient-minus-inefficient”) portfolio based on carbon intensity, and find that EMI portfolio exhibits a large positive cumulative return from 2009. By applying multi-factor asset pricing models using factor-mimicking portfolios of market, size, value, operating profitability, investment, and momentum, we find that those well-known risk factors cannot fully explain EMI portfolio return and the estimated positive alphas of EMI portfolio amount to 7.7~8.9 percent of abnormal returns per year. In addition, estimating factor loadings on industry portfolios, we also find that EMI portfolio has explanatory power that is independent from well-known risk factors. We discuss how carbon intensity is related to other firm-level characteristics concerning corporate governance and financial performance, along with implications for climate finance in the viewpoints of investors, firms and policymakers.

["Financial Reporting Fraud and Other Forms of Misconduct: A Multidisciplinary Review of the Literature"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3021055&partid=22912&did=353548&eid=1110953) [Review of Accounting Studies, Forthcoming](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/PIP_Journal.cfm?pip_jrnl=85410&partid=22912&did=353548&eid=1110953).

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[ZAHN BOZANIC](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=845590&partid=22912&did=353548&eid=1110953), Ohio State University (OSU) - Fisher College of Business,  bozanic.1@osu.edu
[JAMES D. COX](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=46082&partid=22912&did=353548&eid=1110953), Duke University School of Law, Email: JDC@FACULTY.LAW.DUKE.EDU
[QUENTIN DUPONT](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=2583171&partid=22912&did=353548&eid=1110953), University of Washington - Michael G. Foster School of Business
Email: dupontq@uw.edu
[JONATHAN M. KARPOFF](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=17129&partid=22912&did=353548&eid=1110953), University of Washington - Michael G. Foster School of Business
Email: karpoff@u.washington.edu
[RICHARD G. SLOAN](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=17494&partid=22912&did=353548&eid=1110953), University of California, Berkeley - Accounting Group, University of Southern California - Leventhal School of Accounting, Email: sloanr@marshall.usc.edu

Financial reporting fraud and other forms of financial reporting misconduct are a significant threat to the existence and efficiency of capital markets. This study reviews the literature on financial reporting misconduct from the perspectives of law, accounting, and finance. Our goals are to establish a common language for researchers interested in this line of research, describe the main findings and challenges in these literatures, and provide directions for future research. Although research on financial reporting misconduct faces certain challenges, those challenges provide significant opportunities for future research to advance the literature as the answers to many questions on financial reporting misconduct remain unsettled.

["The Ambivalent Role of High-Frequency Trading in Turbulent Market Periods"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3020142&partid=22912&did=353532&eid=1096092) 

[NIKOLAUS HAUTSCH](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=289624&partid=22912&did=353532&eid=1096092), University of Vienna - Department of Statistics and Operations Research, Center for Financial Studies (CFS), Email: nikolaus.hautsch@univie.ac.at
[MICHAEL NOÉ](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=2768535&partid=22912&did=353532&eid=1096092), Eurex Frankfurt AG - Derivatives Market Design, Humboldt University of Berlin - School of Business and Economics, Email: michael-noe@web.de
[S. SARAH ZHANG](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=998860&partid=22912&did=353532&eid=1096092), University of Manchester - Manchester Business School, Email: s.sarahzhang@gmail.com

We show an ambivalent role of high-frequency traders (HFTs) in the Eurex Bund Futures market around high-impact macroeconomic announcements and extreme events. Around macroeconomic announcements, HFTs serve as market makers, post competitive spreads, and earn most of their profits through liquidity supply. Right before the announcement, however, HFTs significantly widen spreads and cause a rapid but short-lived drying-out of liquidity. In turbulent periods, such as after the U.K. Brexit announcement, HFTs shift their focus from market making activities to aggressive (but not necessarily profitable) directional strategies. Then, HFT activity becomes dominant and market quality can degrade.

["The Smart Money Effect Revisited: Is There a 'Smart Money' Effect During Recessions?"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3021552&partid=22912&did=353531&eid=1093204) 

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[TARIQ H. HAQUE](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=1015081&partid=22912&did=353531&eid=1093204), University of Adelaide, Financial Research Network (FIRN), Email: tariq.haque@adelaide.edu.au
[SHAN LI](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=2324722&partid=22912&did=353531&eid=1093204), Xiamen University - Institute for Financial and Accounting Studies, Email: lishan0915@163.com

Moskowitz (2000) and Glode (2011), among others, document that US mutual funds achieve higher alphas in recessions compared to non-recessions. Kacpercyk et al (2014) provide a different result that those US funds that perform well in recessions also perform well in non-recessions. We show that the smart money algorithm can be used to identify these funds, particularly small funds, and that the expenses they charge are not too high. This simple algorithm, based on past flows is consistent with Berk and Green (2004) and Berk and Binsbergen (2015) in that flows are indicative of managerial skill and that in equilibrium, after-expense alphas should be equal to zero.

["The Rise of Automated Investment Advice: Can Robo-Advisers Rescue the Retail Market?"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3019548&partid=22912&did=353343&eid=980453) 
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[BENJAMIN P. EDWARDS](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=2113043&partid=22912&did=353343&eid=980453), University of Nevada, William S. Boyd School of Law
Email: ben.edwards@caa.columbia.edu

Different types of financial advisers serve the massive and widely dispersed retail investment market. In a market riddled with conflicts of interests, many advisers exploit retail customers by pitching suboptimal products, leading to lower investment returns and lower overall growth — but also to greater profits for the financial advisers collecting kickback-style commissions. New financial technology firms, commonly known as Robo-Advisers, may disrupt this market and these exploitative practices. Still, these potentially disruptive automated investment advice firms face significant regulatory risks.

["Corporate Environmental Policy and Shareholder Value: Following the Smart Money"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3025194&partid=22912&did=354151&eid=132149) 
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[CHITRU S. FERNANDO](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=21888&partid=22912&did=354151&eid=132149), University of Oklahoma - Michael F. Price College of Business
Email: cfernando@ou.edu
[MARK SHARFMAN](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=768297&partid=22912&did=354151&eid=132149), University of Oklahoma - Michael F. Price College of Business
Email: msharfman@ou.edu
[VAHAP BÜLENT UYSAL](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=565574&partid=22912&did=354151&eid=132149), University of Oklahoma, Email: uysal@ou.edu

We examine the value consequences of corporate social responsibility through the lens of institutional shareholders. We find a sharp asymmetry between corporate policies that mitigate the firm’s exposure to environmental risk and those that enhance its perceived environmental friendliness (“greenness”). Institutional investors shun stocks with high environmental risk exposure, which we show have lower valuations as predicted by risk management theory. These findings suggest that corporate environmental policies that mitigate environmental risk exposure create shareholder value. In contrast, firms that increase greenness do not create shareholder value and are also shunned by institutional investors.

["The Economics of Distributed Ledger Technology for Securities Settlement"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3023779&partid=22912&did=354145&eid=122708) 

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Email: GARRATT@ECON.UCSB.EDU
[PEDRO GURROLA-PEREZ](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=2747703&partid=22912&did=354145&eid=122708), Bank of England, Email: Pedro.Gurrola-Perez@bankofengland.gsi.gov.uk

Distributed ledger technology (DLT) is a database architecture which enables the keeping and sharing of records in a distributed and decentralized way, while ensuring its integrity through the use of consensus-based validation protocols and cryptographic signatures. In principle, DLT has the potential to reduce costs and increase the efficiency of securities settlement, the ultimate step of every security transaction. In this paper, we first examine to what extent DLT could add value and change securities settlement. We then characterize the innovation process in the post-trade industry and finally, we describe the economics of a hypothetical DLT-based security settlement industry.

Our main conclusions are that:

i) DLT has the potential to improve efficiency and reduce costs in securities settlement, but the technology is still evolving and it is uncertain at this point what form, if any, a DLT-based solution for securities settlement will ultimately take,

ii) technological innovation in the post-trade industry is more likely to achieve its potential with some degree of co-ordination which could be facilitated by the relevant authorities, and

iii) if DLT-based securities settlement becomes a reality, then it is likely to be concentrated among few providers which, in the absence of regulation, could result in inefficient monopoly pricing or efficient price discrimination with service providers capturing much of the market surplus.

[The Beta Neutral Model with Leverage Effect"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3026031&partid=22912&did=354145&eid=122708) 

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Email: sebastien.valeyre@jl-investments.com
[DENIS GREBENKOV](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=1879524&partid=22912&did=354145&eid=122708), CNRS, Ecole Polytechnique, PMC, PMC, CNRS - Ecole Polytechnique
Email: denis.grebenkov@polytechnique.edu
[SOFIANE ABOURA](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=101097&partid=22912&did=354145&eid=122708), Université Paris XIII Nord - Department of Economics and Management
Email: sofiane.aboura@univ-paris13.fr

We present a beta neutral model that includes the leverage effect to allow hedge fund managers to target a near-zero beta for market neutral strategies. For this purpose, we derive a metric of correlation with leverage effect to identify the fine relation between the market beta and volatility changes. An empirical test based on the most popular market neutral strategies is run from 2000 to 2015 with exhaustive data sets including 600 American stocks and 600 European stocks from the S&P 500, Nasdaq 100, and Euro Stoxx 600. Our findings confirm the ability of the beta neutral model to withdraw an important part of the bias from the market neutral strategies.

["The Failure of a Clearinghouse: Empirical Evidence"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3027943&partid=22912&did=353976&eid=1403131) , [Banque de France WP # 638](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/PIP_Journal.cfm?pip_jrnl=1576683&partid=22912&did=353976&eid=1403131)

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[GUILLAUME VUILLEMEY](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=2427358&partid=22912&did=353976&eid=1403131), HEC Paris, Email: vuillemey@hec.fr

We provide the first detailed empirical analysis of the failure of a derivatives clearinghouse: the Caisse de Liquidation, which defaulted in Paris in 1974. Using archival data, we find three main causes of the failure: (i) a weak pool of investors, (ii) the inability to contain the growth of a large member position, and (iii) risk-shifting decisions by the clearinghouse. Risk-shifting incentives aligned the clearinghouse’s interests with those of the defaulting member, induced delays in the liquidation of the defaulted position, and led private renegotiation attempts to fail. Our results have implications for the design of clearing institutions.

["The Road to Repeal of the Glass-Steagall Act"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3026287&partid=22912&did=353976&eid=1403131) Wake Forest Journal of Business and Intellectual Property Law (Forthcoming), [GWU Law School Public Law Research Paper No. 2017-61](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/PIP_Journal.cfm?pip_jrnl=213982&partid=22912&did=353976&eid=1403131)
[GWU Legal Studies Research Paper No. 2017-61](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/PIP_Journal.cfm?pip_jrnl=615826&partid=22912&did=353976&eid=1403131)

[ARTHUR E. WILMARTH](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=292185&partid=22912&did=353976&eid=1403131), George Washington University Law School, awilmarth@law.gwu.edu

The financial crisis of 2007-2009 caused the most severe global economic downturn since the Great Depression. The recent crisis has generated renewed interest in the Glass-Steagall Banking Act of 1933, which Congress adopted in response to the collapse of the U.S. banking system and the freezing of U.S. capital markets during the Great Depression. Glass-Steagall was designed to stabilize the U.S. financial system by separating commercial banks from the capital markets and by prohibiting nonbanks from accepting deposits.

Since the financial crisis, scholars have debated the question of whether the removal of Glass-Steagall's structural barriers during the 1980s and 1990s played a significant role in promoting the destructive credit bubble that led to the financial crisis. Some authors have argued that Glass-Steagall's demise was an important factor that helped to fuel the financial crisis, while others have contended that Glass-Steagall's disappearance did not contribute to the crisis in any significant way. This article sheds further light on that debate by describing Glass-Steagall's positive impact on the stability of the U.S. financial system from World War II through the 1970s as well as the adverse consequences of Glass-Steagall's disappearance.

As explained in Part I.A, the Glass-Steagall Act and the Bank Holding Company Act of 1956 (BHCA) helped to maintain the stability of the banking industry and capital markets from World War II through the 1970s. Domestic and international developments began to challenge the post-New Deal system of financial regulation in the 1970s. However, the structural barriers established by Glass-Steagall and BHCA maintained a significant degree of separation between commercial banks and other financial sectors until Congress removed those barriers in 1999. Glass-Steagall and BHCA limited the risks of contagion across the banking, securities, and insurance industries, thereby helping to ensure that problems arising in one sector would not spill over into the other sectors.

As discussed in Part I.B, large banks and nonbank financial institutions opened loopholes in Glass-Steagall and BHCA after 1980 by persuading federal regulators to approve limited exceptions to their structural prohibitions. Part I.B highlights three of the most important ways in which federal agencies undermined Glass-Steagall and BHCA. First, nonbank financial institutions were allowed to fund their operations by offering short-term financial instruments that were redeemable at par and served as functional substitutes for deposits, including money market mutual funds, commercial paper, and securities repurchase agreements. The largest commercial banks also began to rely significantly on "shadow bank deposits" after they were allowed to establish securities affiliates beginning in 1987. Second, banks received permission to convert their consumer and commercial loans into asset-backed securities through the process of securitization. Third, banks were permitted to develop over-the-counter (OTC) derivatives, which provided synthetic substitutes for securities, exchange-traded options and futures, and insurance. Shadow bank deposits, securitization, and OTC derivatives weakened Glass-Steagall and BHCA and became catalysts for the toxic credit bubble that led to the financial crisis of 2007-2009.

As described in Part II, big banks were not satisfied with the limited victories they achieved by opening loopholes in Glass-Steagall and BHCA. The big-bank lobby pursued a long campaign to repeal Glass-Steagall's and BHCA's provisions that restricted banks from expanding across state lines and prevented banks from establishing full-scale affiliations with securities firms and insurance companies. Congress authorized nationwide banking and branching by enacting the Riegle-Neal Act in 1994. Ambitious bank executives created giant megabanks, which sought to expand their reach into the securities and insurance sectors. When securities firms and insurance companies realized that they could no longer stop product-line expansion by large banks, both sectors abandoned their longstanding defense of Glass-Steagall's and BHCA's structural barriers.

In 1998, the Federal Reserve Board approved a merger between Travelers, a large insurance and securities conglomerate, and Citicorp, the largest U.S. bank. That merger created Citigroup, the first "universal bank" to operate in the United States since the 1930s. The merger relied on a temporary loophole in the BHCA, and it placed great pressure on Congress to repeal Glass-Steagall's and BHCA's anti-affiliation rules.

Citigroup and other large financial institutions launched a massive lobbying campaign that finally persuaded Congress to adopt the Gramm-Leach-Bliley Act (GLBA) in 1999. GLBA authorized the creation of financial holding companies, which could own banks, securities firms, and insurance companies, thereby confirming the legality of Citigroup's universal banking strategy. The twenty-year campaign by big banks to destroy the barriers separating them from the capital markets culminated in the Commodity Futures Modernization Act (CFMA) in 2000. CFMA authorized large financial institutions to offer a complex array of OTC derivatives without any substantive regulation by federal or state authorities.

GLBA and CFMA ratified and significantly expanded the deregulatory measures that federal authorities had implemented on an incremental, piecemeal basis during the 1980s and 1990s. By providing legal certainty for those measures and by expanding their scope, Congress established a new regime of regulatory laxity that enabled giant financial conglomerates to operate with relatively few constraints.

This article contends that Riegle-Neal, GLBA, and CFMA were highly consequential laws because they (i) allowed large banks to become much bigger and more complex, and to undertake a much wider array of high-risk activities, and (ii) permitted securities firms and insurance companies to offer bank-like products (including deposit substitutes), all of which helped to fuel the catastrophic credit boom of the early 2000s. I therefore disagree with commentators who argue that those laws did not have any significant connection to the financial crisis.

This article does not include detailed reforms to address the unstable and crisis-prone financial system created by Riegle-Neal, GLBA, and CFMA. I have discussed possible reforms in previous work, and I will develop a more detailed set of potential reforms in future work. At a minimum, those reforms should accomplish two goals. First, they should shrink the shadow banking system -- and reduce the threat of "runs" by creditors in that system -- by prohibiting nonbanks from offering short-term debt instruments that are payable at par and function as substitutes for bank deposits. Second, they should establish a regime of strict separation between FDIC-insured banks and the capital markets, and they should prohibit FDIC-insured banks from entering into derivatives, except for bona fide hedges against risk exposures arising out of traditional banking activities

[The Financial Stability Dark Side of Monetary Policy, "](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3026025&partid=22912&did=353943&eid=1377912) [Bank of Italy Temi di Discussione (Working Paper) No. 1121](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/PIP_Journal.cfm?pip_jrnl=892909&partid=22912&did=353943&eid=1377912)

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[ANTONIO MARIA CONTI](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=1477906&partid=22912&did=353943&eid=1377912), Bank of Italy, Email: antoniomaria.conti@bancaditalia.it
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Since monetary policy affects risk premiums, and these appear to have a stronger influence on economic activity when they rise than when they fall, temporary monetary expansions may both stimulate the economy and sow the seeds of damaging financial market corrections in the future. We investigate this possibility by using local projection methods to examine the propagation of monetary shocks through US corporate bond markets. We find that, while the transmission of monetary shocks is symmetric, the impact of macroeconomic data releases is asymmetric: spreads are more responsive to bad news. Crucially, these responses precede economic slowdowns rather than directly cause them.

[Short and Long Run Uncertainty"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3027828&partid=22912&did=354538&eid=509892) [NBER Working Paper No. w23676](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/PIP_Journal.cfm?pip_jrnl=209249&partid=22912&did=354538&eid=509892)

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[IAN J. WRIGHT](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=1123703&partid=22912&did=354538&eid=509892), Goldman Sachs, Email: wright.ianj@gmail.com

Uncertainty appears to have both a short-run and a long-run component, which we measure using firm and macro implied volatility data from options of 30 days to 10 years duration. We ask what may be driving uncertainty over these different time horizons, finding that oil price volatility is particularly important for short-run uncertainty, policy uncertainty is particularly important for long-run uncertainty, while currency volatility and CEO turnover appear to equally impact short- and long-run uncertainty. Examining a panel of over 4,000 firms from 1996 to 2013 we find that R&D is relatively more sensitive to long-run uncertainty than investment, and in turn investment is relatively more sensitive to long-run uncertainty than hiring. In a simulation model we investigate the channels underlying this pecking-order response to long-run uncertainty, and show that lower depreciation rates and higher adjustment costs lead R&D and investment to be more sensitive to longer-run uncertainty than hiring. Collectively, these results suggest that recent events that have raised long-run policy uncertainty may be particularly damaging to growth by reducing R&D and investment.

[Regulating Fintech"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3027525&partid=22912&did=354525&eid=475356) [Vanderbilt Law Review, Forthcoming](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/PIP_Journal.cfm?pip_jrnl=81465&partid=22912&did=354525&eid=475356)

[WILLIAM J. MAGNUSON](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=1207170&partid=22912&did=354525&eid=475356), Texas A&M University School of Law, magnuson@tamu.edu

The financial crisis of 2008 has led to dramatic changes in the way that finance is regulated: the Dodd-Frank Act imposed broad and systemic regulation on the industry on a level not seen since the New Deal. But the financial regulatory reforms enacted since the crisis have been premised on an outdated idea of what financial services look like and how they are provided. Regulation has failed to take into account the rise of financial technology (or “fintech”) firms and the fundamental changes they have ushered in on a variety of fronts, from the way that banking works, to the way that capital is raised, even to the very form of money itself. These changes call for a wide-ranging reconceptualization of financial regulation in an era of technology-enabled finance. In particular, this Article argues that regulators’ focus on preventing the risks associated with “too big to fail” institutions overlooks the conceptually distinct risks associated with small, decentralized financial markets. In many ways, these risks can be greater than those presented by large institutions because decentralized fintech markets are more vulnerable to adverse economic shocks, are less transparent to regulators, and are more likely to encourage excessively risky behavior by market participants. The Article concludes by sketching out a variety of regulatory responses that better correspond to fintech’s particular risks and rewards.

[The Dynamics of Financially Constrained Arbitrage"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3023633&partid=22912&did=354168&eid=140704) [Journal of Finance, Forthcoming](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/PIP_Journal.cfm?pip_jrnl=306181&partid=22912&did=354168&eid=140704)

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[DIMITRI VAYANOS](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=15722&partid=22912&did=354168&eid=140704), London School of Economics, Center for Economic Policy Research (CEPR), National Bureau of Economic Research (NBER), Email: d.vayanos@lse.ac.uk

We develop a model in which financially constrained arbitrageurs exploit price discrepancies across segmented markets. We show that the dynamics of arbitrage capital are self-correcting: following a shock that depletes capital, returns increase, and this allows capital to be gradually replenished. Spreads increase more for trades with volatile fundamentals or more time to convergence. Arbitrageurs cut their positions more in those trades, except when volatility concerns the hedgeable component. Financial constraints yield a positive cross-sectional relationship between spreads/returns and betas with respect to arbitrage capital. Diversification of arbitrageurs across markets induces contagion, but generally lowers arbitrageurs' risk and price volatility.

["Remove the Core"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2987954&partid=22912&did=354706&eid=641669) [Brandes Institute Research Paper No. 2017-03](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/PIP_Journal.cfm?pip_jrnl=1130021&partid=22912&did=354706&eid=641669" \t "_blank)

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Consultants at Cambridge Associates have shown how to build what they believe is a better "core-satellite" portfolio. Get rid of the passive core component (such as an S&P 500 Index fund) completely and load up on the satellites. The team compared hypothetical core-satellite portfolios with hypothetical "donut" portfolios, which lacked the core component.
"...over sufficient time periods, not only were the median and higher-end outcomes better for the donut portfolio, but the lowest percentile performance was similar to the core-satellite portfolios," said Cambridge Managing Director Hamilton Lee. "And these results are net of fees."

If you are employing this structure, it's important not to look at individual manager performance, but at the composite level -- and to look at it over a longer time frame, not shorter time frames.

"It's interesting that among proponents of passive management I have gotten less pushback than I expected," said Cambridge Managing Director Jackie Williams. "The results are compelling."

["Predicting Stock Market Returns with an Accounting Factor"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3029049&partid=22912&did=355083&eid=962341)

[LOUIS YANG](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=2435457&partid=22912&did=355083&eid=962341), University of Southern California - Marshall School of Business - Finance and Business Economics Department, Email: louis.yang.2020@marshall.usc.edu

A predictive factor constructed from aggregate accounting variables robustly predicts month-ahead stock market returns. The factor obtains out-of-sample R-squared statistics of up to 3.05% and the predictive performance is economically large with mean-variance investors being willing to pay an annual fee of up to 6.81% for access to its forecasts. Furthermore, its predictive ability is higher for short-term returns and it is distinct from other predictors in the forecasting literature. Using Google search volume of stock tickers, we demonstrate that the predictive power stems from slow information diffusion due to investor inattention.

["Does Portfolio Concentration Affect Performance? Evidence from Corporate Bond Mutual Funds"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3031735&partid=22912&did=355082&eid=958716)

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[YING WANG](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=1125398&partid=22912&did=355082&eid=958716), SUNY Albany - School of Business, Email: ywang@uamail.albany.edu

This paper examines the relation between portfolio concentration and investment performance in corporate bond mutual funds. We find that portfolio concentration, measured at the firm, industry, credit rating levels, is significantly positively related to expected fund performance. This positive relation is stronger among more illiquid funds and funds with better past performance, potentially reflecting concentrated corporate bond funds’ successful exploitation of superior information. Further, investors appear to take into account portfolio concentration in making investment decisions. Overall, our findings are consistent with concentrated investment in corporate bond markets reflecting information advantage.

["Short Selling and Attention Around the Business Cycle"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3028839&partid=22912&did=354908&eid=829929)

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[ERIC K. KELLEY](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=337480&partid=22912&did=354908&eid=829929), University of Tennessee, Email: ekk@utk.edu

We show that firm-level short interest predicts negative returns for individual stocks during economic expansions, while aggregate short interest predicts negative market returns during recessions. Viewing short sellers as informed traders, these findings are consistent with Kacperczyk, Van Nieuwerburgh, and Veldkamp’s (2016) model in which rational yet cognitively constrained traders optimally allocate attention among firm-specific and systematic signals. In their model, traders collect aggregate (firm-specific) information in recessions (expansions) because these times are marked by higher (lower) aggregate volatility and price of risk.

["Fintech and Financial Innovation: Drivers and Depth"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3029731&partid=22912&did=354834&eid=771562) [FEDS Working Paper No. 2017-081](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/PIP_Journal.cfm?pip_jrnl=668605&partid=22912&did=354834&eid=771562)

[JOHN W. SCHINDLER](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=287051&partid=22912&did=354834&eid=771562), Board of Governors of the Federal Reserve System
Email: JOHN.W.SCHINDLER@FRB.GOV

This paper answers two questions that help those analyzing FinTech understand its origins, growth, and potential to affect financial stability. First, it answers the question of why "FinTech" is happening right now. Many of the technologies that support FinTech innovations are not new, but financial institutions and entrepreneurs are only now applying them to financial products and services. Analysis of the supply and demand factors that drive "traditional" financial innovation reveals a confluence of factors driving a large quantity of innovation. Second, this paper answers the question of why FinTech is getting so much more attention than traditional innovation normally does. The answer to this question has to do with the 'depth' of innovation, a concept introduced in this paper. The deeper an innovation, the greater the ability of that innovation to transform financial services. The paper shows that many FinTech innovations are deep innovations and hence have a greater potential to change financial services. A greater potential to transform can also lead to a greater chance of affecting financial stability.

["Climate Change and Long-Run Discount Rates: Evidence from Real Estate"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2639748&partid=22912&did=355325&eid=1267719)
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[JOHANNES STROEBEL](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=1234933&partid=22912&did=355325&eid=1267719), New York University (NYU), National Bureau of Economic Research (NBER), Centre for Economic Policy Research (CEPR), johannes.stroebel@nyu.edu
[ANDREAS WEBER](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=2431201&partid=22912&did=355325&eid=1267719), New York University (NYU) - Leonard N. Stern School of Business
Email: aweber@stern.nyu.edu

The optimal investment to mitigate climate change crucially depends on the discount rate used to evaluate the investment’s uncertain future benefits. The appropriate discount rate is a function of the horizon over which these benefits accrue and the riskiness of the investment. In this paper, we estimate the term structure of discount rates for an important risky asset class, real estate, up to the very long horizons relevant for investments in climate change abatement. We show that this term structure is steeply downward-sloping, reaching 2.6% at horizons beyond 100 years. We explore the implications of these new data within both a general asset pricing framework that decomposes risks and returns by horizon and a structural model calibrated to match a variety of asset classes. Our analysis demonstrates that applying average rates of return that are observed for traded assets to investments in climate change abatement is misleading. We also show that the discount rates for investments in climate change abatement that reduce aggregate risk, as in disaster risk models, are bounded above by our estimated term structure for risky housing, and should be below 2.6% for long-run benefits. This upper bound rules out many discount rates suggested in the literature and used by policy makers. Our framework also distinguishes between the various mechanisms the environmental literature has proposed for generating downward-sloping discount rates.

["The Decision to Concentrate: Active Management, Manager Skill, and Portfolio Size"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3032200&partid=22912&did=355432&eid=1348133) 

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Several recent studies establish that more highly concentrated portfolios produce superior risk-adjusted returns. The untested premise of this literature is that it is the most skillful managers who hold the most concentrated portfolios. In this study, we formally examine the implicit assertion that the initial portfolio concentration decision is meaningfully related to a manager’s inherent investment skill. First, we present a simple theoretical model showing that the greater the manager’s skill level, the more concentrated the portfolio should be. Second, we conduct an extensive simulation analysis of the capacity to make accurate ex ante security return forecasts and show that skilled managers would select only about 3-20% of the available securities and that the portfolio concentration decision is directly proportional to investment prowess. Finally, we provide an empirical examination of the actual skill-concentration relationship for actively managed U.S. equity funds over 2002-2015, documenting that managers who demonstrated skill in the past do form portfolios with higher concentration levels. We conclude that talented asset managers should and actually do hold more concentrated portfolios and that the extent of this concentration decision is meaningfully related to forecasting skill.

["Financial Globalization: A Glass Half Empty?"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3036711&partid=22912&did=355526&eid=1398692)
[World Bank Policy Research Working Paper No. 8194](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/PIP_Journal.cfm?pip_jrnl=561341&partid=22912&did=355526&eid=1398692)

[SERGIO L. SCHMUKLER](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=50352&partid=22912&did=355526&eid=1398692), World Bank - Development Research Group (DECRG)
Email: sschmukler@worldbank.org
[FACUNDO ABRAHAM](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=1382945&partid=22912&did=355526&eid=1398692), *affiliation not provided to SSRN*

Since the 1970s, the world has embarked on a new financial globalization era. Cross-country capital flows have significantly increased in developed and developing countries. However, the characteristics of financial globalization differ from what was originally expected. Various examples illustrate this point. Although the literature predicted large gains from financial globalization (such as additional funding, broad diversification, and deeper financial systems), the positive effects have been more limited. In developed and developing countries, financial globalization has manifested in increasing gross capital flows (inflows and outflows) rather than larger net flows. Capital markets are segmented and only a few large firms access international markets. International institutional investors do not seem to have played a stabilizing role, helping to exacerbate and transmit crises across countries. Although financial globalization has brought several beneficial changes, its net effects and spillovers to the overall economies participating in it have yet to be understood.

["Forecasting the Distribution of Option Returns"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3033242&partid=22912&did=355688&eid=1540861)

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[BRYAN T. KELLY](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=759326&partid=22912&did=355688&eid=1540861), University of Chicago - Finance, National Bureau of Economic Research (NBER), bryan.kelly@chicagobooth.edu

We propose a method for constructing conditional option return distributions. In our model, uncertainty about the future option return has two sources: Changes in the position and shape of the implied volatility surface that shift option values (holding moneyness and maturity fixed), and changes in the underlying price which alter an option's location on the surface and thus its value (holding the surface fixed). We estimate a joint time series model of the spot price and volatility surface and use this to construct an ex ante characterization of the option return distribution via bootstrap. Our "ORB" (option return bootstrap) model accurately forecasts means, variances, and extreme quantiles of S&P 500 index conditional option return distributions across a wide range of strikes and maturities. We illustrate the value of our approach for practical economic problems such as risk management and portfolio choice. We also use the model to illustrate the risk and return tradeoff throughout the options surface conditional on being in a high or low risk state of the world. Comparing against our less structured but more accurate model predictions helps identify misspecification of risks and risk pricing in traditional no-arbitrage option models with stochastic volatility and jumps.

["What Influences Trader Decision to Add or Remove Liquidity?"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3037319&partid=22912&did=356497&eid=466293)

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[TAO HUANG](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=1746699&partid=22912&did=356497&eid=466293), Xi’an Jiaotong Liverpool University, Email: tao.huang@xjtlu.edu.cn
[FEI WU](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=681265&partid=22912&did=356497&eid=466293), Shanghai Jiao Tong University (SJTU) - Shanghai Advanced Institute of Finance (SAIF), Email: fwu@saif.sjtu.edu.cn

We examine determinants of U.S. equity trader decision to add or remove liquidity in electronic markets. Those who add liquidity more are slower, larger-size traders who exhibit smaller price impact and concentrate their trading in fewer markets. At order submission time, when the bid-ask spread is narrower, quoted depth is thinner, and market volatility (volume) is lower, traders are more likely to remove liquidity. Trading costs differ between orders and implicit and explicit costs are negatively (positively) related for orders that add (remove) liquidity. Overall, our findings indicate trader characteristics, market conditions, and trading cost dimensions influence order type decisions.

["Harmful Diversification: Evidence from Alternative Investments"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2911212&partid=22912&did=356496&eid=465225) 

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Email: a.sakkas@soton.ac.uk
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Alternative assets have become as important as equities and fixed income in the portfolios of major investors, and so their diversification properties are also important. However, adding five alternative assets (real estate, commodities, hedge funds, emerging markets and private equity) to equity and bond portfolios is shown to be harmful for US investors. We use 19 portfolio models, in conjunction with dummy variable regression, to demonstrate this harm over the 1997-2015 period. This finding is robust to different estimation periods, risk aversion levels, and the use of two regimes. Harmful diversification into alternatives is not primarily due to transactions costs or non-normality, but to estimation risk. This is larger for alternative assets, particularly during the credit crisis which accounts for the harmful diversification of real estate, private equity and emerging markets. Diversification into commodities, and to a lesser extent hedge funds, remains harmful even when the credit crisis is excluded.

["The Use of Asset Growth in Empirical Asset Pricing Models"](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3026534&partid=22912&did=356496&eid=465225) 

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[HUSEYIN GULEN](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=269069&partid=22912&did=356496&eid=465225), Purdue University, hgulen@purdue.edu
[MIHAI ION](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=1945305&partid=22912&did=356496&eid=465225), University of Arizona, mihaiion@email.arizona.edu

We highlight an important inconsistency between the theoretical motivation and the empirical implementation of the investment factors in Hou, Xue, and Zhang (2015) and Fama and French (2015). We show that correcting for this inconsistency renders the new four and five-factor models much less effective in explaining the cross-section of returns. Specifically, we call attention to the fact that the investment factors used in the empirical tests of both Hou, Xue, and Zhang (2015) and Fama and French (2015) are not, in fact, traditional investment measures (such as measures based on capital expenditures and PPE growth) as one might expect from the theoretical arguments used in the two papers to motivate the inclusion of an investment factor. Instead, these papers both use the “asset growth” measure (i.e., the year-on-year percentage change in total assets) from Cooper, Gulen, and Schill (2008). We perform tests to determine how well these new models perform when using theory implied investment factors instead of an asset growth factor. For both models, there are large decreases in their ability to price the cross-section of returns.

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[JONATHAN L. ROGERS](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=108522&partid=22912&did=356268&eid=273666), University of Colorado at Boulder, jonathan.rogers@colorado.edu
[DOUGLAS J. SKINNER](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=16759&partid=22912&did=356268&eid=273666), The University of Chicago , dskinner@chicagobooth.edu
[SARAH L. C. ZECHMAN](https://hq.ssrn.com/Journals/RedirectClick.cfm?url=https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=362692&partid=22912&did=356268&eid=273666), University of Colorado at Boulder, sarah.zechman@colorado.edu

We describe the process through which the Securities and Exchange Commission (SEC) makes filings “publicly available.” For a sample of Form 4 (insider trade) filings, we show that, during the period we examine, the majority of filings are available to paying subscribers of the SEC's public dissemination system (PDS) feed before they are posted to the EDGAR website, and so provide subscribers and their clients with a private advantage. We show that this advantage translates into an economically significant trading advantage, and prices, volumes, and spreads respond to the news contained in filings beginning around 30 seconds before public posting. These findings indicate that the SEC dissemination process does not always provide a level playing field and that the meaning of publicly available information in capital markets is no longer simple or obvious. In response to our study, the SEC launched an investigation and agreed to eliminate the PDS timing advantage.