

19th SGF CONFERENCE

Swiss Society for Financial Market Research

APRIL 8, 2016
SIX ConventionPoint
Zurich

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*Publishers of
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EDITORIAL

Dear Participants of the SGF Conference 2016,

We would like to warmly welcome you at the 19th Annual Conference of the Swiss Society for Financial Market Research in the heart of the beautiful city of Zurich. As it has become tradition over the past few years, SIX is our main sponsor and acts as our formidable host. We would thus like to express our sincerest thanks to SIX for supporting this event by providing the wonderful ConventionPoint conference center as well as for donating the SIX Best Paper Award 2016 which carries a cash prize of 4000 CHF. Our special thanks go to Dr. Stefan Mäder who made all of this possible.

As every year, a special highlight of the SGF Conference is the keynote speech. We are very happy to announce Professor Dr. Erwin Heri as our distinguished keynote speaker. He is Professor of Financial Theory at the University of Basel and Swiss Finance Institute (SFI) Adjunct Professor. His speech will address the topic of financial literacy and present a project to improve financial literacy of the general public.

We are looking forward to 24 exciting sessions that cover a large variety of research topics such as Asset Pricing, Corporate Finance, Credit Risk, Insurance or Market Microstructure to name just a few. This year, we received more than 300 submissions for the 78 slots available. Our heartfelt thanks go to the members of the Conference Board and more than 200 reviewers who helped us identify the best contributions.

Finally, we would like to thank the Conference Managers Tobias Meyer and Christian Putz for their efforts in organizing such a large event.

We wish all participants an interesting and enjoyable day at the SGF Conference in Zurich.

With our best regards,



Professor Dr. Matthias Muck
Chairman of the Conference Board



Dr. Michael Herold
Conference Director

SCHEDULE

TIME TOPIC

Room

08:00 Registration

Foyer

08:30 Welcome of Participants / Opening Speeches

Dr. Stefan Mäder (SIX Group CFO), Prof. Dr. Matthias Muck (Chairman Conference Board),
Dr. Michael Herold (Conference Director)

Room "Exchange"

	SESSION A	SESSION B	SESSION C	SESSION D	SESSION E	SESSION F
	<i>Room</i>	<i>Room</i>	<i>Room</i>	<i>Room</i>	<i>Room</i>	<i>Room</i>
	<i>"Exchange"</i>	<i>"Auditorium"</i>	<i>"Ask"</i>	<i>"Bid"</i>	<i>"Decision"*</i>	<i>"Executive"</i>

09:00	A1	B1	C1	D1	E1	F1
	Corporate Governance I	International Asset Pricing	Asset Management	Financial Economics	Empirical Asset Pricing I	Insurance

11:00 Coffee Break

11:30	A2	B2	C2	D2	E2	F2
	Corporate Finance I	Asset Pricing I	Behavioral Finance I	Derivatives	Empirical Asset Pricing II	Credit Risk I

13:00 Lunch Break

14:00	A3	B3	C3	D3	E3	F3
	Corporate Finance II	Household Finance	Corporate Governance II	Market Micro-structure I	Empirical Asset Pricing III	Financial Econometrics

15:30 Coffee Break

15:45	A4	B4	C4	D4	E4	F4
	Corporate Finance III	Asset Pricing II	Behavioral Finance II	Market Micro-structure II	Empirical Asset Pricing IV	Credit Risk II

17:15 Coffee Break

17:30 Keynote Speech

Prof. Dr. Erwin W. Heri

Professor of Financial Theory at the University of Basel and SFI Adjunct Professor

SIX Best Paper Award 2016

ZKB Best Paper Award 2015 (for the best professional paper published in FMPM)

FMPM Best Paper Award 2015 (for the best academic article published in FMPM)

Dr. Stefan Mäder (SIX Group CFO), Dr. Thomas Stucki (President of the Swiss Society for Financial Market Research), Prof. Dr. Markus Schmid (Editor FMPM)

Room "Exchange"

18:45 Reception

Bar and Lounge

** Room "Decision" is located on the ground floor.*

KEYNOTE SPEAKER

We are glad to announce Erwin W. Heri, Professor of Financial Theory at the University of Basel and since 2010 also Swiss Finance Institute Adjunct Professor, as our distinguished keynote speaker.



Parallel to teaching and research he held various posts as an executive board member of international renowned financial service providers, e.g. Chief Financial Officer at “Winterthur Insurance Group” and CFO and Chief Investment Officer at “Credit Suisse Financial Services”.

For about 10 years, he was Chairman of the board of a Swiss private banking group listed on the Swiss stock exchange (Valartis Group). For many years, he was also the Chairman of the investment committee of “Publica”, the pension fund of the state government employees in Switzerland.

Today, he is the Chairman of a British family office in Switzerland and holds mandates on a number of advisory boards and boards of directors. He is author of numerous books and articles on financial and investment matters.

He recently started an internet-based financial literacy platform (www.fintool.ch) with the goal to improve the financial education of the broad public in Germany, Switzerland and Austria through a free video-based internet-offering.

SESSION A: ROOM “EXCHANGE”

A1 Corporate Governance I *(p. 18)*

Chair: Boris Nikolov

TIME	AUTHORS AND PAPER	DISCUSSION
09:00	Dirk Jenter, Egor Matveyev, <u>Lukas Roth</u> Good and Bad CEOs	Peter Limbach
09:30	André Betzer, Maximilian Ibel, Hye Seung (Grace) Lee, <u>Peter Limbach</u> , Jesus M. Salas General Managerial Skills and Shareholder Value: Evidence from Sudden Executive Deaths	Daniel Urban
10:00	<u>Isaac Otchere</u> , Sana Mohsni Changing Organizational Form in the Stock Exchange Industry and Risk Taking	Peter Limbach
10:30	Thomas Schmid, <u>Daniel Urban</u> Women on Corporate Boards: Good or Bad?	Florian Eugster

A2 Corporate Finance I *(p. 20)*

Chair: Alexander Wagner

TIME	AUTHORS AND PAPER	DISCUSSION
11:30	<u>Peter Limbach</u> , Markus Schmid, Meik Scholz All Good Things Come to an End: CEO Tenure and Firm Value	Ettore Croci
12:00	Johann Reindl, <u>Alexander Schandlbauer</u> Do Covenants Prevent Asset Substitution - Using A Novel Structural Estimation Approach	Jing Zeng
12:30	Günter Strobl, <u>Jing Zeng</u> The Effect of Activists' Short-Termism on Corporate Governance	Alexander Wagner

A3 Corporate Finance II *(p. 22)*

Chair: Jing Zeng

TIME	AUTHORS AND PAPER	DISCUSSION
14:00	<u>François Derrien</u> , Olivier Dessaint The Effects of Investment Bank Rankings: Evidence from M&A League Tables	Ambrus Kecskés
14:30	<u>Mark R. Moritzen</u> The Impact of Competition and Time-To-Finance on Corporate Cash Holdings	Florens Focke
15:00	Meike Ahrends, Wolfgang Drobetz, <u>Tatjana X. Puhán</u> Cyclicality of Growth Opportunities and the Value of Cash Holdings	Jing Zeng

A4 Corporate Finance III *(p. 24)*

Chair: François Derrien

TIME	AUTHORS AND PAPER	DISCUSSION
15:45	Ralf Elsas, <u>Catharina Klepsch</u> How and when Do Firms Adjust Their Investments Toward Targets?	Mark R. Moritzen
16:15	Jarrad Harford, Ambrus Kecskés, Sattar Mansi Do Long-Term Investors Improve Corporate Decision Making?	Alexander Schandlbauer
16:45	Nihat Aktas, <u>Ettore Croci</u> , Oguzhan Ozbas, Dimitris Petmezas Executive Compensation and Deployment of Corporate Resources: Evidence from Working Capital	François Derrien

SESSION B: ROOM “AUDITORIUM”

B1 International Asset Pricing (*p. 26*)

Chair: Nicole Branger

TIME	AUTHORS AND PAPER	DISCUSSION
09:00	Ivan Petzev, Andreas Schrimpf, <u>Alexander Wagner</u> Has the Pricing of Stocks Become More Global?	Kailin Zeng
09:30	<u>Michael Semenischev</u> Global Bad and Good Uncertainties and their Impact on Macro Aggregates and Stock Returns	Afonso Januario
10:00	Riccardo Colacito, Mariano M. Croce, <u>Federico Gavazzoni</u> , Robert Ready Currency Risk Factors in a Recursive Multi-Country Economy	Daniel Andrei
10:30	<u>Afonso Januario</u> Multinational Firms' Geographic Segmentation and Exchange-Rate Dynamics	Victoria Atanasov

B2 Asset Pricing I (*p. 28*)

Chair: Ilaria Piatti

TIME	AUTHORS AND PAPER	DISCUSSION
11:30	<u>Giuliano Curatola</u> , Michael Donadelli, Patrick Grüning, Christoph Meinerding Investment-Specific Shocks, Business Cycles, and Asset Prices	Mykola Babiak
12:00	Nicole Branger, Nikolai Gräber, <u>Malte Schumacher</u> Commodities Storage and Economic Growth	Tom Steffen
12:30	<u>Daniel Andrei</u> , Bruce Carlin, Michael Hasler Structural Uncertainty and Stock Market Volatility	Ilaria Piatti

B3 Household Finance (*p. 30*)

Chair: John V. Duca

TIME	AUTHORS AND PAPER	DISCUSSION
14:00	<u>Omar Rachedi</u> Portfolio Rebalancing and Asset Pricing with Heterogeneous Inattention	Malte Schumacher
14:30	Marcel Fischer, <u>Bjarne A. Jensen</u> The Debt Tax Shield in General Equilibrium	Patrick Grüning
15:00	Martin Hibbeln, Lars Norden, <u>Piet Usselmann</u> , Marc Gürtler Informational Synergies in Consumer Credit	John V. Duca

B4 Asset Pricing II (*p. 32*)

Chair: Omar Rachedi

TIME	AUTHORS AND PAPER	DISCUSSION
15:45	Diogo Duarte, Kyoungwhan Lee, <u>Gustavo Schwenkler</u> The Systemic Effects of Benchmarking	Giuliano Curatola
16:15	<u>Mykola Babiak</u> Generalized Disappointment Aversion, Learning and Variance Premium	Petar Sabtchevsky
16:45	Nicole Branger, <u>Patrick Grüning</u> , Christian Schlag Commodities, Financialization, and Heterogeneous Agents	Omar Rachedi

SESSION C: ROOM “ASK”

C1 Asset Management (p. 34)

Chair: Bjarne A. Jensen

TIME	AUTHORS AND PAPER	DISCUSSION
09:00	<u>Stephan Jank</u> , Esad Smajlbegovic Dissecting Short-Sale Performance: Evidence from Large Position Disclosures	Laura-Chloé Kuntz
09:30	<u>Gert Elaut</u>, <u>Péter Erdős</u>, <u>John Sjödin</u> An Analysis of the Risk-Return Characteristics of Serially Correlated Managed Futures	Stephan Jank
10:00	Olaf Korn, <u>Laura-Chloé Kuntz</u> Low-Beta Investment Strategies	Lena Jaroszek
10:30	Joost Driessen, <u>Ran Xing</u> The Liquidity Risk Premium Demanded by Large Investors: Dynamic Portfolio Choice with Stochastic Illiquidity	Bjarne A. Jensen

C2 Behavioral Finance I (p. 36)

Chair: Florian Weigert

TIME	AUTHORS AND PAPER	DISCUSSION
11:30	<u>Mahmoud Qadan</u> , Doron Kliger Beliefs-Based Factors and Asset Pricing	Tristan Roger
12:00	Patrick Roger, <u>Tristan Roger</u> , Alain Schatt Behavioral Biases in Number Processing: The Case of Analysts' Target Prices	Catharina Klepsch
12:30	Maik Dierkes, Stephan Germer, <u>Vulnet Sejdiu</u> Irrational Preferences, Asset Prices and Economic Welfare	Florian Weigert

C3 Corporate Governance II (p. 38)

Chair: Lukas Roth

TIME	AUTHORS AND PAPER	DISCUSSION
14:00	<u>Florian Eugster</u> , Alexander Wagner Financial Reporting Quality and the Reaction to Earnings Announcements	Isaac Otchere
14:30	<u>Andreas Barth</u> The Role of Corporate Culture in the Financial Industry	Linus Siming
15:00	<u>Daniel Urban</u> The Effects of Culture on CEO Power: Evidence from Executive Turnover	Lukas Roth

C4 Behavioral Finance II (p. 40)

Chair: Jan Schneemeier

TIME	AUTHORS AND PAPER	DISCUSSION
15:45	Gunter Löffler, Lars Norden, <u>Alexander Rieber</u> Rating Reports: Do Investors Get the Text Message?	Stephan Germer
16:15	Christian Finke, <u>Florian Weigert</u> Does Foreign Information Predict the Returns of Multinational Firms Worldwide?	Daniel Urban
16:45	<u>Florens Focke</u> , Stefan Ruenzi, Michael Ungeheuer Advertising, Attention, and Financial Markets	Jan Schneemeier

SESSION D: ROOM “BID”

D1 Financial Economics (p. 42)

Chair: Martin Brown

TIME	AUTHORS AND PAPER	DISCUSSION
09:00	Markus Behn, <u>Rainer Haselmann</u> , Thomas K. Kick, Vikrant Vig The Political Economy of Bank Bailouts	Matthias Efling
09:30	Tobias Berg, <u>Eva Schliephake</u> Unique Equilibrium in Market-Triggered Contingent Capital	Andreas Barth
10:00	<u>John V. Duca</u> , David C. Ling The Other (Commercial) Real Estate Boom and Bust: The Effects of Risk Premia and Regulatory Capital Arbitrage	Mahmoud Qadan
10:30	Alexandros Kontonikas, Charles Nolan, <u>Zivile Zekaite</u> Always and Everywhere Inflation? Treasuries Variance Decomposition and the Impact of Monetary Policy	Salih Fendoğlu

D2 Derivatives (p. 44)

Chair: Matthias Muck

TIME	AUTHORS AND PAPER	DISCUSSION
11:30	Antonio Cosma, Stefano Galluccio, <u>Paola Pederzoli</u> , Olivier Scaillet Valuing American Options Using Fast Recursive Projections	Felix Brinkmann
12:00	<u>Felix Brinkmann</u> , Olaf Korn Risk-Adjusted Option-Implied Moments	Stefan Weisheit
12:30	Stefan Kanne, <u>Olaf Korn</u> , Marliese Uhrig-Homburg Stock Illiquidity, Option Prices, and Option Returns	Gustavo Schwenkler

D3 Market Microstructure I (p. 46)

Chair: David A. Lesmond

TIME	AUTHORS AND PAPER	DISCUSSION
14:00	<u>Tom Steffen</u> , Alex Frino, Gbenga Ibikunle, Vito Mollica Anticipatory Trading in Brent Futures: Evidence from the Unregulated Dated Brent Benchmark	Gert Elaut
14:30	<u>Jan Schneemeier</u> Firm Investment and Price Informativeness	Michael Stein
15:00	<u>Wenting Zhao</u> , Christoph Kaserer The Impact of Equity Funds' Cash Flows on Stock Market Liquidity: Evidence from the German Stock Market	David A. Lesmond

D4 Market Microstructure II (p. 48)

Chair: Darya Yuferova

TIME	AUTHORS AND PAPER	DISCUSSION
15:45	Roland Füss, Ferdinand Mager, <u>Michael Stein</u> , Lu Zhao Financial Crises, Price Discovery, and Information Transmission: A High-Frequency Perspective	Wenting Zhao
16:15	Jun Uno, Mario Bellia, Loriana Pelizzon, Marti G. Subrahmanyam, <u>Darya Yuferova</u> Low-Latency Trading and Price Discovery without Trading: Evidence from the Tokyo Stock Exchange in the Pre-Opening Period and the Opening Batch Auction	Ralf Baumann
16:45	Matthias Bank, <u>Ralf Baumann</u> Price Formation, Market Quality and the Effects of Reduced Latency in the Very Short Run	Darya Yuferova

SESSION E: ROOM “DECISION”

E1 Empirical Asset Pricing I *(p. 50)*

Chair: Nils Friewald

TIME	AUTHORS AND PAPER	DISCUSSION
09:00	<u>Linus Siming</u> , Björn Wallace Government Policy and Stock Market Returns: Evidence from Repeated Natural Experiments	Jonas Gusset
09:30	<u>Xin Huang</u> Macroeconomic News Announcements, Systemic Risk, Financial Market Volatility and Jumps	Panayotis G. Michaelides
10:00	<u>Xuemin (Sterling) Yan</u> , Lingling Zheng Fundamental Analysis and the Cross-Section of Stock Returns: A Data-Mining Approach	Xin Huang
10:30	<u>David A. Lesmond</u> , Xue Wang Trade Size and the Cross-Sectional Relation to Future Returns	Nils Friewald

E2 Empirical Asset Pricing II *(p. 52)*

Chair: Xuemin (Sterling) Yan

TIME	AUTHORS AND PAPER	DISCUSSION
11:30	<u>Jonas Gusset</u> , Heinz Zimmermann Anomaly in Stock-Bond Correlations - The Role of Monetary Policy	Zivile Zekaite
12:00	<u>Matthias Efin</u> , Rüdiger Fahlenbrach, Christoph Herpfer, Philipp Krüger How Do Investors and Firms React to an Unexpected Currency Appreciation Shock?	Eva Schliephake
12:30	<u>Lena Jaroszek</u> , Alexandra Niessen-Ruenzi, Stefan Ruenzi Is Corporate Fraud Risk Correctly Priced by the Market?	Xuemin (Sterling) Yan

E3 Empirical Asset Pricing III *(p. 54)*

Chair: Eric Jondeau

TIME	AUTHORS AND PAPER	DISCUSSION
14:00	<u>Victoria Atanasov</u> , Ilan Cooper, Richard Priestley, Junhua Zhong The Factor Structure of Time-Varying Discount Rates	Michael Semenischev
14:30	Philippe Mueller, <u>Petar Sabtchevsky</u> , Andrea Vedolin, Paul Whelan Variance Risk Premia on Stocks and Bonds	Federico Gavazzoni
15:00	<u>Ilaria Piatti</u> , Fabio Trojani Predictable Risks and Predictive Regression in Present-Value Models	Eric Jondeau

E4 Empirical Asset Pricing IV *(p. 56)*

Chair: Thomas Dimpfl

TIME	AUTHORS AND PAPER	DISCUSSION
15:45	<u>Fabian Hollstein</u> , Marcel Prokopczuk Aggregate Uncertainty Affects Stock Returns	Paola Pederzoli
16:15	Christian Schlag, <u>Kailin Zeng</u> Horizontal Industry Relationships and Return Predictability	Fabian Hollstein
16:45	<u>Eric Jondeau</u> , Qunzi Zhang Average Skewness Matters!	Thomas Dimpfl

SESSION F: ROOM “EXECUTIVE”

F1 Insurance (p. 58)

Chair: Antje Mahayni

TIME	AUTHORS AND PAPER	DISCUSSION
09:00	Martin Eling, <u>Ruo (Alex) Jia</u> A Walk through the Graveyard: Which Insurance Companies Have to Leave the Market?	Christian Kubitza
09:30	<u>Christian Kubitza</u> , Tobias Niedrig Escaping the Guarantee Trap	Alexander Braun
10:00	Antje Mahayni, <u>Matthias Muck</u> The Benefit of Life Insurance Contracts with Capped Index Participation when Stock Prices are Subject to Jump Risk	Ruo (Alex) Jia
10:30	<u>Alexander Braun</u> , Daliana Luca, Hato Schmeiser Consumption-Based Asset Pricing in Insurance Markets: Yet Another Puzzle?	Matthias Muck

F2 Credit Risk I (p. 60)

Chair: Rainer Haselmann

TIME	AUTHORS AND PAPER	DISCUSSION
11:30	Thomas Dimpfl, <u>Franziska Peter</u> Price Discovery in the Markets for Credit Risk: A Markov Switching Approach	Alexander Rieber
12:00	Fatih Altunok, <u>Salih Fendoğlu</u> Risk and the Strength of Financial Amplification: Evidence from Loan-Level Data	Giorgio Ottonello
12:30	Adelphe Ekponon, <u>Alexandre Jeanneret</u> Macroeconomic Risk, Investor Preferences, and Sovereign Credit Spreads	Rainer Haselmann

F3 Financial Econometrics (p. 62)

Chair: Olaf Korn

TIME	AUTHORS AND PAPER	DISCUSSION
14:00	<u>Roman Croessmann</u> A Sharpe Ratio Neutral Prior for Bayesian Portfolio Selection	Ran Xing
14:30	Efthymios Tsionas, <u>Konstantinos N. Konstantakis</u> , Panayotis G. Michaelides Non-Linearities in Financial Bubbles: Theory & Bayesian Evidence from S&P500	Roman Croessmann
15:00	<u>Thomas Dimpfl</u> , Dirk G. Baur Inter-Quantile Ranges and Volatility of Financial Data	Olaf Korn

F4 Credit Risk II (p. 64)

Chair: Franziska Peter

TIME	AUTHORS AND PAPER	DISCUSSION
15:45	<u>Nils Friewald</u> , Florian Nagler, Christian Wagner Debt Refinancing and Equity Returns	Alexandre Jeanneret
16:15	Tobias Berg, <u>Felix Brinkmann</u> , Philipp Koziol Who do Borrowers Borrow from? Evidence from Multi-Bank Relationships	Piet Usselman
16:45	Rainer Jankowitsch, <u>Giorgio Ottonello</u> , Marti G. Subrahmanyam The New Rules of the Rating Game: Market Perception of Corporate Ratings	Franziska Peter

PAPER AVAILABILITY

Please find abstracts of all papers in the back of this program and online at

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PAPER ABSTRACTS

Good and Bad CEOs

Dirk Jenter (London School of Economics and Stanford University)

Egor Matveyev (University of Alberta)

Lukas Roth (University of Alberta)

This paper analyzes changes in shareholder value and firm performance caused by deaths of incumbent CEOs. We find that CEOs are an important determinant of shareholder value for many firms. The value effects of CEO deaths are heterogeneous. Most sudden deaths, and especially sudden deaths of young and short-tenured CEOs, cause large value losses. Other CEO deaths – non-sudden deaths, and sudden deaths of old and long-tenured CEOs – are on average associated with large value gains. The evidence suggests that many CEO-firm matches generate large surpluses that benefit shareholders. Many other CEOs, however, are either not the optimal match or overpaid.

General Managerial Skills and Shareholder Value: Evidence from Sudden Executive Deaths

André Betzer (University of Wuppertal)

Maximilian Ibel (University of Wuppertal)

Hye Seung (Grace) Lee (Fordham University)

Peter Limbach (Karlsruhe Institute of Technology)

Jesus M. Salas (Lehigh University)

We provide evidence for a positive impact of general managerial skills on shareholder value using a sample of 179 sudden executive deaths between 1975 and 2012. An increase in the general ability index (GAI) by one standard deviation is associated with a decrease in abnormal stock returns of about 1.8 percentage points. We find generalists to be valuable in firms with complex, varying managerial tasks and in recent years. Work experience in different industries and firms seem to be the GAI components most relevant for shareholder value. Results stand various robustness tests and are consistent with the generalist pay premium.

Changing Organizational Form in the Stock Exchange Industry and Risk Taking

Isaac Otchere (Carleton University)

Sana Mohsni (Carleton University)

Recent developments in the stock industry have compelled some exchanges to demutualize and become for-profit entities. We examine the risk-taking behavior of demutualized exchanges and find that prior to the conversion the demutualized exchanges exhibited higher risk than their mutual counterparts. Following demutualization however, the exchanges experienced a significant decrease in risk, which is not attributed to industry-wide effects. Our results are consistent with the conjecture that higher risk induced the conversion to equity ownership. Interestingly, we find that publicly listed exchanges that have gone through the three organizational structures exhibit risk-taking behavior somewhat similar to that of the mutual, demutualized and publicly listed exchanges. We also document evidence of significant increases in non-traditional income for the converted exchanges after demutualization and the increase in non-traditional income is significantly related to the reduction in risk. We therefore attribute the reduction in risk experienced by the converted exchanges to diversification.

Women on Corporate Boards: Good or Bad?

Thomas Schmid (University of Hong Kong)

Daniel Urban (TU Munich)

Prior literature shows that mandatory gender quotas reduce firm value. However, little is known about causal effects of voluntary female board representation. Based on long and short-run event studies around exogenous board member retirements due to death and illness, we find a positive valuation effect of women. Panel regressions on a large sample of 35,000 firms confirm this result. This effect is not driven by women per se, but stems from more rigorous selection, the so-called “glass ceiling”. Thus, firms can benefit from the promotion of women. Thereby, they might be able to avoid the introduction of value-destroying gender quotas.

All Good Things Come to an End: CEO Tenure and Firm Value

Peter Limbach (Karlsruhe Institute of Technology)

Markus Schmid (University of St.Gallen)

Meik Scholz (Karlsruhe Institute of Technology)

We study the trade-off between the benefits (e.g., experience, on-the-job learning) and costs (e.g., CEO-firm mismatch, entrenchment) that arise over a CEO's time in office. We find that CEO tenure exhibits an inverted U-shaped relation with firm value, M&A announcement returns, and profitability. For the average S&P 1500 firm the costs of tenure start to outweigh the benefits after 11-12 years. Optimal CEO tenure, however, varies significantly depending on a firm's economic environment that determines the cost-benefit relation of tenure. Our identification strategy includes alternative explanations, CEO-firm fixed effects, CEO sudden deaths, and economic recessions as well as regulatory changes in corporate governance as exogenous shocks to the cost-benefit relation of tenure. The documented CEO life cycle suggests that regular CEO turnover can be valuable, while a one-size-fits-all policy of CEO term limits may not.

Do Covenants Prevent Asset Substitution - Using a Novel Structural Estimation Approach

Johann Reindl (BI Norwegian Business School)

Alexander Schandlbauer (University of Southern Denmark)

This paper shows that bond covenants mitigate the asset substitution problem. We track defaulted firms for the last seven years prior to bankruptcy and use a structural corporate finance model together with a novel simulated methods of moments approach for conditional samples to detect the unobservable risk-shifting behavior and to identify the mechanisms through which covenants can work. We find that cash-flow based covenants destroy risk-shifting incentives via reducing the convexity of the equity value function and not by tying the hands of the management. Companies with protective covenants are less likely to engage in risk-shifting just prior to bankruptcy and if they do, they increase their cash-flow risk by less. Nonetheless, issuing bonds without covenants is also optimal since the inefficiencies arising from covenants may exceed the agency cost from asset substitution.

The Effect of Activists' Short-Termism on Corporate Governance

Günter Strobl (Frankfurt School of Finance and Management)

Jing Zeng (Frankfurt School of Finance and Management)

This paper investigates whether activist investors' focus on short-term stock prices impedes their role in improving corporate governance. The model builds on the notion that both the act of intervention and the threat of an intervention can generate value for the target firm. While the effect of the activist's threat on the manager's effort and the expected firm value is increasing in the activist's ability, we demonstrate that an activist intervenes excessively when her ability to conduct a value-enhancing intervention is low, but intervenes insufficiently if her ability is high. Moreover, we show that an activist with higher ability finds it optimal to acquire stakes in multiple firms even when her capacity to conduct intervention is limited. While targeting multiple firms dilutes the effect of the activist's threat on each manager, it improves a skillful activist's profit by forcing her to substitute reduced managerial effort with more value-enhancing interventions in equilibrium, alleviating the problem of insufficient intervention. Finally, when facing an activist with low ability, short-term stock-based compensation to the manager disincentivizes effort. Activist short-termism reduces such perverse effect.

The Effects of Investment Bank Rankings: Evidence from M&A League Tables

François Derrien (HEC Paris)

Olivier Dessaint (University of Toronto)

This paper explores how league tables, which are rankings based on market shares, influence the M&A market. A bank's league table rank predicts its future deal flow, above and beyond other determinants of this future deal flow. This creates incentives for banks to manage their league table ranks. League table management tools include selling fairness opinions and reducing fees. Banks use such tools mostly when their incentives to do so are high: when a transaction affects their league table position or when they lost ranks in recent league tables. League table management seems to affect the quality of M&A transactions.

The Impact of Competition and Time-To-Finance on Corporate Cash Holdings

Mark R. Moritzen (University of Southern Denmark)

In this paper we introduce time frictions in the capital market to show how industry specific competition explains the variation in corporate cash holdings. We show that time-to-finance is positively related to cash when firms are exposed to preemption risk, and that the role of cash changes with the level of preemption risk. Firms facing a high risk of preemption puts a higher value on cash for investments and a lower value on cash held for hedging illiquidity risk. Additionally, corporate cash holdings are hump-shaped in competition in the presence of time-to-finance, which reconciles some of the earlier mixed empirical findings. To do so we develop a dynamic model of investment, financing, and cash management decisions with uncertain and lumpy investment opportunities in which firms are subject to time frictions in capital markets and preemption risk.

Cyclicalities of Growth Opportunities and the Value of Cash Holdings

Meike Ahrends (University of Hamburg)

Wolfgang Drobetz (University of Hamburg)

Tatjana X. Puhan (Swiss Life Asset Managers and University of Mannheim)

This paper shows that business cycle dynamics and, in particular, the cyclicalities of a firm's growth opportunities, are important determinants of the value of corporate cash holdings. We find that cash is more valuable if a firm has relatively more attractive growth opportunities in bad states of the business cycle. Cash holdings provide the financial flexibility to invest even during times when capital supply is relatively scarce. This valuation effect is strongest for firms with low financial leverage and high R&D spending. In firms, where changes in cash holdings have a stronger impact on stock returns, cash holdings also have a stronger relation with net investment and operating performance.

How and when Do Firms Adjust Their Investments Toward Targets?

Ralf Elsas (LMU Munich)

Catharina Klepsch (LMU Munich)

Due to adjustment costs, firms' only partially adjust toward desired investment levels. By exploiting unique survey data on firms' desired investments, we examine how and when firms adjust their investments toward stated plans (targets). More precisely, we examine how financing costs due to asymmetric information, disruption costs, and costs due to asset irreversibility influence firms' adjustment costs and thus adjustment behavior. We find that firms with sufficient cash flows to finance all desired investments adjust significantly faster toward targets than firms with insufficient cash flows. Moreover, firms with either minor investment targets, a large fraction of desired replacement investments or low asset irreversibility adjust within shorter time compared to firms with major investment plans, capacity expansion targets or high asset irreversibility, respectively. Finally, although several prior studies find that the financial crisis of 2008 and 2009 reduced firms' realized investment spending, our results indicate that firms' speed of adjustment toward target investments was not influenced by the crisis.

Do Long-Term Investors Improve Corporate Decision Making?

Jarrad Harford (University of Washington)

Ambrus Kecskés (York University)

Sattar Mansi (Virginia Tech)

We study the effect of investor horizons on a comprehensive set of corporate decisions. Long-term investors have the means and motive to monitor corporate managers, which generates corporate decisions that are consistent with shareholder value maximization. We find that long-term investors strengthen corporate governance and restrain managerial misbehaviors such as earnings management and financial fraud. They discourage a range of investment and financing activities but encourage payouts. Shareholders benefit through higher stock returns, higher profitability that is not fully anticipated by the market, and lower risk. Firms diversify their operations. We use a popular identification strategy to establish causality of our results.

Executive Compensation and Deployment of Corporate Resources: Evidence from Working Capital

Nihat Aktas (WHU - Otto Beisheim School of Management)

Ettore Croci (Catholic University of the Sacred Heart)

Oguzhan Ozbas (University of Southern California)

Dimitris Petmezas (University of Surrey)

Firms provide compensation incentives to executives, primarily in the form of bonus payments, to alleviate slack in the deployment of corporate resources to working capital. Financially constrained firms are heavy users of working capital incentives. So are firms that are less exposed to external takeover threats. Among the different components of working capital, inventories and payables are the main drivers of executive bonuses. Overall, our evidence supports the optimal contracting view of bonus payments in executive compensation.

Has the Pricing of Stocks Become More Global?

Ivan Petzev (University of Zurich)

Andreas Schrimpf (Bank for International Settlements)

Alexander Wagner (University of Zurich)

We document that in recent years global factors such as the global Fama-French and Carhart factors have been catching up significantly with their local counterparts in terms of explanatory power (R^2) for international stock returns. This catch-up is driven by a rise in global factor betas, not a rise in factor volatilities, suggesting that the effect is likely to be permanent. On the face of it, this convergence between global and local factor models seems to imply that the pricing of assets has become more global. Yet, there is no conclusive evidence for a global factor model catch-up in terms of pricing errors (alpha) or decreasing residual country-specific factor premia. A pick-up in real rather than financial market integration provides a plausible explanation for the results, which has important practical implications.

Global Bad and Good Uncertainties and their Impact on Macro Aggregates and Stock Returns

Michael Semenischev (University of Münster)

This paper estimates global uncertainties from monthly data on industrial production from a large set of countries. I find, that a rise in global uncertainty has an adverse impact on future macroeconomic growth in 50% and increases risk premia in 35% of the considered countries. Decomposing total uncertainty in bad and good components significantly enhances the results. A rise in bad uncertainty negatively effects future macroeconomic growth in 90% of the considered countries, while a rise in good uncertainty has positive effects. Moreover, it is in particular bad uncertainty that identifies counter-cyclical risk premia, whereas there is only a weak link between good uncertainty and risk premia. The share of countries with significant results increases to 60%. Finally, I assess conditional versions of the global CAPM and the two-factor Fama and French (1998) model. The pricing performance always increases if global uncertainties are employed as conditioning variables. It is rather the bad component of global uncertainty that has additional explanatory power for expected returns in the cross-section. Overall, the results highlight that global uncertainties, and especially bad uncertainty, are key drivers of real economies and financial markets.

Currency Risk Factors in a Recursive Multi-Country Economy

Riccardo Colacito (University of North Carolina-Chapel Hill)

Mariano M. Croce (University of North Carolina-Chapel Hill)

Federico Gavazzoni (INSEAD)

Robert Ready (University of Rochester)

Focusing on the ten countries with the most-traded currencies, we provide novel empirical evidence about the existence of significant heterogeneous exposure to global growth news shocks. We incorporate this empirical fact in a frictionless risk-sharing model with recursive preferences, multiple countries, and multiple consumption goods whose supply is subject to both global and local short- and long-run shocks. Since news shocks are priced, heterogeneous exposure to global long-lasting growth shocks results in both a relevant reallocation of international resources and currency adjustments. Our unified framework replicates the properties of the HML-FX and HML-NFA carry trade strategies studied by Lustig et al. (2011) and Della Corte et al. (2013).

Multinational Firms' Geographic Segmentation and Exchange-Rate Dynamics

Afonso Januario (London Business School)

This paper investigates the role of currency risk as a source of mispricing in equity markets. Using geographic segment disclosures made by multinational firms headquartered in the United States, I find a strong (weak) correlation between firms' abnormal returns and changes in a measure of their sales-weighted currency returns, contemporaneously (one month ahead). More interestingly, splitting the sample by sales geographic concentration yields a four-factor model abnormal return of 137 basis points (16.44% annualized return), significant at the 5% level and robust to the use of different subsamples. The result is robust to the Fama and French (2014) profitability and investment risk factors and the Lustig, Roussanov, and Verdelhan (2011) currency risk factors. This result corroborates the hypothesis of the inattention of investors on the topic of currency movements, which increases with firm geographic concentration. Using Fama-MacBeth (1973) regressions, I do not find that controlling for a firm's own stock reversal and momentum, as well as industry reversal and momentum, the informativeness of the sales segmentation disclosure, and other regional controls, change the magnitude and significance the results.

Investment-Specific Shocks, Business Cycles, and Asset Prices

Giuliano Curatola (Goethe University Frankfurt)

Michael Donadelli (Goethe University Frankfurt)

Patrick Grüning (CEFER - Bank of Lithuania and Vilnius University)

Christoph Meinerding (Goethe University Frankfurt)

We introduce long-run investment productivity risk in a two-sector production economy to explain the joint behavior of macroeconomic quantities and asset prices. Long-run productivity risk in both sectors, for which we provide economic and empirical justification, acts as a substitute for shocks to the marginal efficiency of investments in explaining the equity premium and the stock return volatility differential between the consumption and the investment sector. Moreover, adding moderate wage rigidities allows the model to reproduce the empirically observed positive co-movement between consumption and investment growth.

Commodities Storage and Economic Growth

Nicole Branger (University of Münster)

Nikolai Gräber (University of Münster)

Malte Schumacher (University of Münster)

This paper studies the effects of introducing storable inputs into a general equilibrium model of endogenous growth. Commodities storage is modeled with an occasionally binding non-negativity constraint requiring global non-linear solution methods. The state of commodity holdings has an important impact on utilization of production capacity. The interplay of those two factors can either amplify or dampen exposure to exogenous risk. We find a substantial non-linear impact of inventory levels on growth prospects in the economy. This causing negative co-movements with the risk-free rate, as well as explaining major characteristics of futures markets, such as the term structure of futures prices and premia, and the relation of convenience yields and spot prices.

Structural Uncertainty and Stock Market Volatility

Daniel Andrei (University of California, Los Angeles)

Bruce Carlin (University of California, Los Angeles)

Michael Hasler (University of Toronto)

When the economy is subject to model uncertainty, agents continuously calibrate the parameters of their models to rationalize what they publicly observe. This causes structural uncertainty and disagreement, which affects asset prices in substantial ways. Structural uncertainty is associated with persistent stock-return volatility, consistent with GARCH-type processes. It magnifies stock-return volatility both during recessions and expansions, consistent with empirical evidence. Our model can explain why we observe occasional large changes in asset prices without a correspondingly large change in underlying fundamentals. Finally, disagreement earns a risk premium and is the primary channel through which uncertainty is priced.

Portfolio Rebalancing and Asset Pricing with Heterogeneous Inattention

Omar Rachedi (Banco de España)

Can households' limited attention to the stock market quantitatively account for the inertia in portfolio rebalancing? I address this question introducing an observation cost in a production economy with heterogeneous agents, incomplete markets and idiosyncratic labor income risk. In this environment inattention changes endogenously over time and across agents. I find that inattention can explain the heterogeneous dynamics of active and passive portfolio rebalancing across households as long as borrowing constraints are tight enough. The model generates also limited stock market participation and countercyclical dynamics for both the stock returns volatility and the equity premium.

The Debt Tax Shield in General Equilibrium

Marcel Fischer (Copenhagen Business School and University of Konstanz)

Bjarne A. Jensen (Copenhagen Business School)

We study the general-equilibrium implications of the corporate debt tax shield in an endowment economy with a redistributive tax system that taxes firm profits and household income and redistributes tax revenues in an attempt to harmonize households' lifetime consumption opportunities. In general equilibrium, the debt tax shield not only affects corporate valuation, but also causes poorer households to consume more and save less at younger age. Without debt tax shield, the same welfare improvements for poorer households are achievable with significantly lower tax rates.

Informational Synergies in Consumer Credit

Martin Hibbeln (University of Duisburg-Essen)

Lars Norden (Brazilian School of Public and Business Administration)

Piet Usselmann (Braunschweig Institute of Technology)

Marc Gürtler (Braunschweig Institute of Technology)

Lenders can tap into multiple sources of private information to assess consumer credit risk but little is known about the informational synergies between these sources. Using unique panel data on checking accounts and credit card accounts from the same customers during 2007-2014, we find that activity measures from both account types contain information beyond credit scores and other controls. Checking accounts display warning indications earlier and more accurately than credit card accounts. We also investigate the consistency of information, the reasons for defaults, and selection effects. The evidence highlights sizeable informational synergies that lenders can use to manage credit relationships.

The Systemic Effects of Benchmarking

Diogo Duarte (Boston University)

Kyoungwan Lee (Boston University)

Gustavo Schwenkler (Boston University)

We show that the competitive pressure to beat a benchmark may induce institutional trading behavior that exposes retail investors to tail risk. In our model, institutional investors are different from a retail investor because they derive higher utility when their benchmark outperforms. This forces institutional investors to take on leverage to overinvest in the benchmark. Institutional investors execute fire sales when the benchmark experiences shock. This behavior increases market volatility, raising the tail risk exposure of the retail investor. Ex post, tail risk is only short lived. All investors survive in the long run under standard conditions, and the most patient investor dominates. Ex ante, however, benchmarking is welfare reducing for the retail investor, and beneficial only to the impatient institutional investor.

Generalized Disappointment Aversion, Learning and Variance Premium

Mykola Babiak (CERGE-EI)

This paper provides a generalized disappointment aversion (GDA) interpretation of the variance premium, defined as a difference between the expectations of the market return variance under the risk-neutral and statistical probability measures. We find that the GDA preferences provide a key ingredient in our model. We show that our model with GDA preferences can explain the mean variance premium, while simultaneously matching the mean equity premium, equity volatility and the mean risk free rate observed in the data. Additionally, our model can generate the procyclical variation in wealth-consumption and price-dividend ratios, countercyclical variation in conditional variance premium, equity premium and its volatility as well as the mean reversion of excess returns.

Commodities, Financialization, and Heterogeneous Agents

Nicole Branger (University of Münster)

Patrick Grüning (CEFER - Bank of Lithuania and Vilnius University)

Christian Schlag (Goethe University Frankfurt)

The term ‘financialization’ describes the phenomenon that commodity contracts are traded for purely financial reasons and not for motives rooted in the real economy. Recently, financialization has been made responsible for causing adverse welfare effects especially for low-income and low-wealth agents, who have to spend a large share of their income for commodity consumption and cannot participate in financial markets. In this paper we study the effect of financial speculation on commodity prices in a heterogeneous agent production economy with an agricultural and an industrial producer, a financial speculator, and a commodity consumer. While access to financial markets is always beneficial for the participating agents, since it allows them to reduce their consumption volatility, it matters decisively with respect to overall welfare effects who can trade with whom (but not so much what types of instruments can be traded).

Dissecting Short-Sale Performance: Evidence from Large Position Disclosures

Stephan Jank (Frankfurt School of Finance & Management)

Esad Smajlbegovic (University of Mannheim)

Short sellers are perceived as informed, sophisticated investors. Yet little is known about their actual performance and trading strategies. Using a novel, hand-collected data set of daily position disclosures in Europe, we identify the entry, change, and exit dates of large short-sale positions for a wide cross section of stocks and investors. We find that hedge funds, the predominant investor group, generate an annualized Fama and French (1993) risk-adjusted return of about 5.5%, outperforming other investors. Evidence indicates that hedge funds act as arbitrageurs, generating their returns by trading on the mispricing-related factors, e.g. momentum, betting-against-beta, and quality-minus-junk. In the cross section of hedge funds, local, diversified, and active funds outperform their counterparts. On the position level, we document a first-mover advantage. The profitability of short sales also varies significantly with investors' holding period, location, and industry experience.

An Analysis of the Risk-Return Characteristics of Serially Correlated Managed Futures

Gert Elaut (Ghent University)

Péter Erdős (RPM Risk & Portfolio Management AB)

John Sjödin (Ghent University)

We investigate the implications of low but persistent serial correlation in Managed Futures' returns for portfolio management. Using a measure based on the unweighted sum of autocorrelations, we find that more positively autocorrelated Managed Futures exhibit distinctly different risk-return profiles and outperform, on a risk-adjusted basis, Managed Futures that exhibit lower degrees of serial correlation. The observed premium is unlikely to be explained by a concentration in certain strategies, fund size and fund age, attrition or delisting bias and does not seem to hamper Managed Futures' portfolio benefits as a tail-risk hedge.

Low-Beta Investment Strategies

Olaf Korn (Göttingen University and Centre for Financial Research Cologne)

Laura-Chloé Kuntz (Göttingen University)

This paper investigates investment strategies that exploit the low-beta anomaly. Although the notion of buying low-beta stocks and selling high-beta stocks is natural, a choice is necessary with respect to the relative weighting of high-beta stocks and low-beta stocks in the investment portfolio. Our empirical results for US large-cap stocks show that this choice is very important for the risk-return characteristics of the resulting portfolios and their sensitivities to common risk factors. We also show that investment strategies based on betas have a natural-hedge component and a market-timing component due to the stochastic variation of betas. We construct indicators to exploit the market-timing component and show that they have substantial predictive power for future market returns. Corresponding market-timing strategies deliver large positive excess returns and high Sharpe ratios.

The Liquidity Risk Premium Demanded by Large Investors: Dynamic Portfolio Choice with Stochastic Illiquidity

Joost Driessen (Tilburg University)

Ran Xing (Tilburg University)

Recent empirical work documents large liquidity risk premiums in stock markets. We calculate the liquidity risk premiums demanded by large investors by solving a dynamic portfolio choice problem with stochastic price impact of trading, CRRA utility and a time-varying investment opportunity set. We find that, even with high trading-cost rates and substantial trading motives, the theoretically demanded liquidity risk premium is negligible, less than 3 basis points per year. Assuming forced selling during market downturn enlarges the liquidity risk premium to maximally 20 basis points per year, which is well below existing empirical estimates of the liquidity risk premium.

Beliefs-Based Factors and Asset Pricing

Mahmoud Qadan (University of Haifa)

Doron Kliger (University of Haifa)

Research in psychology has established that religious aspects have a salient effect on individual behavior. Specifically, implicit and subliminal activation of religious ideas promotes honest behavior. The accumulated evidence for the role of the underlying mechanisms so far has been experimentally based, and no complementary analysis using real-life data has been conducted. This study fills this gap by documenting that internal rewards based on faith, moral, and honesty standards based on beliefs affect individual behavior in real life financial situations. Utilizing VIX and VXO we find a significant increase in perceived and realized volatility around High Holidays. We attribute this phenomenon to the issues of beliefs based factor and self-concept maintenance.

Behavioral Biases in Number Processing: The Case of Analysts' Target Prices

Patrick Roger (University of Strasbourg)

Tristan Roger (Paris-Dauphine University)

Alain Schatt (University of Lausanne)

Research in neuropsychology shows that the human brain processes differently small and large numbers. In this paper, we show that financial analysts process differently low prices and high prices when they issue one-year ahead target prices. First, analysts are more optimistic on low price stocks than on high price stocks, even after controlling for risk factors, conflicts of interest and other behavioral biases. Second, the returns implied by target prices are significantly more dispersed on low price stocks. We strengthen these results by showing that target prices become more optimistic and more dispersed after stock splits. Finally, we show that the link between risk-adjusted implied returns and share prices does not survive in analysts' (qualitative) recommendations. Our results suggest that a deeply-rooted behavioral bias in number processing explains a significant part of analysts' forecast errors.

Irrational Preferences, Asset Prices and Economic Welfare

Maik Dierkes (Leibniz University Hannover)

Stephan Germer (Leibniz University Hannover)

Vulnet Sejdiu (Leibniz University Hannover)

In this paper, we link potentially irrational preferences to future economic growth. Our conjecture is that more irrationality leads to worse allocations of real resources and, ultimately, breeds lower GDP growth in the longer run. The empirical challenge is to quantify the optimality of today's decision making to test for its impact on future economic welfare. Fortunately, risk preferences manifest in stock prices immediately and, hence, can be estimated from stock markets. Using monthly aggregate stock prices from 1926 to 2014, we estimate risk preferences via an asset pricing model with Cumulative Prospect Theory (CPT) agents and distill a recently proposed irrationality index. We find that this index predicts future welfare losses. Predictability is stronger and more reliable over longer horizons. Our results suggest that asset prices can be wrong and may lead to inefficient allocations of real resources.

Financial Reporting Quality and the Reaction to Earnings Announcements

Florian Eugster (Stockholm School of Economics)

Alexander F. Wagner (University of Zurich)

We investigate the effect of past financial reporting quality (FRQ) on the future market valuation of earnings surprises. High past FRQ (as measured by the lack of earnings management) is associated with stronger reactions to earnings surprises. The effect is more pronounced for firms with more institutional shareholders and in those with strong internal governance. Moreover, it exists almost exclusively in the Post-SOX period. We further document striking asymmetries: Negative FRQ surprises – that is, negative residuals when FRQ is regressed on factors known to explain FRQ, such as managerial compensation incentives to increase the stock price – more strongly affect market responses to earnings surprises than do positive FRQ surprises. And FRQ affects market responses to positive earnings surprises more strongly than it affects responses to negative earnings surprises. Overall, the results suggest that the market rewards high-FRQ firms by believing their future earnings news more. This channel of market discipline complements, rather than substitutes regulatory action (such as the SOX rules) and strong internal and external corporate governance.

The Role of Corporate Culture in the Financial Industry

Andreas Barth (Johannes Gutenberg University Mainz and GSEFM Frankfurt)

This paper sheds light on the role of corporate culture in the financial industry. As a first step, we contribute to the literature that has described corporate culture as a tool for the self-selection mechanism of workers into firms, presumed a match of workers' attitude with the firms' corporate culture. Second, we investigate the role of corporate culture with respect to performance and risk. Finally, we reopen the discussion on the nexus between CEO compensation and risk-taking against the backdrop of heterogeneous corporate culture types. Our results indicate that financial firms with a stronger competition-oriented corporate culture pay a larger share of total compensation to their executives in terms of variable payments. Moreover, the paper provides evidence for a positive correlation between a competitive corporate culture and banks' buy-and-hold stock price return. This result suggests that competition-oriented firms, by attracting competitive workers, benefit from a strong internal competition between workers which increases firm value. Control-oriented firms are found to have a lower return volatility, which comes at the cost of smaller returns. We observe that this significant correlation of the corporate culture measure is found for given incentives from different compensation schemes.

The Effects of Culture on CEO Power: Evidence from Executive Turnover

Daniel Urban (TU Munich)

Based on a hand-collected dataset with more than 5,000 forced and voluntary CEO transitions across 37 countries, I find that underperforming CEOs are less likely to be dismissed in more hierarchical countries. In those countries, other executives are more prone to accept a given distribution of power and terminating a CEO is considered as a means of last resort so that the incumbent CEO can save her face. Therefore, ousted CEOs in more hierarchical countries are also more likely to move to director or chairman positions in the same firm. This procedure, however, deteriorates post-turnover performance improvement. Furthermore, I detect idiosyncratic variation in corporate policies around exogenous turnovers of CEOs in more hierarchical countries. This is in contrast to existing literature on CEOs in the U.S., where hierarchies are relatively flat. Overall, the findings suggest that national culture gives rise to managerial power and organizational rigidities.

Rating Reports: Do Investors Get the Text Message?

Gunter Löffler (Ulm University)

Lars Norden (Brazilian School of Public and Business Administration)

Alexander Rieber (Ulm University)

We investigate whether the tone of Moody's rating reports relates to the future ratings, default experience, and stock returns of firms in the United States. We consider rating reports with and without rating/outlook/watchlist changes. Irrespective of the report type, we find that the tone is predictive of future downgrades, suggesting that it contains forward-looking information. However, announcement effects in the stock market differ across report types. Stock returns overreact to the tone of reports on negative actions, but they do not or not immediately react to the tone of positive actions and no-change reports. This evidence is consistent with investor overreaction to salient news, and underreaction to news that is less salient.

Does Foreign Information Predict the Returns of Multinational Firms Worldwide?

Christian Finke (University of St.Gallen)

Florian Weigert (University of St.Gallen)

We investigate whether value-relevant foreign information only gradually dilutes into stock prices of multinational firms worldwide. Using an international sample of firms from 22 developed countries, we find that a portfolio strategy based on firms' foreign sales information yields future returns of more than 10% p.a. globally. The return spread due to foreign information is substantial across different geographical regions and cannot be explained by traditional risk factors, firm characteristics, and industry momentum. Our results are in line with limited attention of investors being the main driver of this effect worldwide.

Advertising, Attention, and Financial Markets

Florens Focke (University of Mannheim)

Stefan Ruenzi (University of Mannheim)

Michael Ungeheuer (University of Mannheim)

We investigate the impact of product market advertising on investor attention and financial market outcomes. Using daily advertising data allows us to identify short-term effects of advertising. We measure daily investor attention based on the company's number of Wikipedia page views. We show that TV and newspaper advertising have a positive impact on short-term investor attention. They also positively influence turnover and liquidity, but the effects are not economically significant. Most importantly, asset prices are not influenced by advertising in the short run. These findings are different from studies using yearly advertising expenditures and suggest that attempts to temporarily inflate stock returns via short-term adjustments to advertising are ineffective.

The Political Economy of Bank Bailouts

Markus Behn (European Central Bank)

Rainer Haselmann (Goethe University Frankfurt)

Thomas K. Kick (Deutsche Bundesbank)

Vikrant Vig (London Business School)

In this paper, we examine how the institutional design affects the outcome of bank bailout decisions. In the German savings bank sector, distress events can be resolved by local politicians or a state-level association. We show that decisions by local politicians with close links to the bank are distorted by personal considerations: While distress events per se are not related to the electoral cycle, the probability of local politicians injecting taxpayers' money into a bank in distress is 30 percent lower in the year directly preceding an election. Using the electoral cycle as an instrument, we show that banks that are bailed out by local politicians experience less restructuring and perform considerably worse than banks that are supported by the savings bank association. Our findings illustrate that larger distance between banks and decision makers reduces distortions in the decision making process, which has implications for the design of bank regulation and supervision.

Unique Equilibrium in Market-Triggered Contingent Capital

Tobias Berg (University of Bonn)

Eva Schliephake (University of Bonn)

We show that multiple equilibria in market-triggered contingent capital can largely be ruled out if a bank's asset value is not common knowledge. Financial intermediation theory lends support to the argument that a bank's assets are opaque and therefore not common knowledge. In a global games setup we show that private uncertainty about the true asset value of a bank secures a unique equilibrium, when multiple equilibria would exist otherwise. Our results open up the possibility for market-triggered contingent capital that does not abide to the "no value transfer" restriction.

The Other (Commercial) Real Estate Boom and Bust: The Effects of Risk Premia and Regulatory Capital Arbitrage

John V. Duca (Federal Reserve Bank of Dallas)

David C. Ling (University of Florida)

The last decade's boom and bust in U.S. commercial real estate (CRE) prices was at least as large as that in the housing market and contributed significantly to bank failures. Nevertheless, the role of CRE in the Great Recession has received little attention. This study estimates cohesive models of short-run and long-run movements in capitalization rates (rent-to-price-ratio) and risk premiums across the four major types of commercial properties. Results indicate that CRE price movements were mainly driven by sharp declines in required risk premia during the boom years, followed by sharp increases during the bust phase. Using decompositions of estimated long-run equilibrium factors, our results imply that much of the decline in CRE risk premiums during the boom was associated with weaker regulatory capital requirements. The return to normal risk premia levels in 2009 and 2010 was first driven by a steep rise in general risk premia that occurred after the onset of the Great Recession and later by a tightening of effective capital requirements on commercial mortgage-backed securities (CMBS) resulting from the Dodd-Frank Act. In contrast to the mid-2000s boom, the recovery in CRE prices since 2010 has been mainly driven by declines in real Treasury yields to unusually low levels. Our findings have important implications for the channels through which macro-prudential regulation may or may not be effective in limiting unsustainable increases in asset prices.

Always and Everywhere Inflation? Treasuries Variance Decomposition and the Impact of Monetary Policy

Alexandros Kontonikas (University of Glasgow)

Charles Nolan (University of Glasgow)

Zivile Zekaite (University of Glasgow)

This paper investigates the sources of variation in Treasury bonds returns and the role of monetary policy over the last three decades. Firstly, we decompose unexpected excess returns on 2-, 5- and 10-year Treasuries in three components related to revisions in expectations (news) about future excess returns, inflation and real interest rates. Our results indicate that inflation news is the key driver of Treasuries returns. Secondly, we evaluate the impact of conventional and unconventional monetary policy on Treasuries returns and their components. The monetary policy impact on the Treasury market is largely explained through revisions in inflation expectations.

Valuing American Options Using Fast Recursive Projections

Antonio Cosma (University of Luxembourg)

Stefano Galluccio (BNP Paribas)

Paola Pederzoli (University of Geneva)

Olivier Scaillet (University of Geneva)

This paper introduces a new numerical option pricing method by fast recursive projections. The projection step consists in representing the payoff and the state price density with a fast discrete transform based on a simple grid sampling. The recursive step consists in transmitting coefficients of the representation from one date to the previous one by an explicit recursion formula. We characterise the convergence rate of the computed option price. Numerical illustrations with different American and Bermudan payoffs with discrete dividend paying stocks in the Black-Scholes and Heston models show that the method is fast, accurate, and general. As an application, we characterise the early exercise boundary of an American call option on a dividend paying stock. The boundary is higher under the Merton and Heston model than under Black-Scholes if the dividend is discrete, and lower in the case of a continuous dividend yield. We apply our method to study a sample of call options on stocks with quarterly dividends during the period January 1996 through December 2012. We illustrate that the choice of the model for the underlying asset is important for both the early exercise decision, in accordance with our numerical results, and for the quantification of the dollar amount that the buyer of the option forgoes when he fails to optimally exercise to the advantage of the seller. By using stochastic volatility, jumps and a mixture of these processes in modelling the stock price, the cash amount foregone by call holders is lower than what found using the Black-Scholes model.

Risk-Adjusted Option-Implied Moments

Felix Brinkmann (Deutsche Bundesbank)

Olaf Korn (Göttingen University and Centre for Financial Research Cologne)

Option-implied moments, like implied volatility, contain useful information about an underlying asset's return distribution but are derived under the risk-neutral probability measure. This paper shows how to convert risk-neutral moments directly into the corresponding physical ones, which are required for many applications. The main theoretical result is a representation of physical moments in terms of observed option prices and preferences of a representative investor. As an empirical application of this result, we provide implied estimates of the disappointment aversion of the representative stock market investor using S&P 500 index option prices. We find that disappointment aversion has a pro-cyclical pattern. It is high in times of high index levels and declines when the index falls. We confirm the view that investors with high disappointment aversion leave the stock market during times of turbulence and reenter it after a period of high returns.

Stock Illiquidity, Option Prices, and Option Returns

Stefan Kanne (Karlsruhe Institute for Technology)

Olaf Korn (Göttingen University and Centre for Financial Research Cologne)

Marliese Uhrig-Homburg (Karlsruhe Institute for Technology)

We show that the average absolute difference between historical and implied volatility increases with the illiquidity of the underlying stock. This finding is strong evidence of an effect of the underlying stock's illiquidity on option prices that can be either positive or negative. The observed correspondence between option expensiveness and stock illiquidity also translates into significant excess returns of option trading strategies. These excess returns are not explained by common risk factors suggested in the literature. Simulation results show, however, that the observed patterns of option prices, option returns, and stock illiquidity can be explained by the hedging costs of market makers who are sometimes net long and sometimes net short in options. Our empirical findings are robust with respect to the chosen illiquidity measure, the benchmark volatility estimator, and the return period.

Anticipatory Trading in Brent Futures: Evidence from the Unregulated Dated Brent Benchmark

Tom Steffen (University of Edinburgh, Macquarie University and CMCRC)

Alex Frino (Macquarie University and CMCRC)

Gbenga Ibikunle (University of Edinburgh, University of St. Andrews and ECMCRC)

Vito Mollica (Macquarie University and CMCRC)

We examine the Dated Brent benchmark published by the leading oil price reporting agency, Platts. We find informed anticipatory trading in the Brent futures market during the physical oil price fixing period (16:00 to 16:30 London time). We document enhanced levels of trading volume, trade size and volatility for Brent futures and show significant abnormal returns, in the order of magnitude of 27 bps, realisable by informed futures traders during the 30-minute price fixing window. Results thus suggest that information leaks from the Dated Brent fixing into the futures market, allowing informed traders to front-run the crude oil market. Our findings inform policy makers on the influence of unregulated physical commodity price benchmarks on regulated exchange-traded financial derivatives.

Firm Investment and Price Informativeness

Jan Schneemeier (Federal Reserve Board)

I theoretically investigate how the informational content of stock prices is affected by the structure of firms' capital investment decisions. The efficiency of stock prices is determined by the weight firms attach to private information and by the extent to which investment is predictable. Both factors attract informed trading and lead to more revealing prices. The model predicts that i) individual stock prices should be more informative than aggregate prices, ii) firms with better managers should have more informative prices, iii) a higher degree of stock-based compensation reduces price efficiency and iv) more heterogenous markets are less price efficient.

The Impact of Equity Funds' Cash Flows on Stock Market Liquidity: Evidence from the German Stock Market

Wenting Zhao (TU Munich)

Christoph Kaserer (TU Munich)

Open-ended equity funds often engage in liquidity-motivated trading when they are facing cash in-/outflows. This paper assesses the impact of equity funds' cash flows on overall stock market liquidity. A unique order volume-weighted spread measure considering the whole depth of the limit order book allows us more accurate measurement of stock market liquidity. In a sample of more than 3,000 trading days on the German stock market we find significant evidence that mutual funds' cash flows improve stock market liquidity. One standard deviation increase of total net cash flows reduce overall market liquidity costs in average by 2%. Meanwhile, no significant effect of ETFs' net cash flows has been found on the stock market liquidity. The strongest liquidity contribution is observed during the stock market crisis in 2008/2009 due to higher probability of liquidity-motivated trading from mutual fund managers. In addition, we discover that liquidity contribution from mutual fund managers is driven by those with higher skills in terms of information processing ability.

Financial Crises, Price Discovery, and Information Transmission: A High-Frequency Perspective

Roland Füss (University of St.Gallen)

Ferdinand Mager (EBS Business School)

Michael Stein (University of Duisburg-Essen)

Lu Zhao (Stockholm University)

This paper examines the price discovery processes before and during the 2007-09 subprime and financial crisis, as well as the subsequent European sovereign crisis, for the stock, bond, and U.S. dollar/euro FX markets in the U.S. and Germany in a high-frequency setting. Based on five-second intervals, we analyze how asset prices interact and incorporate information conditional on macroeconomic announcements and news surprises from the U.S. and Germany. Our results show strong state-dependent return and volatility patterns across assets and markets. Moreover, we document significant co-movement and spillover effects that result from a dynamic network of news-based and trading-based information transmissions. We find that some effects we first identify during the financial and subprime crisis vanish, but others persist.

Low-Latency Trading and Price Discovery without Trading: Evidence from the Tokyo Stock Exchange in the Pre-Opening Period and the Opening Batch Auction

Jun Uno (Waseda University and Ca' Foscari University of Venice)

Mario Bellia (Goethe University Frankfurt)

Loriana Pelizzon (Goethe University Frankfurt and Ca' Foscari University of Venice)

Marti G. Subrahmanyam (New York University)

Darya Yuferova (Erasmus University Rotterdam)

We study whether, in the opening batch auction without trading, low-latency traders (including High Frequency Traders (HFTs)) still participate in the equity market, and how the presence of lowlatency traders contributes to price discovery in the subsequent opening call auction. Our analysis evokes shades of the debate on the switch from the current continuous auction in many markets to a periodic auction, affecting the speed advantage of low latency traders. We empirically investigate these questions using a unique dataset provided by the Tokyo Stock Exchange (TSE), one of the largest stock markets in the world, which allows us to develop a more comprehensive classification of traders than in the prior literature, and to investigate the behavior of the different categories of traders, based on their capability for low-latency trading. We find that given the lack of immediate execution, about three quarters of the low latency traders do not participate in the pre-opening period, but participate in the continuous trading regime. However, we also find that a larger presence of low-latency traders in the trading of a stock in the pre-opening period improves the price discovery process. Such traders play a dominant role in terms of the total number of new orders placed in the pre-opening period, which precedes the continuous trading session. Our results suggest that HFTs may not participate in trading in the periodic batch auction when immediate execution is eliminated, and hence, the large reduction in HFT participation may impede the quality of price discovery

Price Formation, Market Quality and the Effects of Reduced Latency in the Very Short Run

Matthias Bank (University of Innsbruck)

Ralf Baumann (UBS Asset Management)

Applying an innovative event study methodology to ultra short return horizons, this paper resolves market adjustment in the aftermath of corporate news events with unprecedented precision. It uncovers the ramifications of the reduction in latency of the German stock market on April 23rd 2007 and shows that it has had positive consequences for market quality. Analyzing second by second time windows the paper demonstrates that price determination, market efficiency as well as quoted spreads and order flow have significantly improved not only in broad average terms, but in particular during informative events.

Government Policy and Stock Market Returns: Evidence from Repeated Natural Experiments

Linus Siming (Bocconi University)

Björn Wallace (University of Cambridge)

Pástor and Veronesi (2012) theoretically show that stock prices should react to the announcement of government policy changes. Utilizing a set of repeated natural experiments, we demonstrate that their main predictions hold. During the Swedish parliament session of 1973–1976, hundreds of policy decisions were taken by drawing a ticket from a ballot containing one Yes and one No vote. In parametric and nonparametric event study tests we find that lottery wins for policies that are perceived to be better (worse) in terms of future corporate earnings compared to existing policies are met by increases (decreases) in stock market prices.

Macroeconomic News Announcements, Systemic Risk, Financial Market Volatility and Jumps

Xin Huang (Federal Reserve Board)

This paper studies financial market volatility and jump responses to macroeconomic news announcements. Based on two decades of high-frequency data, we find that there are significantly more jumps on news days than on no-news days, with the bond market being more responsive than the equity market, and nonfarm payroll employment being the most influential news. Both the first moment of news surprises and the second moments of disagreement and uncertainty affect financial market responses, with their impact significance changing over different market and response types. Market responses to news vary with economic situations, financial systemic risk and the zero-lower-bound policy.

Fundamental Analysis and the Cross-Section of Stock Returns: A Data-Mining Approach

Xuemin (Sterling) Yan (University of Missouri)

Lingling Zheng (Renmin University of China)

We construct a “universe” of over 18,000 fundamental signals from financial statements and use a bootstrap procedure to measure the impact of data mining on stock return anomalies. We find that a large number of fundamental signals are significant predictors of cross-sectional stock returns even after accounting for data mining. This predictive ability is more pronounced among small, high-idiosyncratic volatility, low-institutional ownership, and low-analyst coverage stocks. The long-short returns of best performing signals persist over time and are significantly higher following high-sentiment periods and during earnings announcement days. Our evidence suggests that fundamental-based anomalies are not a product of data mining, and they are best explained by mispricing.

Trade Size and the Cross-Sectional Relation to Future Returns

David A. Lesmond (Freeman School of Business)

Xue Wang (Renmin University of China)

This paper uses trade clusters, centered around 100-share (and increments of 100 shares), 500-share, and 1000-share categories, to analyze the relationship between trade size clusters and the cross-section of future stock returns across momentum portfolios. We find that the winner-loser momentum portfolios that have a high concentration of 500 or 1000-share trade size clusters earn an alpha of almost 1% per month which is almost double the performance of the momentum strategy not predicated on these trade size clusters. The performance of the 500 and 1000-share trade size clusters is not matched by any other trade size cluster. This ability of the 500 and 1000-share trade clusters in better predicting momentum returns persists regardless of the decimalization in stock quotes and is more resilient to “momentum crashes” that plague the conventional momentum strategy. We also link the momentum and value strategies by showing that firms with high past levels of 500-share trade clusters exhibit glamour characteristics while the 100-share trade clusters exhibit more value characteristics.

Anomaly in Stock-Bond Correlations - The Role of Monetary Policy

Jonas Gusset (University of Basel)

Heinz Zimmermann (University of Basel)

The paper estimates constant conditional correlation (CCC) GARCH models to test whether the dramatic changes in stock-bond market correlations can be explained by monetary policy variables such as OIS interest rate shocks or volatility regimes. We find that both specifications are empirically relevant: Correlations decrease after positive monetary shocks (decreasing rates) as well as in times with large central bank activity (high rate volatility regimes).

How Do Investors and Firms React to an Unexpected Currency Appreciation Shock?

Matthias Efing (Geneva School of Economics and Management)

Rüdiger Fahlenbrach (Ecole Polytechnique Fédérale de Lausanne)

Christoph Herpfer (Ecole Polytechnique Fédérale de Lausanne)

Philipp Krüger (Geneva School of Economics and Management)

The Swiss National Bank surprisingly announced in January 2015 that it would no longer hold the Swiss franc at a fixed exchange rate of 1.2 Swiss francs per Euro, a peg it had defended for more than three years. The Swiss franc appreciated by approximately 15% immediately after the announcement. We exploit the removal of the currency peg to study how investors and firms respond to exogenous foreign currency shocks. We find large negative announcement returns for Swiss firms with significant foreign currency exposure. Affected firms experience a drop in profitability and react by reducing capital expenditures and moving production abroad.

Is Corporate Fraud Risk Correctly Priced by the Market?

Lena Jaroszek (University of Mannheim and Centre for European Economic Research)

Alexandra Niessen-Ruenzi (University of Mannheim)

Stefan Ruenzi (University of Mannheim)

The answer is: No. Stocks with predictably higher fraud risk earn significantly lower stock market returns going forward. Based on an out-of-sample estimation of individual firms' fraud risk, we find a significantly negative return premium for firms with the highest fraud propensity. A portfolio investing in firms with the lowest fraud probability and shorting firms with the highest fraud probability yields abnormal returns of more than 10 percent per year. This result is robust to various asset pricing models that control for differences in firms' quality, liquidity, downside risk, or investor preferences. Our results suggest that the market does not efficiently price corporate fraud risk. This finding is puzzling, because limits of arbitrage do not seem to explain our results. Furthermore, abnormal returns are higher after periods of high sentiment, suggesting that the return patterns documented here constitute an anomaly.

The Factor Structure of Time-Varying Discount Rates

Victoria Atanasov (University of Mannheim)

Ilan Cooper (BI Norwegian Business School)

Richard Priestley (BI Norwegian Business School)

Junhua Zhong (Dongbei University of Finance and Economics)

Discount rate variation is driven by a short run business cycle component and a longer run trend component. This leads to state variable hedging of these two components, and ICAPM logic implies a three factor model for expected returns. One factor represents cash flow news and the two other factors represent short term and long term discount rate news. News about both these discount rate components are important in describing the cross section of stock returns. Long run discount rate news is priced consistently across different samples and specifications and commands a higher risk premium than short run discount rate news.

Variance Risk Premia on Stocks and Bonds

Philippe Mueller (London School of Economics)

Petar Sabtchevsky (London School of Economics)

Andrea Vedolin (London School of Economics)

Paul Whelan (Copenhagen Business School)

Investors in fixed income markets are willing to pay a large premium to be hedged against shocks in expected volatility and the size of this premium can be studied through variance swaps. Using thirty years of options and high-frequency futures data we document the following novel stylized facts: First, exposure to bond market volatility is strongly priced with a Sharpe ratio of -1.8, 20% higher than what is observed in the equity market. Second, while there is strong co-movement between equity and bond market variance risk, there are distinct periods when the bond variance risk premium is different from the equity variance risk premium. Third, the conditional correlation between stock and bond market variance risk premia switches sign often and ranges between -60% and +90%. These stylized facts pose a challenge to standard consumption-based asset pricing models.

Predictable Risks and Predictive Regression in Present-Value Models

Ilaria Piatti (University of Oxford)

Fabio Trojani (University of Lugano)

We estimate a tractable present-value model with time-varying risks, which specifies time-varying and horizon-dependent dividend and return expectations consistent with the dynamic and term structure properties of dividend and equity volatilities. We find strong evidence of time-varying expected returns and weaker evidence of a time-varying expected dividend growth. The term structures of dividend growth and return expectations are time-varying and can be flat, downward or upward sloping in periods of economic distress. The term structure of equity and dividend volatility is usually downward sloping, but it is upward sloping at short horizons when uncertainty about future expectations is high.

Aggregate Uncertainty Affects Stock Returns

Fabian Hollstein (Leibniz University)

Marcel Prokopczuk (University of Reading)

Separating the effects of risk and uncertainty, a stylized theoretical model with stochastic volatility suggests the existence of an uncertainty-return trade-off. Proxying aggregate uncertainty by stock market volatility-of-volatility, we detect that time-varying aggregate economic uncertainty commands an economically substantial and statistically significant negative risk premium. We find a two-standard deviation increase in aggregate uncertainty factor loadings to be associated with a decrease in average annual returns ranging from 6.3% to 18.7%. This phenomenon cannot be explained by aggregate volatility, jump risk, and several other firm characteristics and factor sensitivities, or by a crisis effect.

Horizontal Industry Relationships and Return Predictability

Christian Schlag (Goethe University Frankfurt)

Kailin Zeng (Goethe University Frankfurt and Research Center SAFE)

It has been documented that vertical customer-supplier links between industries are the basis for strong cross-sectional stock return predictability (Menzly and Ozbas (2010)). We show that robust predictability also arises from horizontal links between industries (extracted from Compustat segment data), i.e., from the fact that industries are competitors or offer products, which are substitutes for each other. This horizontal signal remains strong in the presence of the predictor based on customer-supplier links and the usual control variables like momentum, short-term reversal, and the lagged industry return. Furthermore, while the vertical signal is weaker for large firms, the horizontal return predictor has pronounced informational value for both small and large stocks. Informed investors take these facts into account when they form their portfolios.

Average Skewness Matters!

Eric Jondeau (Swiss Finance Institute and University of Lausanne)

Qunzi Zhang (Shandong University)

This paper investigates the ability of the average skewness, defined as the average of monthly skewness across firms, to predict future market return. Although the empirical evidence is not conclusive about the predictive ability of the average volatility, we show that, in contrast, the average skewness performs very well at predicting future market return when it is introduced in conjunction with current market return. This result holds for several alterations of the main specification: the average skewness can be computed as the value-weighted or the equal-weighted average of firms' skewness; the result holds after controlling for the size or liquidity of the firms or for the current business cycle conditions; it also holds when skewness is filtered for the market return (idiosyncratic skewness) or when it is defined as the cross-section skewness of monthly firm's returns. We also find that average skewness compares favorably to other usual suspects at predicting subsequent market return. Average skewness generates better out-of-sample performances in an allocation strategy based on market return predictions.

A Walk through the Graveyard: Which Insurance Companies Have to Leave the Market?

Martin Eling (University of St.Gallen)
Ruo (Alex) Jia (University of St.Gallen)

This paper analyzes insurance companies that leave the market in the period 2003-2013 with a sample of 4,655 insurers, among which are 146 failed insurers. We find that technical efficiency negatively and business volatility positively correlates with the insurer's failure probability. Firm growth has a U shaped non-linear relationship with the failure probability. We classify insurers taken over by other firms as a special type of failure, which show different symptoms from other failures (i.e. higher efficiency and profitability). Moreover, we document that the warning signals from failure indicators become stronger as the time to the failure event approaches. Our findings are robust across the financial crisis. Our research relies on a large dataset, a long time period, a cross-country design, and is innovative in using new insurer failure models relying on data envelopment analysis and rare event logistic regressions.

Escaping the Guarantee Trap

Christian Kubitza (Goethe University Frankfurt)
Tobias Niedrig (Goethe University Frankfurt)

We develop an asset-liability model of a stylized German life insurance company to study the performance of participating endowment life insurance policies (characterized by a fixed minimum guarantee and a surplus participation) in different interest rate environments. Our study highlights the extraordinary financial risk that these policies pose on German and many European life insurance companies due to the deferred adjustment of their guarantee levels to different interest rate environments; a phenomenon that we refer to as the guarantee trap. To reduce interest rate dependency and to increase the financial stability of life insurers in the long-run, we investigate a more flexible guarantee mechanism with an adaptable shorter-term (temporary) guarantee. We perform a market consistent valuation of fixed and temporary guarantee products, identify key drivers of default risk and analyze the payout to both policyholders and shareholders. Furthermore, the model design allows us to study the interaction of existing policies with newly sold products with either fixed or temporary guarantees. Our results demonstrate that a temporary guarantee successfully reduces the financial risk associated with traditional fixed interest rate guarantees since the insurer's duration gap diminishes. A welfare analysis shows that both policyholders and shareholders benefit from temporary guarantees.

The Benefit of Life Insurance Contracts with Capped Index Participation when Stock Prices are Subject to Jump Risk

Antje Mahayni (University of Duisburg-Essen)

Matthias Muck (University of Bamberg)

We analyze the benefit to the insured of newly traded, innovative life insurance contracts. On a sequence of yearly reference days, the insured can choose between a guaranteed return (linked to the insurer's asset result) and a capped index participation. The cap is adjusted at the beginning of each year such that both alternatives have the same value and the option to select is costless (product structuring condition). We point out that this condition cannot always be met. If the guaranteed return exceeds the upper bound of the capped index participation, the insurer can make a side profit. We show that a rather low insurance result also implies a rather low stock exposure, even if the insured opts for the index participation. Concerning the impact of the index dynamics, we emphasize that it is important to distinguish between jump and diffusion risk. The amount of (downward) jump risk reduces the cap rates but its overall impact on the expected utility is ambiguous. Finally, we show that the optimal decision strategy of a CRRA investor implies an index selection even if it is unfairly priced such that the insurer indeed makes a side profit.

Consumption-Based Asset Pricing in Insurance Markets: Yet Another Puzzle?

Alexander Braun (University of St.Gallen)

Daliana Luca (University of St.Gallen)

Hato Schmeiser (University of St.Gallen)

We fit the classical consumption-based asset pricing model with power utility to historical property-casualty insurance market data. In doing so, we consider two alternatives for the estimation of the relative risk aversion coefficient. First, we apply an extended version of Stein's Lemma introduced by Söderlind (2009a), which builds on a bivariate mixture normal distribution and thus allows for skewed and leptokurtic asset returns, given the log stochastic discount factor is Gaussian. Second, we follow Hansen and Singleton (1983) in assuming that consumption growth and asset returns are jointly lognormally distributed as well as homoskedastic. Both approaches are complemented by Hansen and Jagannathan (1991) volatility bounds. Based on aggregate annual premiums and claims for Australia, Germany, Italy, Japan, Netherlands, and the United States, we are able to provide evidence of yet another asset pricing anomaly. More specifically, the consumption-based model implies even larger relative risk aversion coefficients in the insurance sectors than in the equity markets of the aforementioned countries. To solve this insurance premium puzzle, we draw on the loss aversion and narrow framing approach by Barberis et al. (2001) as well as the second-degree expectation dependence framework by Dionne et al. (2015), with encouraging results.

Price Discovery in the Markets for Credit Risk: A Markov Switching Approach

Thomas Dimpfl (University of Tübingen)

Franziska Peter (University of Tübingen)

We examine price discovery in the Credit Default Swap and corporate bond market. By using a Markov switching framework we are able to analyze the dynamic behavior of the information shares during tranquil and crisis periods. The results show that price discovery takes place mostly on the CDS market. The importance of the CDS market even increases during the more volatile crisis periods. According to a cross sectional analysis liquidity is the main determinant of a market's contribution to price discovery. During the crisis period, however, we also find a positive link between leverage and CDS market information shares. Overall the results indicate that price discovery measures and their determinants change during tranquil and crisis periods, which emphasizes the importance of more flexible frameworks, such as Markov switching models.

Risk and the Strength of Financial Amplification: Evidence from Loan-Level Data

Fatih Altunok (Central Bank of Turkey)

Salih Fendoğlu (Central Bank of Turkey and Boğaziçi University)

Recent literature has recognized the importance of time-variation in cross-sectional uncertainty, namely risk, for explaining aggregate business cycle fluctuations (Christiano, Motto, and Rostagno, 2014. Risk Shocks. American Economic Review 104, 27-65). In particular, the risk shocks that directly affect the strength of movements in the external finance premium in response to changes in borrowers' leverage have been put forward as one of the main drivers of business cycles. In this paper, we use a novel loan-level credit registry data for Turkey and show that aggregate implications of risk hold at a micro level. That is, controlling for bank-, firm-, and industry-specific variables, we show evidence that risk governs the strength of movements in the loan rate in response to changes in borrower's leverage. Moreover, banks, above and beyond riskiness of their own loan portfolio, make use of cross-sectional dispersion of productive performance of firms across the economy in setting the loan rate. The results are by and large robust to controlling for changes in the mean of firms' productive performances.

Macroeconomic Risk, Investor Preferences, and Sovereign Credit Spreads

Adelphe Ekponon (HEC Montréal)

Alexandre Jeanneret (HEC Montréal)

This paper examines how global macroeconomic conditions and investor preferences influence the level of sovereign credit spreads. We propose a structural model for sovereign debt valuation embedded in a consumption-based environment with a global business cycle, and derive government optimal default and debt policies. Governments choose a higher indebtedness level and prefer to default earlier when a country's economic performance varies with the global business cycle. Moreover, investors demand a compensation for systematic and intertemporal risk, as they dislike countercyclical default risk and uncertainty about future global conditions. Our model thus predicts that a country's exposure to macroeconomic risk affects both the default probability and the price of default risk. We find that both effects are economically important.

A Sharpe Ratio Neutral Prior for Bayesian Portfolio Selection

Roman Croessmann (LMU Munich)

The standard noninformative prior for Bayesian portfolio selection implies strong and unreasonable prior information about the achievable Sharpe ratio. This has critical implications for portfolio selection. We develop a reparametrization that allows to specify a prior which is flat in the achievable Sharpe ratio. Applications suggest that Bayesian portfolio selection with the Sharpe ratio neutral prior does not encounter the usual pathologies of unconstrained mean-variance optimization.

Non-Linearities in Financial Bubbles: Theory & Bayesian Evidence from S&P500

Efthymios Tsionas (Lancaster University Management School)

Konstantinos N. Konstantakis (National Technical University of Athens)

Panayotis G. Michaelides (National Technical University of Athens)

The modeling process of bubbles using advanced mathematical and econometric techniques is a young field of research. In this context, significant model misspecification could result from ignoring potential nonlinearities and, hence, it would seem wise to ensure that no terms with explanatory power are neglected. More precisely, the present paper attempts to detect and date non-linear bubble episodes. To do so, we use Neural Networks to capture the neglected nonlinearities. Moreover, we provide a recursive dating procedure for bubble episodes. When using data on stock price-dividend ratio S&P500 (1871.1-2014.6) employing Bayesian techniques, the proposed approach identifies more episodes than other bubble tests in the literature, while the common episodes are, in general, found to have a longer duration, which is evidence of an early warning mechanism (EWM) that could have important policy implications.

Inter-Quantile Ranges and Volatility of Financial Data

Thomas Dimpfl (University of Tübingen)

Dirk G. Baur (Kühne Logistics University)

We consider the implications derived from quantile autoregressive (QAR) models on the volatility of financial data. We conduct a simulation study to pin down a possible data generating process which leads to the asymmetric, s-shaped pattern of autoregressive coefficient estimates in a QAR estimation of financial returns. An asymmetric GARCH model is identified as the best candidate. We then investigate the relationship between the asymmetry in the GARCH process and the inter-quantile range of QAR estimates. We interpret this range as asymmetric volatility response. Negative returns result in a broader conditional density implying a higher volatility than positive returns. Based on this difference we create a volatility forecast using the estimated density of the QAR model. We illustrate the performance of our approach with an evaluation of Value-at-Risk and variance forecasts.

Debt Refinancing and Equity Returns

Nils Friewald (Norwegian School of Economics)

Florian Nagler (Vienna Graduate School of Finance)

Christian Wagner (Copenhagen Business School)

Previous studies report mixed evidence on how financial leverage affects expected stock returns. Our theoretical and empirical results suggest that these inconclusive findings are driven by differences in firms' debt maturity structures and refinancing needs. In our model, the firm optimizes its capital structure by jointly choosing leverage and the mix of short- and long-term debt, which determines the firm's debt refinancing intensity. Since shareholders commit to cover potential shortfalls from debt rollover, they require a return that increases in, both, leverage and debt refinancing intensity. Our empirical results confirm this model prediction and show that firms with higher (lower) leverage earn higher (lower) stock returns when controlling for the immediacy of debt refinancing. The return differential of high-leverage firms relative to low-leverage firms increases with refinancing intensity and, as also predicted by the model, is directly linked to the value premium. Accounting for differences in firms' debt maturity profiles also provides new insights for the distress puzzle.

Who do Borrowers Borrow from? Evidence from Multi-Bank Relationships

Tobias Berg (University of Bonn)

Felix Brinkmann (Deutsche Bundesbank)

Philipp Koziol (Deutsche Bundesbank)

Most firms have multiple banking relationships. This raises an important question: If a borrower needs new funds, which bank will provide these funds to the borrower? Using data from the German credit registry on the bank-borrower-quarter level, we are able to answer this question using borrower x quarter and bank x quarter fixed effects. We find three main determinants for lending decisions: First, and most significantly, banks with the largest exposure to a borrower are less likely to provide new funds (diversification argument). Second, banks assigning a lower probability of default to a borrower are more likely to provide new funding, suggesting that adverse selection plays a role. Third, banks with a larger relationship scope – measured as having a derivatives exposure with the borrower – are more likely to provide new funds.

The New Rules of the Rating Game: Market Perception of Corporate Ratings

Rainer Jankowitsch (Vienna University of Economics and Business)

Giorgio Ottonello (Vienna Graduate School of Finance)

Marti G. Subrahmanyam (New York University)

In this paper, we analyze the impact of credit rating changes on the pricing and liquidity of US corporate bonds. In particular, we address the question of whether the informativeness of rating events varies in different economic environments, particularly after the introduction of the Dodd-Frank Act. During the financial crisis, rating agencies and rating-contingent regulation were blamed for causing inflated (overly optimistic and often stale) ratings, triggering, to some extent, the near collapse of the financial system, and leading to important regulatory reforms. It is essential, therefore, to understand the impact of downgrades/upgrades on prices and trading activity, particularly in the aftermath of these reforms. We find that the informativeness of rating changes is low before the crisis, particularly for financial bonds. However, after the passage of the Dodd-Frank Act, rating changes lead to significantly stronger market reactions for non-financial bonds, whereas the reactions are weaker for financial bonds, indicating that the new regulatory framework has ambiguous effects on the impact of such changes. We link this finding to the difference in complexity of the securities by testing various hypotheses based on existing models of rating agency behavior in different regulatory and economic environments.

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23rd Annual Meeting of the German Finance Association (DGF)
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September 30 and October 01, 2016

We invite researchers and practitioners to participate in the conference of the German Finance Association at the University of Bonn, September 30 and October 01, 2016. A doctoral workshop will take place on September 29.

The goal of the conference is to bring together researchers and practitioners to discuss the latest theoretical and empirical research from all areas of finance, banking, and insurance. The academic keynote speech will be held by **Jean-Charles Rochet**, Professor of Banking at the University of Zurich.

Guidelines for the submission of papers:

- Submissions (PDF files, in English, completed work only) must be made via the online submission system (ConfTool); this will be possible from February 20, 2016, on.
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- **NEW:** There will be a **poster session** on Friday during lunchtime. When submitting your work, you can choose whether you would also be willing to present in the poster session. This will not influence the likelihood of getting accepted for a regular session. A poster session provides a great opportunity to discuss your work intensively with others. It can be helpful especially for future **job market candidates**. Members of a faculty that wants to hire can go to the poster session and talk to interesting young academics.
- All submitted papers will be subject to a double-blind review process. The deadline for submissions is April 30, 2016 (midnight, CET).

Please visit www.dgf2016.uni-bonn.de for additional in-formation, and www.conftool.net/dgf2016/ for registration and submission. We are looking forward to an interesting conference and to welcoming you in Bonn. In case of any questions, please contact us via dgf2016@uni-bonn.de.

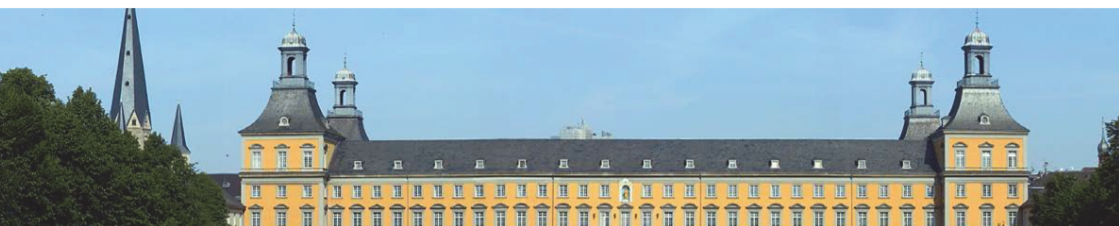
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