SGF CONFERENCE 2017

20th Annual Conference of the Swiss Society for Financial Market Research

March 31, 2017
SIX ConventionPoint
Zurich

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The Swiss Society for Financial Market Research (SGF)

Publishers of
Financial Markets and Portfolio Management (FMPM)

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EDITORIAL

Dear Participants of the SGF Conference 2017,

We would like to warmly welcome you at the Annual Conference of the Swiss Society for Financial Market Research in the heart of the beautiful city of Zurich. In 2017, we are pleased to celebrate the 20th anniversary of the SGF Conference with you.

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 2017 which carries a cash prize of 4'000 CHF. Our special thanks go to Chris Landis and Dr. Stefan Mäder who made all of this possible.

We are very happy to announce Professor Dr. Jean-Pierre Danthine as our distinguished keynote speaker. He is President of the Paris School of Economics and former vice-chairman of the Governing Board of the Swiss National Bank (SNB). His speech will address the topic: "Should Swiss-based investors hedge their currency exposures?". We are convinced that his insights will be of interest to academics and practitioners alike.

We are looking forward to 24 exciting sessions that cover a large variety of research topics such as Asset Pricing, Corporate Finance, Household Finance, Insurance or Market Microstructure to name just a few. This year, we received more than 330 submissions for the 78 slots available. Our heartfelt thanks go to the members of the Conference Board and more than 175 reviewers who helped us identify the best contributions.

Finally, we would like to thank the Conference Manager Tobias Meyer for his 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,

Dr. Michael Herold
Conference Director

Professor Dr. Matthias Muck
Chairman of the Conference Board

SCHEDULE

TIME	TOPIC					
	Room					
08:00	**Registration**					
	Foyer					
08:30	**Welcome of Participants / Opening Speeches**					
	Chris Landis (Division CEO SIX Swiss Exchange) 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**
	Room "Exchange"	*Room "Auditorium"*	*Room "Ask"*	*Room "Bid"*	*Room "Decision"**	*Room "Executive"*
09:00	**A1** Empirical Asset Pricing I	**B1** Financial Inter-mediation	**C1** Corporate Finance I	**D1** Derivatives I	**E1** Asset Allocation	**F1** Insurance
11:00	Coffee Break					
11:30	**A2** International Empirical Asset Pricing	**B2** Interest Rates & Term Structure	**C2** Corporate Finance II	**D2** Derivatives II	**E2** Asset Pricing I	**F2** Credit Risk
13:00	Lunch Break					
14:00	**A3** Empirical Asset Pricing II	**B3** Market Microstructure I	**C3** Corporate Finance III	**D3** Behavioral Finance I	**E3** Financial Economics	**F3** Risk Mgmt. & Financial Econometrics
15:30	Coffee Break					
15:45	**A4** Empirical Asset Pricing III	**B4** Household Finance	**C4** Corporate Governance	**D4** Behavioral Finance II	**E4** Asset Pricing II	**F4** Market Microstructure II
17:15	Coffee Break					
17:30	**Keynote Speech**					

Prof. Dr. Jean-Pierre Danthine, President of the Paris School of Economics
"Should Swiss-Based Investors Hedge Their Currency Exposures?"

SIX Best Paper Award 2017 for the best paper presented at the SGF Conference 2017
ZKB Best Paper Award 2016 for the best professional paper published in FMPM
FMPM Best Paper Award 2016 for the best academic article published in FMPM

Chris Landis (Division CEO SIX Swiss Exchange)
Iwan Deplazes (Head Asset Management Swisscanto Invest by Zürcher Kantonalbank)
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 delighted to announce Professor Dr. Jean-Pierre Danthine as our distinguished keynote speaker.

His speech will address the topic: "Should Swiss-based investors hedge their currency exposures?".

Jean-Pierre Danthine is President of the Paris School of Economics, member of the Board of Trustees of the Center for Economic Policy Research (CEPR) in London, and member of the Board of the Fondation Leenaards in Lausanne.

He was a member of the Governing Board of the Swiss National Bank (SNB) from January 2010 to April 2012 and its vice-chairman from May 2012 until he retired on June 30, 2015. Before joining the SNB, Jean-Pierre Danthine was Professor at the University of Lausanne and Managing Director of the Swiss Finance Institute.

SESSION A: ROOM "EXCHANGE"

A1 Empirical Asset Pricing I *(p. 17)*   Chair: Thomas Quistgaard Pedersen

TIME	AUTHORS AND PAPER	DISCUSSION
09:00	Regina Hammerschmid **Commodity Return Predictability**	Mohammad Ali Isleimeyyeh
09:30	Sebastian Stöckl, Lars Kaiser **Higher Moments Matter! Cross-Sectional (Higher) Moments and the Predictability of Stock Returns**	Georg Cejnek
10:00	Georg Cejnek, Otto Randl **Dividend Risk Premia**	Stig Vinther Møller
10:30	M. Max Croce, Tatyana Marchuk, Christian Schlag **The Leading Premium**	Thomas Quistgaard Pedersen

A2 International Empirical Asset Pricing *(p. 19)*   Chair: Sebastian Müller

TIME	AUTHORS AND PAPER	DISCUSSION
11:30	Thomas A. Maurer, Thuy-Duong Tô, Ngoc-Khanh Tran **Optimal Factor Strategy in FX Markets**	Ines Chaieb
12:00	Ines Chaieb, Vihang Errunza, Hugues Langlois **Is Liquidity Risk Priced in Partially Segmented Markets?**	Thomas A. Maurer
12:30	Priyank Gandhi, Hanno Lustig, Alberto Plazzi **Equity is Cheap for Large Financial Institutions: The International Evidence**	Sebastian Müller

A3 Empirical Asset Pricing II *(p. 21)*   Chair: Alberto Plazzi

TIME	AUTHORS AND PAPER	DISCUSSION
14:00	Alexander Hillert, Michael Ungeheuer **The Value of Visibility**	Sebastian Stöckl
14:30	Andre Guettler, Patrick Hable, Patrick Launhardt **The Out-of-Sample Predictive Power of Aggregate Insider Trading**	Jenny Pirschel
15:00	Tzuo Hann Law, Dongho Song, Amir Yaron **Fearing the Fed: How Wall Street Reads Main Street**	Alberto Plazzi

A4 Empirical Asset Pricing III *(p. 23)*   Chair: Tzuo Hann Law

TIME	AUTHORS AND PAPER	DISCUSSION
15:45	Heiko Jacobs, Sebastian Müller **Anomalies across the Globe: Once Public, No Longer Existent?**	Philippe Masset
16:15	Philippe Masset, Jean-Marie Cardebat, Benoît Faye, Eric Le Fur **Analyzing the Risk of an Illiquid Asset: The Case of Fine Wine**	Pavel Lesnevski
16:45	Pavel Lesnevski, Esad Smajlbegovic **Surprise in Short Interest**	Tzuo Hann Law

SESSION B: ROOM "AUDITORIUM"

B1 Financial Intermediation *(p. 25)* Chair: Jan Schneemeier

TIME	AUTHORS AND PAPER	DISCUSSION
09:00	<u>Alexander Schäfer</u> **Beating the Black Box of Risk-Weighted Capital: Is a Leverage Ratio Justified?**	Marlis Schairer
09:30	Natalia Podlich, Isabel Schnabel, <u>Johannes Tischer</u> **Banks' Trading after the Lehman Crisis - Flight to Liquidity but No Fire Sales**	Maria Näther
10:00	Hans-Peter Burghof, <u>Marlis Schairer</u> **Loan Performance of Contractual Savings for Housing**	Alexander Schäfer
10.30	<u>Maria Näther</u>, Uwe Vollmer **National versus Supranational Bank Regulation: Gains and Losses of Joining a Banking Union**	Jan Schneemeier

B2 Interest Rates & Term Structure *(p. 27)* Chair: Christian Schlag

TIME	AUTHORS AND PAPER	DISCUSSION
11:30	Matteo Leombroni, Andrea Vedolin, <u>Gyuri Venter</u>, Paul Whelan **Central Bank Communication and the Yield Curve**	Leopold Sögner
12:00	Martin Møller Andreasen, Tom Engsted, <u>Stig Vinther Møller</u>, Magnus Sander **Bond Market Asymmetries across Recessions and Expansions: New Evidence on Risk Premia**	Gyuri Venter
12:30	Andrea Buraschi, Ilaria Piatti, <u>Paul Whelan</u> **Expected Term Structures**	Christian Schlag

B3 Market Microstructure I *(p. 29)* Chair: Karl Ludwig Keiber

TIME	AUTHORS AND PAPER	DISCUSSION
14:00	<u>Benjamin Clapham</u>, Martin Haferkorn, Kai Zimmermann **Does Speed Matter? The Role of High-Frequency Trading for Order Book Resiliency**	Alex Weissensteiner
14:30	<u>Andriy Shkilko</u>, Konstantin Sokolov **Every Cloud Has a Silver Lining: Fast Trading, Microwave Connectivity and Trading Costs**	Karl Ludwig Keiber
15:00	<u>Thomas Johann</u>, Erik Theissen **The Best in Town: A Comparative Analysis of Low-Frequency Liquidity Estimators**	Nils Friewald

B4 Household Finance *(p. 31)* Chair: Martin Brown

TIME	AUTHORS AND PAPER	DISCUSSION
15:45	<u>Tobin Hanspal</u> **The Effect of Personal Financing Disruptions on Entrepreneurship**	Jordan Moore
16:15	Christine Laudenbach, Benjamin Loos, <u>Jenny Pirschel</u> **Recent Experiences and Risk Taking: Trading Responses to Changes in the Local Environment**	Thomas A. Maurer
16:45	Benjamin Bennett, Radhakrishnan Gopalan, <u>Thomas A. Maurer</u> **The Collateral Value of Housing: Evidence from Servicemember Pension Choice**	Alexander Hillert

SESSION C: ROOM "ASK"

C1 Corporate Finance I *(p. 33)*   Chair: Jasmin Gider

TIME	AUTHORS AND PAPER	DISCUSSION
09:00	Alexander Hillert, Anja Kunzmann, Stefan Ruenzi **M & A(dvertising)**	Ettore Croci
09:30	Gishan Dissanaike, Wolfgang Drobetz, Peyman Momatz **Does Competition Policy Affect Acquisition Efficiency? Evidence from the Reform of European Merger Control**	Iana Zborshchyk
10:00	Axel Kind, Iana Zborshchyk **Why Do Managers Misrepresent Financial Statements?**	Felix von Meyerinck
10:30	Constantin Charles, Markus Schmid, Felix von Meyerinck **Peer Pressure in Corporate Earnings Management**	Jasmin Gider

C2 Corporate Finance II *(p. 35)*   Chair: Markus Schmid

TIME	AUTHORS AND PAPER	DISCUSSION
11:30	Peter Cziraki, Jasmin Gider **Perks or Peanuts? The Dollar Profits to Insider Trading**	Andrea Schertler
12:00	Felix von Meyerinck, Kirsten Tangaa Nielsen **Executive Networks and Shareholder Value: Evidence from Sudden Deaths**	Isabella Karasamani
12:30	Emanuele Bajo, Ettore Croci, Nicoletta Marinelli **Institutional Investor Networks and Firm Value**	Wolfgang Drobetz

C3 Corporate Finance III *(p. 37)*   Chair: Alexander F. Wagner

TIME	AUTHORS AND PAPER	DISCUSSION
14:00	Vidhan K. Goyal, Daniel Urban, Wenting Zhao **Index Membership and Capital Structure: International Evidence**	Felix von Meyerinck
14:30	Philipp Horsch, Philip Longoni, David Oesch **Intangible Capital and Firm Leverage**	Anja Kunzmann
15:00	Mascia Bedendo, Emilia Garcia-Appendini, Linus Siming **Cultural Traits and the Choice between Formal and Informal Financing**	Alexander F. Wagner

C4 Corporate Governance *(p. 39)*   Chair: Linus Siming

TIME	AUTHORS AND PAPER	DISCUSSION
15:45	Nihat Aktas, Panayiotis C. Andreou, Isabella Karasamani, Dennis Philip **CEO Duality, Agency Costs, and Internal Capital Allocations**	David Oesch
16:15	Ranja Gibson Brandon, Matthias Sohn, Carmen Tanner, Alexander F. Wagner **Investing in Managerial Honesty**	Daniel Urban
16:45	Thomas K. Kick, William L. Megginson, Andrea Schertler **Bank Executives' outside Directorships and Career Outcomes**	Linus Siming

SESSION D: ROOM "BID"

D1 Derivatives I *(p. 41)* Chair: Fabian Hollstein

TIME	AUTHORS AND PAPER	DISCUSSION
09:00	Steffen Hitzemann, Michael Hofmann, Marliese Uhrig-Homburg, Christian Wagner **Margin Requirements and Equity Option Returns**	Hendrik Hülsbusch
09:30	Manuel Ammann, Marc Arnold, Simon Straumann **Illuminating the Dark Side of Financial Innovation: The Role of Investor Information**	Michael Hofmann
10:00	Luis Goncalves-Pinto, Bruce D. Grundy, Allaudeen Hameed, Thijs van der Heijden, Yichao Zhu **Why Do Option Prices Predict Stock Returns? The Role of Price Pressure in the Stock Market**	Simon Straumann
10:30	Manuel Ammann, Alexander Feser **Information Uncertainty and the Puzzle of Option-Implied Skewness**	Fabian Hollstein

D2 Derivatives II *(p. 43)* Chair: Thijs van der Heijden

TIME	AUTHORS AND PAPER	DISCUSSION
11:30	Mohammad Ali Isleimeyyeh **The Role of Financial Investors in Commodity Futures Risk Premium**	Peter Hieber
12:00	Fabian Hollstein, Marcel Prokopczuk, Chardin Wese Simen **The Term Structure of Option Prices**	Alexander Feser
12:30	Nicole Branger, Hendrik Hülsbusch, Alexander Kraftschik **The Volatility-of-Volatility Term Structure**	Thijs van der Heijden

D3 Behavioral Finance I *(p. 45)* Chair: Vikram Nanda

TIME	AUTHORS AND PAPER	DISCUSSION
14:00	Nic Schaub **The Role of Data Providers as Information Intermediaries**	Tobin Hanspal
14:30	Jordan Moore **Rankings of Published P/E Ratios and Value Investor Attention**	Michael Ungeheuer
15:00	Michael Ungeheuer, Martin Weber **The Perception of Dependence, Investment Decisions, and Stock Prices**	Vikram Nanda

D4 Behavioral Finance II *(p. 47)* Chair: Nic Schaub

TIME	AUTHORS AND PAPER	DISCUSSION
15:45	Alok Kumar, Stefan Ruenzi, Michael Ungeheuer **Daily Winners and Losers**	Patrick Launhardt
16:15	Barbara Seitz, Andreas W. Rathgeber, Alfred Lameli, Tobias Gaugler **Sharing More than Dialects: Herding Behavior in Bank Risk-Taking Explained by Cultural Vicinity**	Michael Ungeheuer
16:45	Suman Banerjee, Vikram Nanda, Steven Xiao **Using Managerial Attributes to Identify Market Feedback Effects: The Case of Mutual Fund Fire Sales**	Nic Schaub

SESSION E: ROOM "DECISION"

E1 Asset Allocation *(p. 49)*   Chair: Michael Herold

TIME	AUTHORS AND PAPER	DISCUSSION
09:00	Giuliano Curatola, Ilya Dergunov **International Portfolio Diversification and Macroeconomic Fluctuations when Preferences Are Time-Varying**	Denitsa Stefanova
09:30	Claus Munk **A Mean-Variance Benchmark for Household Portfolios over the Life Cycle**	Julian Thimme
10:00	Redouane Elkamhi, Denitsa Stefanova **Where to Hide in Bad Times: Or Should One Still Diversify Internationally?**	Ferenc Horvath
10:30	Ferenc Horvath, Frank de Jong, Bas J.M. Werker **Robust Pricing of Fixed Income Securities**	Paul Whelan

E2 Asset Pricing I *(p. 51)*   Chair: Claus Munk

TIME	AUTHORS AND PAPER	DISCUSSION
11:30	Tom Engsted, Thomas Quistgaard Pedersen **The Predictive Power of Dividend Yields for Future Inflation: Money Illusion or Rational Causes?**	Giuliano Curatola
12:00	Bjarne A. Jensen, Marcel Fischer **The Debt Tax Shield, Economic Growth and Inequality**	Malte Schumacher
12:30	Michael Donadelli, Patrick Grüning **Innovation Dynamics and Fiscal Policy: Implications for Growth, Asset Prices, and Welfare**	Claus Munk

E3 Financial Economics *(p. 53)*   Chair: Patrick Grüning

TIME	AUTHORS AND PAPER	DISCUSSION
14:00	Stine Louise Daetz, Marti G. Subrahmanyam, Dragon Yongjun Tang, Sarah Qian Wang **Did ECB Liquidity Injections Help the Real Economy?**	Regina Hammerschmid
14:30	Jan Schneemeier **Shock Propagation through Cross-Learning in Opaque Markets**	Johannes Tischer
15:00	Ally Zhang **Amplification and Spillover with Financial Arbitrage, Production and Collateral Constraints**	Patrick Grüning

E4 Asset Pricing II *(p. 55)*   Chair: Bjarne A. Jensen

TIME	AUTHORS AND PAPER	DISCUSSION
15:45	Christian Schlag, Michael Semenischev, Julian Thimme **Predictability and the Cross-Section of Expected Returns in Models with Long-Run Risks**	Ole Wilms
16:15	Nicole Branger, Nikolai Graeber, Malte Schumacher **Asset Pricing in Production Economies when Capital Inputs Are Heterogeneous**	Ally Zhang
16:45	Walter Pohl, Karl Schmedders, Ole Wilms **Asset Pricing with Heterogeneous Agents and Long-Run Risk**	Bjarne A. Jensen

SESSION F: ROOM "EXECUTIVE"

F1 Insurance *(p. 57)*   Chair: Matthias Muck

TIME	AUTHORS AND PAPER	DISCUSSION
09:00	Martin Eling, Ruo Jia, <u>Philipp Schaper</u> **Get the Balance Right: A Simultaneous Equation Model to Analyze Growth, Profitability, and Safety**	Oliver Lubos
09:30	Antje Mahayni, Oliver Lubos, <u>Sascha Offermann</u> **Minimum Return Rate Guarantees under Default Risk - Optimal Design of Quantile Guarantees**	Thai Huu Nguyen
10:00	An Chen, <u>Peter Hieber</u>, Thai Nguyen **Funding Life Insurance Contracts with Guarantees: How Can We Optimally Respond to the Policyholder's Needs?**	Katharina Stein
10:30	Nicole Branger, Antje Mahayni, Nicolaus Schweizer, <u>Cathleen Sende</u> **Precautionary Saving and Insurance under Generalized Mean-Variance Preferences**	Christian Hilpert

F2 Credit Risk *(p. 59)*   Chair: Simone Westerfeld

TIME	AUTHORS AND PAPER	DISCUSSION
11:30	Stefan Morkoetter, <u>Roman Stebler</u>, Simone Westerfeld **Revenues versus Reputation: Warring Incentives in the Rating Industry**	Günseli Tümer-Alkan
12:00	<u>Christian Hilpert</u>, Stefan Hirth, Alexander Szimayer **History Matters - Credit Rating under Asymmetric Information**	Stine Louise Daetz
12:30	Yalin Gündüz, Steven Ongena, <u>Günseli Tümer-Alkan</u>, Yuejuan Yu **CDS and Credit: Testing the Small Bang Theory of the Financial Universe with Micro Data**	Andreas W. Rathgeber

F3 Risk Management & Financial Econometrics *(p. 61)*   Chair: Antje Mahayni

TIME	AUTHORS AND PAPER	DISCUSSION
14:00	An Chen, <u>Thai Huu Nguyen</u>, Mitja Stadje **Optimal Investment under VaR-Regulation and Minimum Insurance**	Philipp Schaper
14:30	Jon Danielsson, <u>Chen Zhou</u> **Why Risk Is So Hard to Measure**	Roman Stebler
15:00	Jaroslava Hlouskova, <u>Leopold Sögner</u> **GMM Estimation of Affine Term Structure Models**	Chen Zhou

F4 Market Microstructure II *(p. 63)*   Chair: Andriy Shkilko

TIME	AUTHORS AND PAPER	DISCUSSION
15:45	<u>Karl Ludwig Keiber</u> **Insider Trading and Sentiment Trading**	Benjamin Clapham
16:15	<u>Alex Weissensteiner</u> **Correlated Noise - On Why Passive Investment Might Improve Market Efficiency**	Thomas Johann
16:45	<u>Nils Friewald</u>, Florian Nagler **Dealer Inventory and the Cross-Section of Corporate Bond Returns**	Andriy Shkilko

PAPER AVAILABILITY

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

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For further information, please also refer to the conference homepage

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PAPER ABSTRACTS

Commodity Return Predictability

Regina Hammerschmid (University of Zurich)

The futures curve of an aggregate commodity portfolio is time-varying and changes from upward (contango) to downward sloping (backwardation) which implies negative or positive expected returns. The basis arises as a natural fundamental to predict commodity returns. However, the empirical evidence on the aggregate portfolio level is very weak. I construct a factor based on different forward rates along the futures curve and find that commodity returns are predictable. Economic fundamentals, such as industrial production or global trade, positively predict aggregate commodity returns and used jointly with this forward rates factor significantly improve overall predictability in- and out-of-sample. I find evidence that expected aggregate commodity returns are procyclical. When economic activity is high, the commodity yield curve tends to be inverted and expected returns are high.

Higher Moments Matter! Cross-Sectional (Higher) Moments and the Predictability of Stock Returns

Sebastian Stöckl (University of Liechtenstein)
Lars Kaiser (University of Liechtenstein)

In this paper we investigate the predictive power of cross-sectional volatility, skewness and kurtosis for future stock returns. Adding to the work of Maio (2016), who finds cross-sectional volatility (CSV) to forecast a decline in the equity premium with high predictive power in-sample as well as out-of-sample, we highlight the additional role of cross-sectional skewness (CSS) and cross-sectional kurtosis (CSK). Applying a principal component approach, we show that cross-sectional higher moments add to the quality of CSV by stabilizing the predictive performance and yielding a positive trend in and out-of-sample predictive quality since the burst of the dot-com bubble. In particular, we observe CSS to span the predictive quality of CSV over short-forecasting horizons, whereas CSK significantly contributes to long-horizon forecasting of 12 months and above. Results are both statistically and economically significant.

PAPER ABSTRACTS: A1 EMPIRICAL ASSET PRICING I

Dividend Risk Premia

Georg Cejnek (ZZ Vermögensverwaltung; Vienna)
Otto Randl (WU Vienna University of Economics and Business)

This paper studies time variation in expected excess returns of traded claims on dividends, bonds, and stock indices for international markets. We introduce a novel dividend risk factor which complements the well-known bond risk factor of Cochrane and Piazzesi (2005) for the U.S., the U.K., the Eurozone and Japan, and run predictive regressions of one-year annual excess returns on both risk factors. Employing our dividend risk factor and the bond risk factor jointly we are able to fit the variation in local stock index returns well. By aggregating over the factors of the four core regions, we create global dividend and bond risk factors which capture excess returns of most of the developed market MSCI country indices as well as a variety of other assets including high yield bonds and a volatility selling strategy. Our findings highlight the value of the information contained in the dividend and bond forward curves and suggest substantial comovement in international risk premia.

The Leading Premium

M. Max Croce (University of North Carolina-Chapel Hill)
Tatyana Marchuk (Goethe University Frankfurt)
Christian Schlag (Goethe University Frankfurt)

In this paper, we compute conditional measures of lead-lag relationships between GDP growth and industry-level cash-flow growth in the US. Results show that firms in leading industries pay an average annualized return 4% higher than that of firms in lagging industries. The difference in the returns of leading and lagging firms is priced in the cross section of equity returns, even after we adjust for the Fama-French three-factor model. This finding can be rationalized in a model in which (a) agents price growth news shocks, and (b) leading industries provide valuable resolution of uncertainty about the growth prospects of lagging industries.

Optimal Factor Strategy in FX Markets

Thomas A. Maurer (Washington University in St. Louis)
Thuy-Duong Tô (University of New South Wales)
Ngoc-Khanh Tran (Washington University in St. Louis)

We construct a dynamic currency trading strategy that earns a remarkable out-of-sample Sharpe ratio of 1.04 before and 0.78 after transaction costs. It substantially outperforms other popular carry trade strategies in terms of Sharpe ratio, skewness, kurtosis, maximum drawdown, expected recovery time, and percentage of positive returns. Popular factor pricing models in international finance do not explain the superior performance. Our strategy predicts future (1- to 24-month ahead) returns and changes in global FX market volatility. A pricing model using our trading strategy as a single factor outperforms and subsumes the popular "Dollar"-"Carry" two factor pricing model.

Is Liquidity Risk Priced in Partially Segmented Markets?

Ines Chaieb (University of Geneva and Swiss Finance Institute)
Vihang Errunza (McGill University)
Hugues Langlois (HEC Paris)

We analyze the impact of liquidity costs and market segmentation on asset pricing. The freely traded securities command a global market risk premium and world liquidity risk premia whereas the securities that can be held by only a subset of investors command additionally a conditional local market risk premium and conditional local liquidity risk premia. Our model provides a formal framework for testing important issues such as liquidity levels and risks in a realistic world market setting and for examining the interaction between investability and illiquidity. Empirical test results for a sample of 21 emerging markets strongly support theoretical predictions.

Equity is Cheap for Large Financial Institutions: The International Evidence

Priyank Gandhi (University of Notre Dame)
Hanno Lustig (Stanford Graduate School of Business and NBER)
Alberto Plazzi (USI Lugano and Swiss Finance Institute)

Equity is a cheap source of funding for a country's largest financial institutions. In a large panel of 31 countries, we find that the stocks of a country's largest financial companies earn returns that are significantly lower than stocks of non-financials with the same risk exposures. In developed countries, only the largest banks' stock earns negative risk-adjusted returns, but, in emerging market countries, other large non-bank financial firms do. Even though large banks have high betas, these risk-adjusted return spreads cannot be attributed to the risk anomaly. Instead, we find that the large-minus-small, financial-minus-nonfinancial, risk-adjusted spread varies across countries and over time in ways that are consistent with stock investors pricing in the implicit government guarantees that protect shareholders of the largest banks. The spread is significantly larger for the largest banks in countries with deposit insurance, backed by fiscally strong governments, and in common law countries that offer shareholders better protection from expropriation. Finally, the spread predicts large crashes in that country's stock market and output.

PAPER ABSTRACTS: A3 EMPIRICAL ASSET PRICING II

The Value of Visibility

Alexander Hillert (Goethe University Frankfurt)
Michael Ungeheuer (University of Mannheim)

We analyze the relation between firm visibility and stock returns, using a novel dataset on New York Times coverage of U.S. firms from 1924 to 2013. We find that firms with persistently higher levels of media coverage exhibit predictably higher returns. Top-quintile outperform bottom-quintile coverage stocks by 2.64% per year (Sharpe Ratio of 0.47, Momentum: 0.47). Higher media coverage predicts significant improvements in corporate governance, as well as higher sales growth and profitability growth. Thus the evidence is consistent with visibility creating value through monitoring and advertising, while stock markets inadequately price the positive effects of firm visibility.

The Out-of-Sample Predictive Power of Aggregate Insider Trading

Andre Guettler (Ulm University)
Patrick Hable (2iQ Research GmbH)
Patrick Launhardt (Ulm University)

In this paper, we investigate whether aggregate insider trading improves the performance of models forecasting equity premia commonly considered in the literature. We show that aggregate insider trading contributes to most of these benchmark models in statistical and economic terms. Furthermore, our investigation reveals that in contrast to previous studies which confine predictability to recession periods, aggregate insider trading provides investors with an indicator to improve forecasts in expansions. Lastly, based on insiders' and short sellers' ability to predict cash flows, our results suggest that combining insider and short selling information yields a valuable model to forecast equity premia.

PAPER ABSTRACTS: A3 EMPIRICAL ASSET PRICING II

Fearing the Fed: How Wall Street Reads Main Street

Tzuo Hann Law (Boston College)
Dongho Song (Boston College)
Amir Yaron (University of Pennsylvania)

Using intraday equity returns around macroeconomic news announcements (MNAs), we find strong evidence of persistent cyclical variation in equity's response to MNA surprises. The reaction of equity is particularly strong coming out of recessions and is gradually attenuated as the economy expands. We show that this cyclical pattern can be explained by a regime-switching model. In the model, we find that the direction and duration of the market's response reflects the evolution of market beliefs about monetary policy. The risk of an interest rate hike can entirely mitigate (and even reverse) the effect of positive MNA surprises on returns. This mechanism is consistent with the data - positive MNA surprises coincide with negative stock market returns when there is substantial uncertainty over monetary policy.

PAPER ABSTRACTS: A4 EMPIRICAL ASSET PRICING III

Anomalies across the Globe: Once Public, No Longer Existent?

Heiko Jacobs (University of Mannheim)
Sebastian Müller (German Graduate School of Management and Law)

Motivated by McLean and Pontiff (2016), we study the pre- and post-publication return predictability of 138 anomalies in 39 stock markets. Based on more than a million anomaly country-months, we find that the United States is the only country with a statistically significant and economically meaningful post-publication decline in long/short returns. The surprisingly large differences between the U.S. and international markets cannot be fully explained with general time effects or differences in limits to arbitrage, in-sample anomaly profitability, data availability, or local risk factor exposure. Our results have implications for the recent literature on arbitrage trading, data mining, and market segmentation.

Analyzing the Risk of an Illiquid Asset: The Case of Fine Wine

Philippe Masset (Ecole hôtelière de Lausanne)
Jean-Marie Cardebat (Université de Bordeaux & Bordeaux Wine Economics)
Benoît Faye (INSEEC and Bordeaux Wine Economics)
Eric Le Fur (INSEEC and Bordeaux Wine Economics)

We use a unique and very deep database to examine the performance of wine investments during 2003-2014. Our results reveal that the returns stemming from those investments are important but can largely be explained by their exposure to common risk factors. As such and contradicting prior evidence, fine wines do not seem to offer abnormal returns. While explicitly accounting for non-synchronous trading, we indeed show that the market beta of wine is always positive and significant. Liquidity risk also turns out to be an essential determinant of wine returns. The fact that the liquidity factor, which is estimated on the basis of stock returns, can explain the returns on an exotic asset such as wine suggests that illiquidity is a common, cross-asset source of risk. Hence, this paper contributes to the literature on alternative investments and wine as an asset class and provides additional evidence regarding the nature of liquidity risk.

Surprise in Short Interest

Pavel Lesnevski (University of Mannheim)
Esad Smajlbegovic (Erasmus University Rotterdam)

In this paper we propose a simple and intuitive proxy of informed short selling: surprise in short interest. This measure accounts for important cross-sectional differences in short selling and provides a number of novel insights. We find that stocks with a positive surprise in short interest significantly underperform stocks with a negative surprise in short interest. This return spread is not explained by standard stock characteristics or short-sale constraints. Consistent with the notion of short sellers' informed trading, the surprise in short interest also predicts future surprises in company fundamentals. Lastly, in line with Shleifer and Vishny's (1997) limits-to-arbitrage argument, the return predictability is stronger among illiquid and volatile stocks.

PAPER ABSTRACTS: B1 FINANCIAL INTERMEDIATION

Beating the Black Box of Risk-Weighted Capital: Is a Leverage Ratio Justified?

Alexander Schäfer (German Council of Economic Experts)

We compare Basel's risk-weighted-assets ratio to an un-weighted leverage ratio in explaining bank distress amid the subprime crisis, using banks' profits of a broad global sample as a dependent variable. Our key findings are: (i) Based on the full sample, the leverage ratio serves as the better predictor for bank distress, confirming the results of numerous recent studies. (ii) Controlling for different bank types, the superior predictive power of the leverage ratio holds only for banks that are exposed to a large amount of market risk. This result might be attributed to the market risk amendment to Basel I in 1996 under which banks were allowed to calibrate their risk-weighted assets for market risk exposures on the basis of proprietary risk models. (iii) When banks are traditionally regulated by a leverage ratio such as in the US or Canada, the leverage ratio again loses predictive power in explaining bank distress. This may be due to the built up in off-balance leverage of US banks prior to the crisis which was not accounted as formal leverage. Hence, an ill-designed leverage ratio might be prone to manipulation and the proper design might rise substantial complexity issues. This is in contrast to strong claims in the policy debate that a leverage ratio will serve as a simple and transparent regulatory measure of bank risk.

Banks' Trading after the Lehman Crisis - Flight to Liquidity but No Fire Sales

Natalia Podlich (Deutsche Bundesbank)
Isabel Schnabel (University of Bonn, MPI Bonn, CEPR, and CESifo)
Johannes Tischer (University of Bonn, Deutsche Bundesbank, and GSEFM Frankfurt)

Based on a detailed trade-level dataset, we analyze the proprietary trading behavior of German banks in the months directly preceding and following the Lehman collapse in September 2008. We consider both the immediate reaction after the event and the response to unconventional monetary policy measures introduced shortly after – the introduction of full allotment and the change in eligibility criteria for collateral in central bank refinancing operations. We do not find any evidence of fire sales in the German banking sector although price reactions point towards tight market liquidity, especially after the Lehman collapse and in OTC markets. There is evidence of a flight to liquidity and possibly a search for yield, but not of distress sales. Banks' trading behavior depends on whether they are constrained or not with respect to their liquidity and capital positions. Price reactions are mostly driven by constrained banks.

PAPER ABSTRACTS: B1 FINANCIAL INTERMEDIATION

Loan Performance of Contractual Savings for Housing

Hans-Peter Burghof (University of Hohenheim)
Marlis Schairer (University of Hohenheim)

We argue that the combination of a loan with a mandatory saving period as a precondition for loan approval can be used as a mechanism to improve the creditworthiness of the pool of borrowers. This result is based on the argument that the personal creditworthiness of a borrower is strongly correlated with his ability to save on a regular basis. Using in house data of a large German CSH supplier we estimate a Cox Proportional Hazard Model to show that default rates of CSH contracts are in fact lower than those of comparable loans. This effect remains after controlling for other information on the creditworthiness of the borrower.

National versus Supranational Bank Regulation: Gains and Losses of Joining a Banking Union

Maria Näther (Leipzig University)
Uwe Vollmer (Leipzig University)

We ask how the structure of international banking affects the decision of a national regulator to join a banking union. In a banking union regulatory powers of a national supervisor are transferred to the supranational level. We focus on capital requirements, which limit bank leverage, prevent bank risk taking, and restrict bank return in case of project success. A national regulator ignores possible gains or losses, which accrue to other jurisdictions if banks are internationally active, while a supranational regulator takes also these spillover effects into account. We analyze the origin, size, and determinants of spillover effects and show how they constrain a country´s willingness to participate in a banking union. Our results may explain why some Member States of the European Union currently hesitate to join European Banking Union.

Central Bank Communication and the Yield Curve

Matteo Leombroni (Stanford University)
Andrea Vedolin (London School of Economics)
Gyuri Venter (Copenhagen Business School)
Paul Whelan (Copenhagen Business School)

We extract novel measures of ECB target rate announcement and communications shocks using high frequency data on money market rates and study their impact on yields of Eurozone countries. We document the following results: First, we find little significant effect for shocks during the target rate decision window, but both economically and statistically highly significant effects during the communication window; hence, forward guidance matters. Second, monetary policy shocks during the communication window mainly affect yields at intermediate maturities. Third, we observe large cross-sectional differences across countries, with yields in peripheral countries being less affected than in core countries. Finally, monetary policy shocks significantly reduce the yield spread between peripheral and core countries especially during the most recent debt crisis. We rationalize these findings in a parsimonious international term structure model where interest rates are determined by the interaction between risk-averse arbitrageurs and reaching-for-yield investors.

Bond Market Asymmetries across Recessions and Expansions: New Evidence on Risk Premia

Martin Møller Andreasen (Aarhus University)
Tom Engsted (Aarhus University)
Stig Vinther Møller (Aarhus University)
Magnus Sander (Aarhus University)

This paper provides new evidence on bond risk premia by conditioning the classic Campbell-Shiller regressions on the business cycle. In expansions, we find mostly positive intercepts and negative slopes, but the results are completely reversed in recessions with negative intercepts and positive slopes. The pattern in these coefficients is explained by a term structure model with business cycle dependent loadings in the market price of risk. This model also predicts realized excess returns with the right sign during expansions and recessions, whereas the Gaussian ATSM is unable to explain realized excess returns on medium- and long-term bonds during recessions.

Expected Term Structures

Andrea Buraschi (Imperial College Business School)
Ilaria Piatti (University of Oxford)
Paul Whelan (Copenhagen Business School)

This paper studies the properties of bond risk premia in the cross-section of subjective expectations. We exploit an extensive dataset of yield curve forecasts from financial institutions and document a number of novel findings. First, contrary to evidence presented for stock markets but consistent with rational expectations, the relation between subjective expectations and future realizations is positive, and this result holds for the entire cross-section of beliefs. Second, when predicting short term interest rates, primary dealers display superior forecasting ability when compared to non-primary dealers. Third, we reject the null hypothesis that subjective expected bond returns are constant. When predicting long term rates, however, primary dealers have no information advantage. This suggests that a key source of variation in long-term bonds are risk premia and not short-term rate variation. Fourth, we show that consensus beliefs are not a sufficient statistics to describe the cross-section of beliefs. Moreover, the beliefs of the most accurate agents are those most spanned by a contemporaneous cross-section of bond prices. This supports equilibrium models and Friedman's market selection hypothesis. Finally, we use ex-ante spanned subjective beliefs to evaluate several reduced-form and structural models. We find support for heterogeneous beliefs models and also uncover a number of statistically significant relationships in favour of alternative rational expectations models once the effect of heterogeneous beliefs is taken into account.

PAPER ABSTRACTS: B3 MARKET MICROSTRUCTURE I

Does Speed Matter? The Role of High-Frequency Trading for Order Book Resiliency

Benjamin Clapham (Goethe University Frankfurt)
Martin Haferkorn (Goethe University Frankfurt)
Kai Zimmermann (Goethe University Frankfurt)

This paper explores limit order book resiliency following liquidity shocks in the presence of high-frequency traders. Based on a unique data set that enables the identification of orders submitted by algorithms and subscribers of co-location services, we study whether high-frequency traders are involved in the replenishment of the order book. We analyze order submission and deletion activity before and after liquidity shocks initiated by large market orders. Our results show that exclusively high-frequency traders reduce the spread within the first seconds after the liquidity shock making use of their speed advantage. However, liquidity recovery in terms of order book depth takes significantly longer and is accomplished by human traders' submission activity only.

Every Cloud Has a Silver Lining: Fast Trading, Microwave Connectivity and Trading Costs

Andriy Shkilko (Wilfrid Laurier University)
Konstantin Sokolov (Wilfrid Laurier University)

In modern markets, trading firms spend generously to gain a speed advantage over their rivals. The marketplace that results from this rivalry is characterized by speed differentials, whereby some traders are faster than others. Is such a marketplace optimal? To answer this question, we study a series of exogenous weather-related episodes that temporarily remove speed advantages of the fastest traders by disrupting their microwave networks. During these episodes, adverse selection declines accompanied by improved liquidity and reduced volatility. Liquidity improvement is larger than the decline in adverse selection consistent with the emergence of latent liquidity and enhanced competition among liquidity suppliers. The results are confirmed in an event-study setting, whereby a new business model adopted by one of the technology providers reduces speed differentials among traders, resulting in liquidity improvements.

The Best in Town: A Comparative Analysis of Low-Frequency Liquidity Estimators

Thomas Johann (University of Mannheim)
Erik Theissen (University of Mannheim)

In this paper we conduct the most comprehensive comparative analysis of low-frequency liquidity measures so far. We review a large number of estimators and use a broad range of procedures to evaluate them. We find that the performance of estimators is highly dependent on the particular application and that no single best estimator exists. Against this background, we further analyze which firm characteristics determine the accuracy of the low-frequency estimators, we analyze whether a composite low-frequency estimator can outperform the best individual measures, and we analyze whether changes in the trading protocol (such as a reduction of the minimum tick size or the introduction of NYSE Open Book and NYSE Hybrid) affect the performance of the low-frequency estimators. Our ultimate objective is to guide researchers in their search for the right measure for a particular application.

PAPER ABSTRACTS: B4 HOUSEHOLD FINANCE

The Effect of Personal Financing Disruptions on Entrepreneurship

Tobin Hanspal (Goethe University Frankfurt)

I show that disruptions to personal sources of financing, aside from commercial lending supply shocks, impair the survival and growth of small businesses. Entrepreneurs holding deposit accounts at retail banking institutions that defaulted following the financial crisis reduce personal borrowing and are consequently more likely to exit their firm. Exposure to the corresponding investment losses from delisted publicly traded bank stocks strongly reduces the rate of firm survival, particularly for early-stage ventures. At the intensive margin, owners who remain in business reduce employees after personal wealth losses. My results suggest that personal finance is an important component of firm financing.

Recent Experiences and Risk Taking: Trading Responses to Changes in the Local Environment

Christine Laudenbach (Goethe University Frankfurt)
Benjamin Loos (University of Mannheim)
Jenny Pirschel (Centre for European Economic Research)

Factors determining individual investors' (over)trading and risk-taking behavior are difficult to establish. Using panel data, we compare the behavior of individual investors with different exposures to non-informative shocks within their local environment. We use ZIP codes to match investors with nearby bankruptcies of mostly small firms. Results show that investors increase turnover and decrease risk taking, and that trading responses are strongly related to the proximity and recency of local bankruptcies. Results are similar when we limit the analysis to investors least likely to be personally affected by bankruptcies.

PAPER ABSTRACTS: B4 HOUSEHOLD FINANCE

The Collateral Value of Housing: Evidence from Servicemember Pension Choice

Benjamin Bennett (Ohio State University)
Radhakrishnan Gopalan (Washington University in St. Louis)
Thomas A. Maurer (Washington University in St. Louis)

We evaluate the effect of personal characteristics and house prices on servicemembers' pension choices, which vary in the time-profile of cash flows. Personal discount rates vary through time between 2001-2009 and are larger during crisis years. Due to the collateral value of housing, an increase in house prices is associated with a lower propensity of servicemembers choosing immediate liquidity. The effect of house prices is robust to controlling for macroeconomic factors including GDP growth, per capita income growth, changes in the state coincident index, unemployment rate, interest rates, stock returns and the net percentage of banks tightening loan standards.

M & A(dvertising)

Alexander Hillert (Goethe University Frankfurt)
Anja Kunzmann (University of Mannheim)
Stefan Ruenzi (University of Mannheim)

We investigate the advertising strategies of firms around the announcement of mergers and acquisitions. We assume managers believe product advertising to be an effective tool in attracting investors' attention, which may result in temporarily increased stock prices. Target firms make use of this tool: In the quarter before the announcement of a stock-financed M&A deal, we observe an average increase of 62% in their advertising expenses. For acquiring firms, we do not find any increased advertising before stock-financed M&As. However, we do observe a significant increase in advertising in the week after the announcement suggesting that acquirers want to transfer a positive image and convince target shareholders to accept the deal.

Does Competition Policy Affect Acquisition Efficiency? Evidence from the Reform of European Merger Control

Gishan Dissanaike (University of Cambridge)
Wolfgang Drobetz (Hamburg University)
Peyman Momtaz (Hamburg University)

We use the reform of the European Commission Merger Regulation as a natural experiment to examine the more general relationship between merger control and the profitability of corporate acquisitions. Our results suggest that acquisition efficiency is significantly lower in controlled deals, but the reform-induced improvement of legal certainty ameliorated this effect. These valuation effects are more pronounced in concentrated industries and in national cultures where firms tend to be more intolerant to uncertainty. Our results are consistent with the hypothesis that uncertainty about merger control decisions impedes M&A activity, which amplifies managerial entrenchment and enables managers to make agency-motivated acquisitions.

PAPER ABSTRACTS: C1 CORPORATE FINANCE I

Why Do Managers Misrepresent Financial Statements?

Axel Kind (University of Konstanz)
Iana Zborshchyk (University of Konstanz)

We study the relation between managerial ability and financial fraud. In a principal-agent model, accounting manipulation arises endogenously as a manager's response to incentives provided by (i) equity-based compensation, (ii) the risk of violating debt covenants, and (iii) the pressure to perform due to high expectations. The model suggests that more skillful managers are less likely to engage in illegal accounting manipulation. The results of an empirical analysis conducted on a matched sample of 128 manipulating and 302 control firms indicate that an increase in managerial ability from its lower to its upper quartile reduces financial fraud in a range between -19% and -32%, depending on the model specification. However, we do not find empirical support for the often-discussed link between equity-based compensation and financial fraud.

Peer Pressure in Corporate Earnings Management

Constantin Charles (University of St.Gallen)
Markus Schmid (University of St.Gallen)
Felix von Meyerinck (University of St.Gallen)

We show that peer firms play an important role in shaping corporate earnings management decisions. To overcome identification issues in isolating peer effects, we use fund flow-induced selling pressure by passive open-end equity mutual funds as exogenous shocks to firms' stock prices. Managers respond to such exogenous price shocks by adjusting earnings management policies. We then measure individual firms' reactions to changes in earnings management at peer firms as a result of such exogenous price shocks. The documented peer effect in earnings management is not only statistically, but also economically significant. Our results are robust to alternative measures of fund flow-induced selling pressure and earnings management, and to estimating instrumental variables regressions in which we instrument peer firms' earnings management with mutual fund flow-induced selling pressure.

Perks or Peanuts? The Dollar Profits to Insider Trading

Peter Cziraki (University of Toronto)
Jasmin Gider (University of Bonn)

While prior research has documented large percentage returns to insider trading, it is less clear whether insiders make large dollar profits on their trades. This is the first paper to present large-sample, comprehensive evidence on the dollar profits from legal insider trading. We show that dollar profits are economically insignificant for a typical insider, the median insider in our sample earning annual abnormal profits of $464 per year. Further, we show that insiders with high abnormal returns on their trades do not make large dollar profits. We then gauge how much outside shareholders lose to insiders, estimating that a median amount of $3,000 is redistributed each firm-year from outsiders to corporate insiders. Finally, we use variation in SEC budgets over time and the implementation of SOX to assess whether governance can reduce insider trading profits. Here, we show that while returns decrease, dollar profits may actually increase with higher enforcement intensity or stricter reporting requirements. Overall, while trades of corporate insiders may predict future returns as prior research has shown, our results indicate that the typical insider benefits little from this information in dollar terms.

Executive Networks and Shareholder Value: Evidence from Sudden Deaths

Felix von Meyerinck (University of St.Gallen)
Kirsten Tangaa Nielsen (Copenhagen Business School)

This paper uses a large-scale quasi-natural experiment to determine the value of executive connections for firms' shareholders. The identification strategy rests on the idea that sudden executive deaths trigger unexpected and exogenous dissolutions of executive connections between firms. By studying the market reactions of the firms where the connected executives work, we are able to isolate the value of connections. Using a sample of 42 executives that suddenly pass away while working for S&P500 firms, our results show that connected firms experience a significant reduction in shareholder value. We also find evidence that connections to inside directors, connections established via previous overlapping work engagements, and within-industry connections are most valuable.

PAPER ABSTRACTS: C2 CORPORATE FINANCE II

Institutional Investor Networks and Firm Value

Emanuele Bajo (University of Bologna)
Ettore Croci (Catholic University of the Sacred Heart)
Nicoletta Marinelli (University of Macerata)

This paper investigates the role of institutional investor networks on firm value. Using US data over the period 2001-2013, we document that block-holdings from more central institutional investors (i.e. with larger co-ownership ties) enhance firm value more than those held by other investors. Our findings are consistent with the view that central institutional investors provide a certification benefit to the firm. On the opposite, we do not find evidence that the increase in value is due to monitoring, advisory, or information cost effects. The documented effects are robust to alternative specifications of network centrality and to endogeneity concerns.

PAPER ABSTRACTS: C3 CORPORATE FINANCE III

Index Membership and Capital Structure: International Evidence

Vidhan K. Goyal (Hong Kong University of Science and Technology)
Daniel Urban (TU Munich)
Wenting Zhao (TU Munich)

How much do shocks to the information environment in equity markets matter for debt supply and the financing of firms? We find that the use of debt increases by about 1-2 percentage points following exogenous additions of stocks to an index. The leverage response is primarily in public debt markets. These results suggest that index additions affect leverage because an increase in public information reduces information asymmetries for lenders and increases their willingness to buy information-sensitive debt. Indeed, stocks added to an index are followed by more equity analysts. Overall, we support the view that information production in equity markets spills over into debt markets.

Intangible Capital and Firm Leverage

Philipp Horsch (University of St.Gallen)
Philip Longoni (University of Zurich)
David Oesch (University of Zurich)

This study presents causal evidence that a loss of intangible capital affects capital structure by decreasing leverage. We instrument for a loss in intangible capital at the firm level by exploiting patent invalidations from the US Court of Appeals for the Federal Circuit (CAFC), where judges with heterogeneous attitudes towards patent validity are randomly assigned to court cases by a computer program. We find that patent invalidation leads to a statistically and economically significant decrease in leverage. The effect is stronger for firms with higher leverage, firms closer to default, and for firms using patents as loan collateral.

PAPER ABSTRACTS: C3 CORPORATE FINANCE III

Cultural Traits and the Choice between Formal and Informal Financing

Mascia Bedendo (Audencia Business School)
Emilia Garcia-Appendini (University of St.Gallen)
Linus Siming (Audencia Business School)

This paper documents that firm managers with different cultural backgrounds who live side-by-side to each other can display large and important differences in corporate financing decisions. We exploit cultural differences within a geographical area that shares a common regulatory, institutional, and macroeconomic framework: The autonomous province of South Tyrol in Northern Italy, which is mainly comprised of individuals from either an Italian or a Germanic cultural background. Firms with managers from the Italian group are less capitalized than firms run by managers from the Germanic group. This difference in capitalization translates into a more intense use of informal sources of financing: Italian-run firms resort significantly more to trade credit as a source of financing, and are willing to lend more credit to their customers. The differences we document can be explained by a culturally embedded preference for interacting within informal networks rather than within formal institutions.

CEO Duality, Agency Costs, and Internal Capital Allocations

Nihat Aktas (WHU – Otto Beisheim School of Management)
Panayiotis C. Andreou (Cyprus University of Technology and Durham University)
Isabella Karasamani (Cyprus University of Technology and Durham University)
Dennis Philip (Durham University)

This study examines the impact of CEO duality on investment allocation efficiency and firm value. When a CEO is also the chair of the board (i.e., dual CEO), the firm makes relatively more investments in business segments with low growth opportunities than do firms in which these roles are held by different individuals. Such capital (mis)allocations violate the internal capital market efficiency tenet, exhibiting negative overall value consequences. However, the adverse impact of CEO duality on investment efficiency and value prevails only in firms with low CEO compensation incentives. Overall, the findings of this study indicate that the capital allocation process is an important channel through which CEO duality lowers firm value, and compensation incentives are an important internal device to mitigate this negative value effect.

Investing in Managerial Honesty

Rajna Gibson Brandon (University of Geneva and Swiss Finance Institute)
Matthias Sohn (Zeppelin University)
Carmen Tanner (Zeppelin University and University of Zurich)
Alexander F. Wagner (University of Zurich and Swiss Finance Institute)

How does investor perception of managerial honesty affect investment choices? Do some investors try to avoid "sinful" CEOs, like they avoid "sin stocks"? Two laboratory experiments shed light on these questions. Investors on average perceive a CEO to be more committed to honesty when he previously resisted engaging in earnings management at personal cost. Differences in this perception lead to important differences in investment decisions. Higher perceived managerial commitment to truthfulness is attractive to both investors with an individualistic, profit-maximizing orientation and to pro-socially oriented investors, but for different reasons. The former are sensitive to announced future returns, and they discount the announcements of a CEO perceived as dishonest. The latter do not care about returns, but seek to invest with a CEO who shares their honesty values. Overall, these results suggest (a) that (perceived) honesty of the CEO matters, (b) a pivotal role of investors' personal values on their investment choices, and (c) that investors segment into stocks based on the joint effects of these two driving forces.

Bank Executives' outside Directorships and Career Outcomes

Thomas K. Kick (Deutsche Bundesbank)
William L. Megginson (University of Oklahoma)
Andrea Schertler (Leuphana University of Lüneburg)

We employ a unique sample of 5000+ outside directorships held by German executive bank directors over 1993-2015 to examine whether these directorships proxy reputational capital and/or bankers' private information. We exploit various circumstances of executive directors' appointments and bank performance with bank-fixed-effect and difference-in-differences estimations to show that outside directorships enhance value for the bank and improve executives' career outcomes, mostly because these posts signal good managerial ability and access to valuable private information about clients. Overall, our results suggest that bankers' outside directorships have a dual role in the German corporate governance system.

Margin Requirements and Equity Option Returns

Steffen Hitzemann (Ohio State University)
Michael Hofmann (Karlsruhe Institute of Technology)
Marliese Uhrig-Homburg (Karlsruhe Institute of Technology)
Christian Wagner (Copenhagen Business School)

In equity option markets, traders face margin requirements both for the options themselves and for hedging-related positions in the underlying stock market. We show that these requirements carry a significant margin premium in the cross-section of equity option returns. The sign of the margin premium depends on demand pressure: If end-users are on the long side of the market, option returns decrease with margins, while they increase otherwise. Our results are statistically and economically significant and robust to different margin specifications and various control variables. We explain our findings by a model of funding-constrained derivatives dealers that require compensation for satisfying end-users' option demand.

Illuminating the Dark Side of Financial Innovation: The Role of Investor Information

Manuel Ammann (University of St.Gallen)
Marc Arnold (University of St.Gallen)
Simon Straumann (University of St.Gallen)

This paper investigates the impact of investor information on financial innovations. We identify specific channels through which structured product issuers exploit retail investors by using their privileged access to information. Our results imply that imperfect investor information regarding volatility and dividends is crucial to explain the pricing and design of structured products. This insight is of systemic importance because it suggests that banks' behavior in the financial innovation market aggravates investor information problems of the financial system.

PAPER ABSTRACTS: D1 DERIVATIVES I

Why Do Option Prices Predict Stock Returns? The Role of Price Pressure in the Stock Market

Luis Goncalves-Pinto (National University of Singapore)
Bruce D. Grundy (University of Melbourne)
Allaudeen Hameed (National University of Singapore)
Thijs van der Heijden (University of Melbourne)
Yichao Zhu (Australian National University)

We show that option-based predictors of stock returns, such as implied-volatility spreads, skews, and changes therein, are significantly affected by price pressure in the stock market not reflected in option prices. These option-based predictors are transforms of the difference between the option-implied stock value and the traded stock price (DOTS). We find that DOTS is strongly related to return reversals, order imbalances, and illiquidity in stocks, but is only weakly related to trading activity in options. This suggests that price pressure in stocks is an important driver of the stock return predictability derived from option prices.

Information Uncertainty and the Puzzle of Option-Implied Skewness

Manuel Ammann (University of St.Gallen)
Alexander Feser (University of St.Gallen)

How is option-implied information incorporated into asset prices? We show empirically that option-implied quantile skewness is priced differently depending on which portion of the risk-neutral distribution it is estimated from: Quantile skewness estimated from the tail (center) of the risk-neutral distribution is positively (negatively) related to future stock returns. This finding explains contradictory results on the pricing of risk-neutral skewness in the literature. Our results are consistent with investors who rely on information from traded options and disregard information from the extrapolated tail of the volatility surface. Furthermore, we find that quantile skewness is highly correlated with central skewness but more robust. Estimates of quantile skewness are accurate even if option prices only span a small domain, have large gaps between strikes, and are observed with noise.

PAPER ABSTRACTS: D2 DERIVATIVES II

The Role of Financial Investors in Commodity Futures Risk Premium

Mohammad Ali Isleimeyyeh (Paris Dauphine University)

In this paper, I study the impact of financial investors on the commodities futures risk premium, that is the financialization of commodity markets. I implement our tests based on the theoretical model of Isleimeyyeh et al. (2017), which demonstrates that the futures risk premium is determined by the hedging pressure and the stock market returns restricted to the sign and the magnitude of commodity-equity correlation. I investigate three commodities: crude oil (WTI), natural gas and heating oil. The dataset covers the period between 1995 and 2015. The regressions are estimated for several futures maturities. First, I find that the impact of hedging pressure on the futures risk premium is stable between 1995 and 2015 for all maturities. Second, I show that the impact of stock returns on the futures risk premium becomes stable significant after 2008. For long maturities, I find that stock market effect is stronger than the hedging pressure impact.

The Term Structure of Option Prices

Fabian Hollstein (Leibniz University Hannover)
Marcel Prokopczuk (Leibniz University Hannover and University of Reading)
Chardin Wese Simen (University of Reading)

We derive the relationship between model-free option implied variance, correlation, and beta of different maturities. Consistent with the expectations hypothesis, we find that the slope of the term structure of variance is mainly informative about the path of future variance. In general, we also cannot reject the expectations hypothesis for the term structure of option implied correlation and beta. Hence, there is little indication of a time-varying term premium in these term structures. Our results are robust to the presence of jumps and further tests related to potential statistical biases.

The Volatility-of-Volatility Term Structure

Nicole Branger (University of Münster)
Hendrik Hülsbusch (University of Münster)
Alexander Kraftschik (University of Münster)

We use the model-free implied risk-neutral measure of variance and VIX option prices to investigate the volatility-of-volatility (VVIX) term structure. Using daily data from September 2007 to August 2014, we find that the term structure is in nearly all cases downward sloping and has fairly distinct dynamics compared to the term structure of the VIX. As such, both carry different pieces of information about market uncertainty. Our results show that the second PCA component (Slope^{VVIX}) of the VVIX, not its level, is a significant risk factor. In joint regressions, Slope^{VVIX} predicts straddle returns of S&P 500 and VIX options, incremental to the slope of the VIX term structure and the variance risk premium. To disentangle the different drivers of the VVIX term structure, we propose an affine approximation method of the VVIX. Using parameter estimates of a VIX option pricing model, we identify three factors that describe 95% of the daily levels of the term structure. Continuous volatility-of-volatility adds most to the term structure, followed by variance jumps and a lower bound component. The absolute and relative contribution of these factors vary systematically, reasoning the dynamics of the VVIX term structure. These systematic changes of the risk-factors can be explained well by the instantaneous variance-of-variance to variance (q/V) ratio.

PAPER ABSTRACTS: D3 BEHAVIORAL FINANCE I

The Role of Data Providers as Information Intermediaries

Nic Schaub (University of St.Gallen)

This study investigates whether financial data providers serve as information intermediaries in capital markets. To this end, we examine whether the timeliness of earnings information disseminated by First Call (Thomson Reuters) affects the market's reaction to earnings announcements. We document that the immediate price response is weaker and the post-earnings announcement drift stronger for earnings releases disseminated with a delay by First Call as compared to immediate distributions. A significant part of the stronger drift is clustered around the day when the data provider sends out the delayed information, suggesting that the results can be interpreted causally.

Rankings of Published P/E Ratios and Value Investor Attention

Jordan Moore (University of Rochester)

Price-earnings (P/E) ratios are the most popular proxy for fundamental value and are widely published using a common methodology. This paper shows that stock with high P/E rankings are especially salient to individual value investors, who buy attention-grabbing stocks and provide liquidity. Value strategies using real-time P/E ratios are significantly more profitable than value strategies using lagged P/E ratios or real-time book-to-market ratios. A value-weighted extreme decile P/E attention strategy earns an average monthly return of 119 basis points from 1973 to 2015 with an annual Sharpe ratio of 0.94. The strategy returns are robust to fundamental factors and momentum in prices and earnings individually. P/E rankings are positively associated with liquidity and relative changes in trading volume, and negatively associated with idiosyncratic volatility. Financial data providers only publish P/E ratios for stocks with positive earnings. Consistent with the role of attention, P/E rankings only predict returns, changes in trading volumes, and liquidity strategy returns for stocks with positive earnings.

The Perception of Dependence, Investment Decisions, and Stock Prices

Michael Ungeheuer (University of Mannheim)
Martin Weber (University of Mannheim)

We study how investors perceive dependence between stock returns, how this influences investment decisions and stock prices. Our findings suggest that investors understand differences in dependence, but correlation does not properly capture their perception of dependence. In several laboratory experiments, we show that subjects understand dependence in frequent, moderate returns, but do not understand dependence in infrequent, extreme returns. Consistent with a counting heuristic, they diversify more at lower frequencies of comovement, even if correlation increases due to strong positive dependence in extreme returns. Applying our insights from experiments to 1963-2015 US stock returns, we find that there is a robust return premium for stocks with high frequencies of comovement with the market return. Our findings suggest that dependence between stock returns matters for investors and aggregate market outcomes. They also suggest that investors could improve portfolio selection by taking into account biased beliefs about dependence.

PAPER ABSTRACTS: D4 BEHAVIORAL FINANCE II

Daily Winners and Losers

Alok Kumar (University of Miami)
Stefan Ruenzi (University of Mannheim)
Michael Ungeheuer (University of Mannheim)

The probably most salient feature of the cross-section of stock returns is a stock's status as daily top winner or loser: they are tabulated in many newspapers and on popular webpages, making them highly visible and eventually subject to attention driven buying pressure. We find that stocks ranked as daily winners and losers last month underperform those that did not make the rankings by 1.60% next month, and 15%-20% during the subsequent three years. The stocks that did not make the rankings exhibit an insignificant relation between returns and idiosyncratic volatility, suggesting that the idiosyncratic volatility puzzle only exists among ranked stocks.

Sharing More than Dialects: Herding Behavior in Bank Risk-Taking Explained by Cultural Vicinity

Barbara Seitz (University of St.Gallen)
Andreas W. Rathgeber (University of Augsburg)
Alfred Lameli (Philipps-Universität Marburg)
Tobias Gaugler (University of Augsburg)

We expand on research concerning the well-pronounced influence of geographical peer groups on human behavior. For this purpose, bank-specific risk-taking behavior and its relation to culturally close banks – measured by geographical as well as linguistic distance – is examined. We hypothesize that the level of risk taken by a distinct bank can be explained by the risk-taking behavior of other culturally close banks. Using a complete panel survey of all 1,111 separate and independent German cooperative banks from 2007 to 2010, we show with a high level of significance that banks adapt to the behavior of their culturally defined peer group. Interestingly, linguistic distance is superior to the geographical proxy. Results are robust after controlling for typical macroeconomic, bank specific, and – to eliminate unintentional herding – regional determinants. Our results are also robust to common econometrical and economic specifications. We amend existing literature on geographical herding firstly by a full census of German cooperative banks. As each cooperative bank is privileged with territorial exclusivity, our research is based on an intersect-free full coverage of the entire national territory. Secondly, we are able to refine research on geographical herding by measuring cultural vicinity via linguistic, i.e. dialect, proximity. Based on the evidence of banks selecting their peer group not by a "best-in-class" approach, but rather by dialectical proximity, we can show evidence of irrational herding resulting from psychosociological phenomena, such as mere exposure, as well as conformity effects.

PAPER ABSTRACTS: D4 BEHAVIORAL FINANCE II

Using Managerial Attributes to Identify Market Feedback Effects: The Case of Mutual Fund Fire Sales

Suman Banerjee (University of Wyoming)
Vikram Nanda (University of Texas at Dallas)
Steven Xiao (University of Texas at Dallas)

We develop a simple model of feedback and learning in the aftermath of a "fire sale," and test its implications. Our model is based on the notion of market-feedback in which investors such as mutual funds gather information about a firm's potential investment opportunities. This information finds its way into stock prices and helps firms to decide on whether to engage in new investments. The incentive for mutual funds to produce information comes from two potential sources of profits: "trading" profits and capital gains on portfolio "holding". We show that fire sales can disrupt the incentive to produce information, especially by reducing profits on portfolio holdings. Further, we show that unbiased (or rational) firm managers tend to rely to a greater extent on market-produced information, and are more likely to be affected by the information disruption caused by fire-sales. Rational managers are more likely to cutback on their investments and suffer a drop in firm value. On the other hand, an overconfident (OC) CEO with positively biased beliefs is inherently less dependent on market feedback and is less affected by a fire sale. Our empirical findings strongly support the testable implications of our model. We find a monotonic relationship between level of overconfidence and investment-Q sensitivity. A striking finding is that firms headed by OC CEOs suffer little drop in firm value following a fire sale vis-á-vis firms headed by non-OC CEOs.

International Portfolio Diversification and Macroeconomic Fluctuations when Preferences Are Time-Varying

Giuliano Curatola (Goethe University Frankfurt and Research Center SAFE)
Ilya Dergunov (Goethe University Frankfurt and Research Center SAFE)

We propose a 2-country asset pricing model where agents' preferences change endogenously as a function of the popularity of internationally traded goods. When agents are more sensitive to changes in the popularity of domestic goods than to changes in the popularity of foreign goods, the local stock market reacts more to changes in preferences of local agents than to changes in preferences of foreign agents. Therefore, the home bias arises because the home-country stock represents a better investment opportunity to hedge against future preference fluctuations. We test our model and find that preference evolution is a plausible driver of key macroeconomic variables and stock returns.

A Mean-Variance Benchmark for Household Portfolios over the Life Cycle

Claus Munk (Copenhagen Business School)

We embed human capital as an innate, illiquid asset in Markowitz' one-period mean-variance framework. By solving the Markowitz problem for different values of the ratio of human capital to financial wealth, we emulate life-cycle effects in household portfolio decisions. The portfolio derived with this approach is very similar to the optimal portfolio derived in the much more complicated dynamic life-cycle models. An application of our simple method illustrates that young households may optimally refrain from stock investments because a house investment combined with a mortgage is more attractive from a pure investment perspective. Another application establishes some theoretical support for the growth/value tilts in households' portfolios found empirically.

PAPER ABSTRACTS: E1 ASSET ALLOCATION

Where to Hide in Bad Times: Or Should One Still Diversify Internationally?

Redouane Elkamhi (University of Toronto)
Denitsa Stefanova (University of Luxembourg)

Among the stylized features of international equity markets is the pronounced asymmetric nonlinear dependence and upward trend in correlations. Such features call into question investors' efforts to diversify internationally. We propose a model to capture those well understood characteristics of international equity index returns. Casting them in a dynamic portfolio problem, we evaluate the gains for a home-biased investor from including foreign assets in her portfolio. We find that accounting for the optimal dynamic demand for hedging on top of a standard mean-variance portfolio policy brings substantial benefits from international portfolio exposure. Such benefits become increasingly sizable over long investment horizons.

Robust Pricing of Fixed Income Securities

Ferenc Horvath (Tilburg University)
Frank de Jong (Tilburg University)
Bas J.M. Werker (Tilburg University)

We analyze a dynamic investment problem with interest rate risk and ambiguity. After deriving the optimal terminal wealth and investment policy, we expand our model into a robust general equilibrium model and calibrate it to U.S. data. We confirm the bond premium puzzle, i.e., we need an unreasonably high relative risk-aversion parameter to explain excess returns on long-term bonds. Our model with robust investors reduces this risk-aversion parameter substantially: a relative risk aversion of less than four suffices to match market data. Additionally we provide a novel formulation of robust dynamic investment problems together with an alternative solution technique: the robust version of the martingale method.

The Predictive Power of Dividend Yields for Future Inflation: Money Illusion or Rational Causes?

Tom Engsted (Aarhus University)
Thomas Quistgaard Pedersen (Aarhus University)

In long-term US data the stock market dividend yield is a strong predictor of long-horizon inflation with a negative slope coefficient. This finding is puzzling in light of the traditional Modigliani-Cohn money illusion hypothesis according to which the dividend yield varies positively with expected inflation. To rationalize the finding we develop a consumption-based asset pricing model with recursive preferences and money illusion. The model with reasonable values of risk aversion and intertemporal elasticity of substitution, and either rational or adaptive expectations, implies significantly negative slope coefficients that increase numerically with the horizon in regressions of future inflation onto the dividend yield, in accordance with the data. A less plausible purely rational version of the model with no money illusion but with a positive link from expected inflation to real consumption growth, i.e. inflation non-neutrality, also generates a negative inflation-dividend yield relationship.

The Debt Tax Shield, Economic Growth and Inequality

Bjarne A. Jensen (Copenhagen Business School)
Marcel Fischer (Copenhagen Business School)

We study the implications of the corporate debt tax shield in a growth economy that taxes household income and firm profits and redistributes tax revenues in an attempt to harmonize the lifetime consumption opportunities of households that differ in their endowments. Our model predicts that the debt tax shield (1) increases the risk-free rate, (2) leads to a higher growth rate of the economy, and (3) increases the degree of disparity in households' lifetime consumption opportunities. We further quantify how the debt tax shield affects the tradeoff between the goals of achieving a high growth rate of the economy and a low degree of inequality.

Innovation Dynamics and Fiscal Policy: Implications for Growth, Asset Prices, and Welfare

Michael Donadelli (Goethe University Frankfurt and Research Center SAFE)
Patrick Grüning (CEFER, Bank of Lithuania and Vilnius University)

We study the equilibrium implications of different fiscal policies on macroeconomic quantities, asset prices, and welfare by utilizing two endogenous growth models. The expanding variety model features only homogeneous innovations by entrants. The Schumpeterian growth model features heterogeneous innovations: "incremental" innovations by incumbents and "radical" innovations by entrants. The government finances its expenditure stream by labor income and corporate taxes and supplies subsidies to household's consumption, to final goods firm's capital investment, and to investments in research and development (R&D) by entrants and, if applicable, incumbents. Regardless of the innovation structure, an increase in consumption subsidies induces lower economic growth resulting in sizable welfare costs. Differently, higher R&D subsidies induce higher economic growth alongside a welfare loss in the homogeneous innovation model. However, in the heterogeneous innovation model subsidies to incumbents are growth-enhancing and welfare-depressing, whereas subsidies to entrants lead to lower growth but higher welfare. Only higher capital investment subsidies lead to jointly higher growth and welfare in both innovation models. Fiscal policies should therefore prioritize the allocation of resources to capital investment.

PAPER ABSTRACTS: E3 FINANCIAL ECONOMICS

Did ECB Liquidity Injections Help the Real Economy?

Stine Louise Daetz (Copenhagen Business School)
Marti G. Subrahmanyam (New York University)
Dragon Yongjun Tang (University of Hong Kong)
Sarah Qian Wang (University of Warwick)

In an attempt to boost the Eurozone economy, the European Central Bank (ECB) launched a plethora of unconventional monetary interventions since 2010. While the series of Longer-Term Refinancing Operations (LTROs) was among the most prominent of these, their efficacy, measured by their impact on corporate policies in the Eurozone, is an important but unanswered issue. We analyze a large panel of individual corporations across countries in the Eurozone, and find that non-financial corporations issued more long-term debt and hoarded more cash following the ECB liquidity injections. However, this increase in corporate liquidity was not employed in a productive manner, as corporations generally did not subsequently increase their investments or employment, regardless of their banking connections. The exceptions to this weak response were corporations in countries with corresponding accommodative fiscal policies such as tax cuts.

Shock Propagation through Cross-Learning in Opaque Markets

Jan Schneemeier (Federal Reserve Board)

This paper studies how firms' learning from their neighbor's stock price ("cross-learning") affects the exposure of firm investment and stock prices to local firm-specific shocks. In my framework, firms are located in a circular network and share a common productivity shock with their direct neighbors. Stock prices reflect informed traders' private information about future productivity shocks and firm managers learn from their neighbor's stock price to improve investment efficiency. In opaque networks, managers cannot filter out movements in their neighbor's price that arise because this firm is learning from its neighbor as well. Consequently, local shocks are transmitted from one firm to all other firms and can have a sizeable impact on aggregate variables. This impact is particularly strong in more uncertain episodes, when managers face a higher incentive to cross-learn.

PAPER ABSTRACTS: E3 FINANCIAL ECONOMICS

Amplification and Spillover with Financial Arbitrage, Production and Collateral Constraints

Ally Zhang (University of Zurich and Swiss Finance Institute)

We construct a dynamic model economy in which households from segmented markets have varying financial asset demands. Intermediaries make arbitrage profit by exploiting the price difference in segmented financial markets. Meanwhile, they are required to separately post their production investment as collateral to support liquidity supply. We show that without uncertainty the intermediaries exhibit self-recovery capacity after negative shocks. We also demonstrate that with uncertainty and agents' inaccurate estimation of future market demand, looser collateral constraints can disturb such self-recovery process and further incur systemic risk through over investment in financial markets and under investment in production. On the contrary, more financial fiction with tighter collateral constraints can stabilize the economy and boost the production sector at the cost of market liquidity. The dynamic interaction between the endogenous collateral constraint and liquidity supply turns out to be a powerful transmission mechanism by which the effects of disturbance persist, amplify and spill over to other sectors.

PAPER ABSTRACTS: E4 ASSET PRICING II

Predictability and the Cross-Section of Expected Returns in Models with Long-Run Risks

Christian Schlag (Goethe University Frankfurt)
Michael Semenischev (University of Münster)
Julian Thimme (Goethe University Frankfurt)

In long-run risks models excess returns on arbitrary assets are predictable via the price-dividend ratio and the variance risk premium of the aggregate stock market. We propose a simple empirical test for the ability of such a model to explain the cross-section of expected returns by sorting stocks based on the sensitivity of expected returns to these quantities. We show that models with only one uncertainty-related state variable, like the classic long-run risks model, are not able to pass this test. However, even extensions with more state variables mostly fail. We derive criteria for the market prices of risks a model has to meet to be in line with the data.

Asset Pricing in Production Economies when Capital Inputs Are Heterogeneous

Nicole Branger (University of Münster)
Nikolai Graeber (University of Münster)
Malte Schumacher (University of Münster)

This paper studies asset pricing implications of heterogeneity across capital inputs. We build a general equilibrium model including two types of capital. The agents in our economy have Epstein and Zin (1989) preferences and technology is exposed to long-run risks in productivity growth. Following the literature, production inputs differ with respect to rates of depreciation and adjustment cost. We explain both, differences in returns and investment behaviour for two types of capital. Model implied asset pricing and relevant macroeconomic moments are in line with empirical data. To fully capture the effect of small but persistent shocks to the expected growth rate of productivity in a DSGE framework, the model is solved with a global non-linear solution algorithm. It is shown, when including long-run risks in productivity growth in conjunction with capital heterogeneity, using local Taylor-expansion based methods will not suffice, to obtain a satisfactory accuracy of approximation.

Asset Pricing with Heterogeneous Agents and Long-Run Risk

Walter Pohl (University of Zurich)
Karl Schmedders (University of Zurich and Swiss Finance Institute)
Ole Wilms (University of Zurich)

This paper examines the effect of agent belief heterogeneity on long-run risk models. We find that for the long-run risk explanation to adequately explain the equity premium, it is not sufficient for long-run risk to merely exist: agents must all agree that it exists. Agents who believe in a lower persistence level come to dominate the economy rather quickly, even if their belief is wrong. This drives the equity premium down below the level observed in the data.

PAPER ABSTRACTS: F1 INSURANCE

Get the Balance Right: A Simultaneous Equation Model to Analyze Growth, Profitability, and Safety

Martin Eling (University of St.Gallen)
Ruo Jia (Peking University)
Philipp Schaper (University of St.Gallen)

We analyze the relationships among the three main strategic goals of every company: growth, profitability, and safety. Extant literature suggests that the relationships among these goals are two-directional. Therefore, we develop a novel simultaneous equation model to empirically test three pairs of hypotheses simultaneously and over time with a sample of 1,988 European insurance companies over eleven years. Our results suggest that moderate firm growth has a positive impact on profitability; however, extremely high growth reduces profitability. Moderate firm growth also tends to reduce risk, probably due to its stabilizing effect on underwriting results. In addition, we find evidence that insurers with relatively low profitability are risk-seeking, a result in line with prospect theory. The analysis over time shows that insurers which initially prioritize profitability over growth are more likely to reach the state of "profitable growth" than vice versa. Our results emphasize the existing results on underwriting discipline and show that all three dimensions must be considered simultaneously and in a multi-period context to fully evaluate firm performance.

Minimum Return Rate Guarantees under Default Risk - Optimal Design of Quantile Guarantees

Antje Mahayni (University of Duisburg-Essen)
Oliver Lubos (University of Duisburg-Essen)
Sascha Offermann (University of Duisburg-Essen)

The paper analyzes the optimal design of participating life insurance contracts with minimum return rate guarantees under default risk. Unless there is a default event, the insured receives the maximum of a guaranteed rate and a participation in the investment returns of the insurer. Accounting of default risk modifies the payoff of the insured by means of a default put implying a compound option feature (nested maximum). We also consider regulatory requirements posed on the maximal admissible default probability implying a quantile guarantee. In spite of the compound option feature, the (yearly return) payoff of the default put (and the liabilities) can be represented by the payoff of a portfolio of plain vanilla options on the investment returns simplifying a fair contract prizing (posed by a competitive market). In a complete market setup, the optimal (expected utility maximizing) payoff of a quantile guarantee can be stated in closed form. Because of the market completeness, the solution can be implemented for any equity to debt ratio. We illustrate the utility loss which arises if the insurer implements a suboptimal investment strategy.

PAPER ABSTRACTS: F1 INSURANCE

Funding Life Insurance Contracts with Guarantees: How Can We Optimally Respond to the Policyholder's Needs?

An Chen (Ulm University)
Peter Hieber (Ulm University)
Thai Nguyen (Ulm University)

Due to the increasing solvency requirements for return guarantees and a general decrease in interest rate levels, the attractiveness of equity-linked life insurance contracts with guarantee has recently substantially decreased. To regain competitiveness for these products, insurance companies need to be more flexible in their contract design and think of tailormade retirement products that still satisfy the policyholder's needs. One such possibility is to adapt the investment strategy of the premium pool according to the policyholder's preferences. In this article, we determine the investment strategy that maximizes the expected utility of the policyholder's insurance contract payoff. In a numerical example, we show that for a constant relative risk aversion (CRRA) investor, the flexibility in the investment strategy can significantly increase the policyholder's utility. Fairly priced guarantee contracts can then lead to about the same expected utility as an asset investment (i.e. the Merton [1969]-portfolio).

Precautionary Saving and Insurance under Generalized Mean-Variance Preferences

Nicole Branger (University of Münster)
Antje Mahayni (University of Duisburg-Essen)
Nikolaus Schweizer (University of Tilburg)
Cathleen Sende (University of Duisburg-Essen)

We analyze the optimal insurance demand in a dynamic setup with two periods. In addition to the possibility to insure, the investor is allowed to transfer wealth between the two periods, i.e. she can save. While it is difficult to interpret the optimal saving and insurance decisions without disentangling time and risk preferences, we do so in a generalized mean variance setup. In this dynamic setup we state a natural way to separate between time and risk preferences by means of a variance decomposition. We show that we are indeed able to disentangle the preferences. While the variance within the period where a loss can occur determines the optimal insurance level, the aversion against the variance between the expected wealth at different times gives the optimal savings decision. The results are tractable and easy to interpret.

PAPER ABSTRACTS: F2 CREDIT RISK

Revenues versus Reputation: Warring Incentives in the Rating Industry

Stefan Morkoetter (University of St.Gallen)
Roman Stebler (University of St.Gallen)
Simone Westerfeld (University of St.Gallen)

This paper investigates rating agencies' conflicts of interest in monitoring the credit quality of solicited credit ratings in structured finance. Based on monthly rating migration data from Fitch, Moody's, and Standard & Poor's on all U.S. residential mortgage-backed securities issued between 1985 and 2012 (154'643 individual tranches), our results provide empirical evidence that rating agencies exert less severe downgrades and defer the timing of downgrades for securities of those issuers that display a stronger presence in the securitization market. We observe that the ex-post default probability of such tranches is significantly higher compared to tranches of c.p. less active issuers, ruling out issuers' experience as an explanation for their preferential treatment by rating agencies.

History Matters - Credit Rating under Asymmetric Information

Christian Hilpert (Hamburg University)
Stefan Hirth (Aarhus University)
Alexander Szimayer (Hamburg University)

We analyze how a firm's reputation and track record affect its credit rating. In a dynamic continuous-time rating game, the rating agency learns the firm's quality over time by observing distorted information on the firm's cash flow. The rating agency's optimal strategy is to issue a higher rating for the same current cash flow, if the historical minimum has been sufficiently low. Thus, we point out that the rating is not only driven by the most recent information, but history matters. Moreover, we derive conditions for the rating policy such that it maintains the incentives for the rated firm neither to mimic another higher quality firm, nor to intentionally generate lower observed cash flows.

PAPER ABSTRACTS: F2 CREDIT RISK

CDS and Credit: Testing the Small Bang Theory of the Financial Universe with Micro Data

Yalin Gündüz (Deutsche Bundesbank)
Steven Ongena (University of Zurich, Swiss Finance Institute, KU Leuven and CEPR)
Günseli Tümer-Alkan (VU University Amsterdam)
Yuejuan Yu (Shandong University)

Is CDS trading motivated by hedging and does it affect the availability of credit? To answer these questions we couple comprehensive bank-firm level CDS trading data from the Depository Trust and Clearing Corporation with the German credit register containing bilateral bank-firm credit exposures. We find that following the Small Bang in the European CDS market, extant credit relationships with riskier firms increase banks' CDS trading and hedging of these firms. Holding more CDS contracts of safer firms leads banks to supply relatively more credit to them. Only if banks were properly hedged before the Small Bang they take more risk.

PAPER ABSTRACTS: F3 RISK MGMT. & FINANCIAL ECONOMETRICS

Optimal Investment under VaR-Regulation and Minimum Insurance

An Chen (Ulm University)
Thai Huu Nguyen (Ulm University)
Mitja Stadje (Ulm University)

We look at an optimal investment problem of a financial institution operating under a joint Value-at-Risk constraint and a portfolio insurance constraint. This analysis is particularly relevant for an insurance company operating under the Solvency II regulation which aims to maximize the expected utility of its shareholders, while at the same time being required to provide its policyholders a minimum guaranteed amount. Using static Lagrangian method, we solve the pointwise utility optimization problem to achieve the global maximum by carefully comparing the local maximizers with the jump point or the boundary. Our theoretical and numerical results show that contrary to a pure Value-at-Risk regulation, combining a VaR constraint with a portfolio insurance gives a comprehensive protection in very bad market scenarios, while significantly reducing the regulatory costs of a pure portfolio insurance strategy.

Why Risk Is So Hard to Measure

Jon Danielsson (London School of Economics)
Chen Zhou (De Nederlandsche Bank and Erasmus University Rotterdam)

This paper analyzes the robustness of standard techniques for risk analysis, with a special emphasis on the Basel III risk measures. We focus on the difference between value-at-risk and expected shortfall, their small sample properties, the scope for manipulating risk measures and how estimation can be improved. Overall, the paper find that risk forecasts are extremely uncertain at low sample sizes, with value-at-risk more accurate than expected shortfall, while value-at-risk is easily manipulated without violating regulations. Finally the implications for practitioners and regulators are discussed along with best practice suggestions.

GMM Estimation of Affine Term Structure Models

Jaroslava Hlouskova (Institute for Advanced Studies, Vienna)
Leopold Sögner (Institute for Advanced Studies, Vienna)

This article investigates parameter estimation of affine term structure models by means of the generalized method of moments. Exact moments of the affine latent process as well as of the yields are obtained by using results derived for p-polynomial processes. Then the generalized method of moments, combined with random-search and Quasi-Bayesian methods, is used to get reliable parameter estimates and to perform inference. After a simulation study, the estimation procedure is applied to empirical interest rate data.

PAPER ABSTRACTS: F4 MARKET MICROSTRUCTURE II

Insider Trading and Sentiment Trading

Karl Ludwig Keiber (European University Viadrina Frankfurt (Oder))

This paper studies strategic insider trading in continuous time when sentiment traders are present in the securities market. In equilibrium, we characterize both the insider's trading strategy and the market maker's pricing rule. We find that both the insider's trading aggressiveness and the insider's unconditional expected profits are decreasing in the informational content of sentiment trading. The impact of the sentiment traders' trading activity is reported to be non-monotonic. We identify securities markets in which the sentiment traders' trading activity increases or decreases both the insider's trading aggressiveness and the insider's expected profits, respectively. The securities market's liquidity is found to be independent of the informativeness of sentiment trading. But, the depth of the securities market increases in the sentiment traders' trading activity. Finally, sentiment trading does not affect the price discovery process adversely. We conclude that sentiment trading does not impose any negative externality to the securities market at all. Caring about market quality, regulators should not be worried about sentiment trading at all.

Correlated Noise - On Why Passive Investment Might Improve Market Efficiency

Alex Weissensteiner (Free University of Bozen-Bolzano)

We analyze a market in which agents process noisy signals and, based on that, trade a single asset. We derive a closed-form expression for their expected payoffs, which allows us to illustrate the impact of the pairwise covariance between the hidden value of a company, the processed signal and the price. Dependent on the behavior of the market maker, we discuss efficient and inefficient markets. For a market maker interested in a level playing field among the traders, we provide a linear pricing expression, which leads to an efficient market. On the contrary, a selfish, profit-maximizing behavior of the market maker induces inefficient markets in which the expected payoffs of the agents differ. A numerical example shows that in inefficient markets the best pure strategy of agents playing a Nash game will deviate from the Bayesian updating rule. Especially agents with highly correlated noise to other traders improve their expected payoffs by reducing the information processing activity, and by doing so they even increase the efficiency of the market.

Dealer Inventory and the Cross-Section of Corporate Bond Returns

Nils Friewald (Norwegian School of Economics)
Florian Nagler (Bocconi University)

Inventory models of dealership markets imply that intermediaries reduce their exposure to inventory risk by offering prices different from fundamental values. Therefore, inventory levels should affect asset prices and thus returns. We explore the cross-sectional relation between US corporate bond inventories and returns. Our findings provide strong support for the asset pricing implication of inventory models, that is, the risk-adjusted return of a high-minus-low inventory-sorted portfolio is 21 basis points per week. Furthermore, we examine several drivers of the inventory risk premium; for example, we emphasize the importance of inventory risk sharing in pricing bonds.

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Kind regards,

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LiveX 3	15:45-17:15	11	SIX Swiss Exchange Training, Selnaustr. 30, Schulungsraum 1.UG

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