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Does Bank Screening Matter? Private Information and Public Securities Issues

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Abstract

When bank asset portfolios were first securitized in the 1970s, much attention was paid to making the securitized instruments, such as mortgage-backed securities (MBSs), attractive to what was then a limited number of institutional investors. Following the initial issues, the practice of securitization and demand for securitization instruments both grew strongly throughout the 70s and 80s, and at particularly rapid rates from the 1990s until the crisis of 2007-2008. Since the crisis, demand has fallen off sharply, although at least one new issue of residential mortgage backed securities was reported in April 2012. This paper focuses on a little-recognized but crucial feature of securitization, namely the role of bank information production in determining the quality of securitization instruments. The paper argues both that bank information production is fundamental to determining the quality of securitization instruments, and that the impacts of any changes in information production activity take time for market agents to assess. Moreover, since bank information is produced by assessing individual loan applications, changes in information processing practices can take place rapidly and can also be difficult to detect. The combined result of these features is that information on market-traded securitization instruments can become stale, leading in turn to the possibility of sudden changes in securities valuation as and when information dissemination problems are detected. The paper models the process in order to study the implications in detail. The paper then argues that the skin-in-the game provisions of current Dodd-Frank legislation are too weak to cure information production and transmission problems. On the other hand, a bank-issued put accompanying a securitization issue could go far toward resolving the moral hazard and timing problems affecting the securitization process.

How do Price Limits Influence French Market Microstructure? A high Frequency Data Analysis in Terms of Return, Volatility and Volume

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Abstract

The purpose of the regulated halts on stock exchange markets is to spread the information on the market and to protect the interests of the small shareholders. The aim of this work is to empirically investigate the price limits on the French stock exchange market. We analyze the impact of such halts on the main market factors: return, volatility and volume. Our study concerns intraday data relating to securities that belong to the CAC40 stock index over the period January 1998-December 2001. Finally, we put forward a mitigated effectiveness of the price limits, depending on the period.

Bailout Uncertainty in a Microfounded General Equilibrium Model of the Financial System

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Abstract

This paper develops a micro-founded general equilibrium model of the financial system composed of ultimate borrowers, ultimate lenders and financial intermediaries. The model is used to investigate the impact of uncertainty about the likelihood of governmental bailouts on leverage, interest rates, the volume of defaults and the real economy. The distinction between risk and uncertainty is implemented by applying the maxmin with multiple priors framework to lenders' beliefs about the probability of bailout. Results of the analysis include: (i) An unanticipated increase in bailout uncertainty raises interest rates, the volume of defaults in both the real and financial sectors and may lead to a total drying up of credit markets. (ii) Lower exante bailout uncertainty is conducive to higher leverage - which raises moral hazard and makes the economy more vulnerable to expost increases in bailout uncertainty. (iii) Bailout uncertainty raises the likelihood of bubbles, the amplitude of booms and busts as well as the banking and the credit spreads. (iv) Bailout uncertainty is associated with higher returns' variability in diversified portfolios and systemic risks, (v) Expansionary monetary policy reinforces those effects by inducing higher aggregate leverage levels.

Is the World Heading towards Crisis-Induced Irrational Exuberance in International Assets? Investigating under Global Financial Stability APT

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Abstract

This paper develops a Global Financial Stability APT to uncover any looming risks to global financial stability with respect to crisis-induced irrational exuberance for 29 world major assets. Findings suggest that the crisis has unleashed substantial post betas increases for ASX All Ordinaries Index, INR, RUB, Corn, Wheat and Platinum, let alone significantly pronounced leverage in case of currencies. Furthermore, under inter-assets linkages, strong evidence of ‘‘waiting for dead men’s shoes’’ irrational exuberance effects prevail in case of Platinum, AUD, NZD, Nasdaq Composite Index and ASX All Ordinaries Index. Strong substitution impacts of MSCI and DXY on ‘‘BRICS’’ countries’ currencies impacts are also noted along with bullish forces on AUD and NZD. Overall findings do corroborate existence of some possible irrational exuberance. The GFS-APT is expected to be widely used by policy-makers worldwide in gauging international asset risk.

Interest Rates and Credit Spread Dynamics

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Abstract

This paper revisits the relation between callable credit spreads and interest rates. We allow the evolution of credit spreads following shocks to government rates to depend on recent levels and changes in government rates. After conditioning on government yields, we find a negligible response in callable corporate bond spreads to shocks in government rates. In contrast to existing studies, our results imply that after controlling for the prevailing interest rate environment, there is little evidence that variation in the call premium has an appreciable impact on credit spreads.

Explaining Hedge Fund Performance Fees

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Abstract

This paper investigates the relationship between hedge fund performance fees and risk adjusted returns. Existing literature argues that performance fees induce risk-taking behavior from fund managers because higher risk increases the value of the performance fee option. This paper introduces the "effort" in the model and reasons that the performance of hedge funds and the payoff of the performance fee contract are endogenously determined by the fund manager's effort. Therefore, the performance fee contract aligns the interest of the fund manager and the investor, and creates a win-win risk sharing instead of a risk shifting situation. Empirically, I find that performance fees are positively associated with risk adjusted returns in terms of the Sharpe ratio and Sortino ratio.

FX Market Iliquidity and Funding Liquidity Constraints

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Abstract

Using a broad data set for 20 exchange rates over 13 years, we construct two measures of the common component of liquidity across currencies, transaction costs and market depth. We find that funding liquidity constraints impact on both aspects of FX market liquidity, after controlling for global volatility, market returns and seasonality. The impact of funding liquidity relates to market declines when suppliers to liquidity face capital tightness and to crisis times, when there are severe liquidity dry-ups. Furthermore, funding liquidity together with our other explanatory variables explain unexpected changes in FX market illiquidity as well.

RII: A New Index for Assessing Internationalization of Chinese Currency

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Abstract

The diversified reform of the international currency system in the post-financial crisis era brought opportunities for the Internationalization of Chinese currency RMB. The year 2011 has seen a huge progress in the trade settlement and international financial transaction of RMB. However, an objective evaluation of the improvement in RMB internationalization is still difficult. Different from the index of the proportion of international reserve currency, this essay is to analyze the internationalization based on the pricing, trading and reserve functions of international currency. The innovation of this essay lies in the compilation principles of RII and the construction of index system. RII stood at 0.45 in 2011, indicating its preliminary recognition from the international community. But there is still great gap in the internationalization between RMB and other major currencies like US dollars, Euro.

The Usefulness of Factor Models in Forecasting the Exchange Rate: Results From the Brazilian Case

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Abstract

This paper studies the usefulness of factors embedded on the common movements of exchange rates in forecasting the exchange rate Real/Dollar. The results show that when considering the entire period of the sample, from January 1999 to August 2011, no one model containing the factors is able to beat the random walk benchmark. However, when the period directly following the adoption of the floating exchange rate regime is discarded, there is evidence that several models containing these factors beat the random walk. Lastly, the paper shows that the addition of factors improves the predictive power of the models comprising only macroeconomic variables commonly used in the literature to forecast the exchange rate.

Precious Metals, Stocks, and the Macroeconomics Environment: A FAVAR Model Approach

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Abstract

This empirical study investigates the nature of spillovers between precious metals prices, i.e. gold and silver, the stock market, and a number of macroeconomic variables for the G7 countries over the 1981-2010 period. Through the methodological approach of the Factor-Augmented Vector Autoregression (FAVAR) model, the empirical findings display that the price transmission across precious metal markets, financial markets, and the macroeconomy is substantial. In particular, the results exemplify the role of the macroeconomic environment in explaining the behavior of both gold and silver returns, while the performance of the financial markets do not appear to contribute as much. In other words, macroeconomic uncertainty, but not financial (stock) market uncertainty, primarily impacts the extent to which investors enter or exit the precious metals markets.

Merger Activity in Industry Equilibrium

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Abstract

We study the effects of mergers and acquisitions on industry dynamics. We develop an infinite horizon model of a competitive industry, which features mergers, entry, exit, and investment by heterogeneous firms. Merger synergies arise from improvements in productivity and cost efficiencies. We characterize the time-series and cross-sectional evolution of firm productivities and merger opportunities in a rational expectations equilibrium. Consistent with the empirical evidence, our model generates procyclical entry and merger activity, as well as counter-cyclical exit. The presence of a merger market induces higher entry rates and lower exit rates, reduces the counter-cyclicality of exit, and increases the mean and variance of the cross-sectional distribution of firm-level productivities. While entry and exit induce the mean productivity to be counter-cyclical, this pattern is reversed when the possibility of mergers is taken into account.

Counterparty Risk in Exchange Traded Notes (ETNs)

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Abstract

In this paper we address the issue of counterparty credit risk in Exchange Traded Notes (ETNs). An ETN is a tracking product which is designed as an unsecured debt security and is therefore subject to the issuer's default risk. We describe a standard reduced-form pricing framework to gauge the theoretical effect credit risk should have on ETNs. We then derive firm-specific, real market credit risk measures using Credit Default Swap (CDS) data to construct model-implied risk-adjusted ETN prices. Our results indicate that a substantial credit risk discount should be priced into ETNs. In sharp contrast, however, based on real market ETN quotes, we found no evidence for credit risk pricing by market players.

Capital Controls and Bank Runs: Theory and Evidence from Brazil and South Korea

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Abstract

Banking crises in emerging market economies (EMEs) are often preceded by increased leverage, greater reliance on foreign borrowing and heightened exchange rate volatility. Capital controls can impact each of these variables. Thus, it is no surprise that many EMEs have used this policy to enhance financial stability. But do capital controls lower the likelihood of financial crises, both in theory and in practice? This study examines the theoretical value of capital controls in reducing the probability of bank runs. I develop a global game model with information-based bank runs and strategic complementarities within and between foreign and domestic creditors. My analysis appears to be the first to model the interconnectedness of foreign and domestic creditor behavior. The framework pins down the probability of a bank run and shows that a capital control can lower the probability of a domestic bank run and of capital flight. I also find that a control on outflows is relatively more effective than a control on inflows. Finally, I test the model's implications using the abnormal returns of Brazilian and South Korean bank stock prices as a proxy for the probability of bank runs.

Does Board Gender-Diversity Matter in M&A Activities?

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Abstract

This paper focuses on the economic consequences of gender-diverse boards in M&A.Using a sample of 649 acquisitions by US publicly listed firms between 2001-2009,we find that gender diversity of boards has no effect on either the size of the bid premium or on the market reaction to the t/o announcements,but it has a positive impact on the long term performance of the acquiring firm.These findings are consistent with a number of robustness tests.

The good and bad news about the new liquidity rules of Basel III in Western European countries

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Abstract

New liquidity rules phased in under Basel III define the new net stable funding ratio (NSFR) to promote sustainable funding structures at financial institutions. In this paper we analyze characteristics and drivers of NSFR for a sample of 921 Western European banks between 1996 and 2010. We find that a majority of banks have historically not fulfilled NSFR minimum requirements, in particular larger and faster growing institutions as well as banks also active in asset management and investment banking. Many of them have started increasing NSFR with the onset of financial crisis 2008 while this ratio had been sliding in earlier years. Interestingly, potential advantages in funding costs for low NSFR banks do not seem to translate into higher profitability and results of these banks are more volatile.

Fund Flows and Performance in Brazil

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Abstract

This paper analyzes how fund flows react to past performance in the dynamic Brazilian equity fund market over the period 2001 to 2012. The study also tests for a "smart money" effect (Zheng (1999)), or whether funds that receive more money subsequently outperform those that receive less money. We find that investors' flows chase past performance, and that there are differences in the flow-performance relationship between retail and institutional funds. We do not find evidence of a "smart money" effect for the whole sample of funds. Nonetheless, flows in small and retail funds, which are often seen as populated by less sophisticated investors, do anticipate future fund performance.

Currency Excess Returns and Global Downside Market Risk

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Abstract

Sensitivity to downside risk in global stock markets, i.e. exposure to the global stock market when it is falling, is priced in average, bilateral currency excess returns. Upside risk, exposure to a rising global stock market, is not. Differences in the sensitivity to global downside risk explain more than 40% of the cross-sectional dispersion in 20 monthly, bilateral currency excess returns from the U.S. investor's perspective during the sample period from January 1999 to March 2012. Moreover, we show that exposure to a recently proposed "carry trade" risk factor for currency excess returns reflects global downside risk.

Underwriters and the Broken Chinese Wall: Institutional Holdings and Post-IPO Securities Litigation

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Abstract

We examine whether underwriters have an information advantage over other institutional investors in new public companies. We focus our attention on a sample of publicly traded firms that have become the target of an IPO-related securities class action lawsuit filed under Section 11 of the 1933 Securities Act between January 1991 and December 2006 and a matched sample of similar non-sued firms. By comparing aggregate institutional holdings changes in sued and non-sued firms as well as holding revisions by different types of institutions that are classified based on their involvement in the IPO process, we find evidence suggesting that lead underwriters retain an information advantage in the firms they take public and that they capitalize on this information by closing out or reducing their holdings in sued firms prior to the eventual litigation date. At the same time, an examination of analyst opinions suggests that analysts affiliated with lead underwriters are somewhat reluctant to reduce their earnings forecasts or downgrade sued firms prior to the litigation date – a pattern that is inconsistent with their otherwise aggressive trading behavior.

Do Auditors Play a Positive Role in the Resolution of Debt Covenant Violations?

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Abstract

We investigate whether auditors exercise closer monitoring and thus charge higher fees in response to debt covenant violations. Using a hand-collected sample focusing on initial covenant violations, we document that audit fees experience an average increase of about 20 percent in the year immediately following the violation year and continue to stay at a high level until three years after the initial violation. Difference-in-differences analysis shows that the increase in audit fees in response to covenant violations is more (less) pronounced when the benefit (cost) of closer auditor monitoring is likely to be higher. Further analysis links the observed increase in audit fees with the improvement in audit committee independence and diligence in response to covenant violations. Our findings provide new evidence that auditors play a positive role in the resolution of debt covenant violations and highlight the importance of corporate governance factors in the audit process.

Capitalizing on the Greatest Anomaly in Finance with Mutual Funds

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Abstract

Contrary to the predictions of CAPM, empirical research has shown that investing in low-beta stocks can improve the mean-variance efficiency of an investor's portfolio. Through forming portfolios of mutual funds based on beta, I examine whether or not mutual fund investors can capitalize on this anomaly. I find that one investing in a portfolio of funds in the top quintile of beta can improve her excess returns by an average of 2.76% a year without increasing risk by holding a levered position in a portfolio of funds in the bottom quintile instead.

Growth of IPOs: A comparative analysis of emerging markets and developed markets

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Abstract

Abstract Growth of IPOs: A comparative analysis of emerging markets and developed markets Initial Public Offerings (IPOs) are widely researched in developed financial markets, especially in Europe and in the United States but not so well in numerous emerging markets, such as India, China and Brazil (Procianoy and Cigerza, 2007).In this paper, we tries to study the a comparative growth analysis of IPO markets in Emerging Countries and Developed Countries.For this we have used semi log equation .Since individual growth rates do not reveal much, we adopted a panel data approach also. The main conclusions are that China behaves like developed countries. India is more conservative. Also around the global financial crisis a bubble is noticeable, which gives way to a sharp decline in growth. Finally, Global companies do as badly as World IPOs because there is no difference in their growth patterns in terms of the three indicators: i) Capital Raised. ii) Number of IPOs iii) Size of Issue.

Market Risk Premium used in 82 countries in 2012: a survey with 7,192 answers

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Abstract

This paper contains the statistics of the Equity Premium or Market Risk Premium (MRP) used in 2012 for 82 countries. We got answers for 93 countries, but we only report the results for 82 countries with more than 5 answers. Most previous surveys have been interested in the Expected MRP, but this survey asks about the Required MRP. The paper also contains the references used to justify the MRP, comments from persons that do not use MRP, and comments from persons that do use MRP.

CDS spreads and spread change determinants: A firm-specific and market-factors study

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Abstract

We examine the determinants of CDS spreads and spread changes on a broad database of 692 US firms during the period from early 2002 to late 2009. We find that firm-specific variables consistent with structural models substantially explain spread changes. Yet contrary to previous studies we discover that these variables have limited explanatory power after controlling for common market variables, especially when ratings are observable. We show that market variables still have explanatory power after controlling for firm-specific variables. Further, we show that ratings explain cross-section variation in CDS spreads even after controlling for structural model variables.

Euro at Risk: The Impact of Members Countrie's Credit Risk on the Stability of the Common Currency

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Abstract

In this paper, we empirically investigate the impact of the credit risk of Eurozone member countries on the stability of the Euro. In the absence of a common euro bond, euro-area credit risk is induced though the credit default swaps of the member countries. The stability of the euro is examined by decomposing dollar-euro exchange rate options into the moments of the riskneutral distribution. We document that during the sovereign debt crisis changes in the creditworthiness of member countries have significant impact on the stability of the euro. In particular, an increase in member countries' credit risk results in an increase of volatility of the dollar-euro exchange rate along with soaring tail risk induced through the risk-neutral kurtosis. We find that member countries' credit risk is a major determinant of the euro crash risk as measured by the risk-neutral skewness. We propose a new indicator for currency stability by combining the risk-neutral moments into an aggregated risk measure and show that our results are robust to this change in measure. Noticeable is the fact that during the sovereign debt crisis, the creditworthiness of countries with vulnerable fiscal positions is the main riskendangering factor of the euro-stability.

Econometric Techniques to Examine Volatility in PEX Bulls and Bears

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Abstract

This study is empirically aimed at testing volatility persistent in PEX bulls and bears. It attempts to explore whether stock market volatility present a different behavior during PEX bulls and bears. In order to define bull and bear phases, we employed the 200-day moving average, so that we found three cycles including 3 bulls and 3 bears. Thus, the study employed Rescaled Range (R/S) to calculate the values of difference parameter d so as to find evidence of long memory behavior for the daily data observations from August, 1997 to March, 2012. According to R/S results, the study found that the estimates of parameter d are above 0 and below 0.5 for bear phases, while the values are above 0.5 for the bull phases implying long memory stationarity for the volatility process. This means that volatility is more persistent in the PEX bears markets than in the PEX bull markets. Further, the PEX bears markets are longer than PEX bulls markets. As a result, volatility persistent in PEX bears and risk should be considered by investors.

Organizational Capital and Investment-Cash Flow Sensitivity: The Effect of Management Quality Practices

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Abstract

This paper examines the influence of organizational capital, as evident in management quality practices, on the response of firm investment to internal cash flows. We provide novel and strong evidence that investment sensitivity to internal cash flows decreases in the presence of superior management practices. We also find that superior management practices are associated with lower capital constraints, as measured by the Kaplan-Zingales Index. Our results are robust to numerous tests. Overall, our findings suggest that intangible organizational capital is important for investment decisions and that superior management is compatible with value-maximizing behavior.

The Stochastic Seasonal Behavior of Energy Commodity Convenience Yiels

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Abstract

This paper contributes to the commodity pricing literature by modeling the convenience yield consistently with its empirically observed properties. Specifically, in this paper we show how a four-factor model for the stochastic behavior of commodity prices, with two long- and short-term factors and two additional seasonal factors, can accommodate some of the most important empirically observed characteristics of commodity convenience yields, such as mean reversion and stochastic seasonality. Based on this evidence, it is presented and estimated a theoretical model to characterize the commodity convenience yield dynamics which is coherent with the previous findings. We also show that commodity price seasonality can be better estimated through convenience yields rather than through futures prices.

Capital Structure Choice, Information Asymmetry and Debt Capacity: Evidence from India

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Abstract

We empirically investigate whether emerging market firms follow pecking order while making their financing choices. We consider an unbalanced panel of all Indian listed firms from 1992 to 2011 for the study. The estimated annual pecking order coefficient ranges from 0.21 to 0.58, rejecting the argument that sample firms follow pecking order in their financing choices. We report that pecking order theory fares worse among firms that face higher asymmetric information costs. It is found to be performing relatively better among firms (irrespective of level of the asymmetric information costs) with higher debt capacity. We also report that pecking order coefficient improves once we consider the concave nature of relationship between change in debt and financial deficit. However, when we nest pecking order approach in conventional leverage regression, it adds abysmally small amount of extra explanatory power. Overall, we argue that debt financing does not dominate equity financing in magnitude and Indian firms issue substantial amount of equity to cover their financing deficit.

Coupon Spreads, Repo Specials and Limits to Arbitrage in the 10-Year US Treasury Market

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Abstract

We define a coupon spread as the price difference between a 10-year US Treasury note and its replicating portfolio of fungible coupon strips from 20- and 30-year Treasury bonds. We measure repo specialness using the Federal Reserve's overnight securities lending program. We analyze the limits to arbitrage using two panels ending on March 31, 2011: a) daily coupon spreads on all outstanding 10-year Treasury notes, starting May 17, 1997; and b) daily repo specials on all 10-year notes, starting April 29, 1999. We find important systematic components in coupon spreads. The most important of these is a "level factor" that is positively correlated with Hu, Pan, and Wang's (2012) Noise measure. We document historically high levels of coupon spreads in late 2008 and early 2009, that were only lowered by the Fed's announcement that its asset buying would extend to US Treasury notes and bonds. These high coupon spreads occur in the context of historically low repo special rates and a low on-the-run premium in this market, in the midst of the financial crisis.

Investor Perceptions of Risk and Return in IT Stocks: An Empirical Study

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Abstract

India is one of the fast growing economies of the world. Its stock markets command the interest of global funds as revealed by the high correlation of over 0.80 between India's MSCI Index and the rest of the world as represented by the MSCI All-Countries World Index. The structure, functioning and profiles of the investing public have all transformed the Indian Capital Markets. Post liberalization, there has been a transfer of risks from the State to organizations and individuals. These shifts have given rise to behavioural issues as to how the Indian investor is managing in this scenario.One way to understand the perceptions and likely behaviour of investors is to empirically examine the issue and quantify their responses. It is imperative that the individual investor's reactions, expectations and evaluation criteria be examined to understand their temperament and criteria in taking stock decisions.The present paper is an outcome of a sample survey made titled " Risk Return Analysis of Bangalore – based IT Companies' stocks: A study of Investor perceptions" made between 2005 – 2007. The paper highlights the key perceptions of risk and risk tolerance of select respondent groups with reference to IT Stocks.

Firm Characteristics and Intellectual Capital Disclosure in Spanish IPO Prospectuses

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Abstract

Initial public offerings (IPOs) have been studied from different perspectives, and one of great interest is the information provided by IPO prospectuses. This paper is the result of an investigation about the intellectual capital information in the Spanish IPO prospectuses. In order to develop this investigation, we have created an original database. Secondly, we have analyzed the type of information, and in the third place, we have explained the information differences among companies. The studies about this issue carried out in different countries point out to contradictory results. We conclude that the firm sector, firm size and the ownership held by previous shareholders after the IPO are the variables which better explain the differences in the information given by companies in IPO prospectuses; although in some cases the period when the company went public has a significant influence.

Size and Value Premium in Sectoral Portfolios: An Application to the Euro Area

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Abstract

Abstract The elimination of the exchange rate risk within the Euro Area and the subsequent integration process has opened new paths for portfolio and risk management, making sectoral diversification useful investment strategy in the last decade. In this paper we use a GARCH-M model with non-normal error distribution and the Fama French -three factor model to explain the daily sectoral returns in Euro Area over the period 2001-10-01 to 2012-10-03. This is to answer the questions if value and size premiums exist in Euro Area's sectoral return in different market regimes. In contrary to most empirical studies, we identify growth and value stocks using six factors as defined by STOXX indices, namely, projected price/earnings (P/E) ratio, projected earnings growth, trailing P/E ratio, trailing earnings growth, price/book (P/B) ratio and dividend yield. The results suggest that in general there is a size premium effect (i.e. small cap stocks outperform large Cap stocks) and that value premium (i.e. value stocks outperform growth stocks) exists only in the bull market. In addition, value stocks is generally associated with higher beta than growth stocks in all markets, which contradicting the risk-based view explanation in CAPM sense.

The Neural Behavior of Finance Investors: A Gender Analysis

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Abstract

This investigation is among the first to analyze if male and female patterns of brain activity associated with financial decision making are different or not. We analyze if these differences exist when they make decision of buying, selling or holding stocks. The investigation was done with 40 volunteer (20 male and 20 female) that played an investment simulation with hundred decisions and, during all the decision process we capture, based on Electroencephalogram technology (EEG) brain electric activity. We find that male and female use different parts of the brain to make investment financial decision. When the analyze was done to decisions of buying, selling or holding we find that male use the same neural circuits to make these decisions but female not.

Cash Flow Hedging and Liquidity Choices

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Abstract

This paper studies the interaction between corporate hedging and liquidity policies. We present a theoretical model that shows how corporate hedging facilitates greater reliance on cost-effective, externally-provided liquidity in lieu of internal resources. We test the model's predictions by employing a new empirical approach that separates cash flow hedging from other hedging instruments. Using detailed, hand-collected data, we find that cash flow hedging reduces the firm's precautionary demand for cash and allows it to rely more on bank lines of credit. Furthermore, we find a significant positive effect of cash flow hedging on firm value, where prior evidence is mixed.

Investing in the Asset Growth Anomaly across the Globe

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Abstract

We document the existence of an anomalous asset growth effect globally and find that it comprises some combination of a market mispricing and some pervasive global systematic risk. To support our findings, we explore a battery to tests to include how country-level governance and market characteristics explain the cross-country differences in the effect. We also find evidence that any profits to a trading strategy based on the asset growth effect globally are somewhat diminished by high arbitrage costs.

A Double Threshold GARCH Model for Foreign Exchange Intervention

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Abstract

This paper proposes a double-threshold GARCH model for exchange rate intervention, where the Central Bank's reaction function depends on the deviations of the actual exchange rate from its fundamental value, as well as on the conditional variance of the process. Once the change in regime is allowed for both the mean and volatility equations, the threshold value for intervention can be infered from the data on past interventions.

Random SPS, TBT, and Other Standards: Short-Run Factor Specificity and the Economics of Encouraging Uncertainty

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Abstract

This paper concerns cloudy SPS and TBT rules. For example, Korea and other nations often switch standards and so make it hard to compete. Automobiles is a good example wherein things like emission stadards and even bumber heights are constantly changing. The paper explores the optimal standards “tariff” ina dynamic context when some factors or production can adjust only over some time period, not instantaneouly. Phenomena such as “tariff cycles” can emerge.

It's how you pay: Pay-for-Performance and Acquirer Returns

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Abstract

I examine how pay for performance influences bidder returns both pre and post Sarbanes Oxley (SOX). I find that firms with positive pay for performance outperform their bidders by 2.77% around the five day event window. The positive affect of pay for performance is significant in all time periods (pre and post SOX). In addition, pay for performance results in higher bidder returns post SOX where pay for performance is higher. The positive affect of pay for performance is more important for larger acquirers both pre and post SOX as well as small acquirers post SOX. The positive affect of pay for performance is more important for listed target acquisitions pre SOX and more important for non-listed targets post SOX. Following acquisitions, bidders with positive pay for performance experience greater long run returns.

The Affine Nature of Aggregate Wealth Dynamics

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Abstract

The paper derives a parsimonious two-component affine diffusion model for a world stock index to capture the dynamics of aggregate wealth. The observable state variables of the model are the normalized index and the inverse of the stochastic market activity, both modeled as square root processes. The square root process in market activity time for the normalized aggregate wealth emerges from the affine nature of aggregate wealth dynamics, which will be derived under basic assumptions and does not contain any parameters that have to be estimated. The proposed model employs only three well interpretable structural parameters, which determine the market activity dynamics, and three initial parameters. It is driven by the continuous, nondiversifiable uncertainty of the market and no other source of uncertainty. The model, to be valid over long time periods, needs to be formulated in a general financial modeling framework beyond the classical no-arbitrage paradigm. It reproduces a list of major stylized empirical facts, including Student-t distributed log-returns and typical volatility properties. Robust methods for fitting and simulating this model are demonstrated.

CEO Compensation and Risk-Shifting in the US Banking Industry

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Abstract

The incentive contracting problem between the bank's shareholders and the CEO involves both the alignment of the shareholders' and the CEO's objectives as well as a commitment problem with respect to other stakeholders. We investigate whether CEO compensation – designed as a mechanism of aligning the CEO's interests with those of the shareholders – significantly induces risk-shifting behavior towards other stakeholders. Contrary to the common beliefs, we do not find any evidence that CEO's incentive pay has exacerbated risk-shifting. This result is consistent with the behavior of risk-averse CEOs who are concerned with the sensitivity of their personal wealth to firm performance. The results are robust to various specifications and controls.

Do “Gut Feelings” Affect Insurance Demand?

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Abstract

This paper investigates whether an individual’s emotional profile affects their insurance decision making. We explore how the emotional reaction in conditions of ambiguity and the fear of the unknown affect insurance choices. We conducted psycho-physiological experiments on a sample of 645 individuals and find evidence that these emotional variables offer contributions by increasing the predictive power of models for insurance demand, alongside traditional socioeconomic variables and psychographic traits. A selective role of emotional influence has been proven to exist when comparing different insurance policies, such as life, health, casualty and indemnity insurance.

Arbitrage and Spread in FX market: an Extended Glosten and Milgrom Model

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Abstract

Based on the arbitrage index, this paper analyzes the impact of information asymmetry on bid-ask spreads in FX market. Unlike the classical models established in Glosten and Milgrom model(1985) and kyle model (1985) whose main focus is informational asymmetry induced by private channels, this paper focuses on the asymmetry induced by differences of analytical power. Those who have private information might still suffer from noise trader risks before the true value is finally realized. However, arbitragers won't. Hence, the arbitrage index established in this paper as a measure of average arbitrage opportunity should be positively correlated with bid-ask spreads.

Idiosyncratic Risk in the Australian Stock Market: A Precursor to a Windfall of Returns?

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Abstract

This paper examines the expected stock returns behaviour as a function of realized idiosyncratic volatility risk for the Australian stock market. The idiosyncratic volatility series, measured relative to the Fama-French three-factor model, is non-stationary and follows a random walk. The quantile regression application in panel data structure reveals a significant relationship impact in the returns-distribution tails implying big losses or gains. The relationship in the presence of other predictors is dynamic and parabolic, and holds for unit-root corrected data and in size-sorted portfolios. The findings caution using high idiosyncratic risk as a precursor to a windfall of returns.

Linear Beta Pricing With Inefficient Benchmarks

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Abstract

Current asset pricing models require mean-variance efficient benchmarks, which are generally unavailable because of partial securitization and free float restrictions. We provide a pricing model that uses inefficient benchmarks, a two-beta model, one induced by the benchmark and one adjusting for its inefficiency. While efficient benchmarks induce zero-beta portfolios of the same expected return, any inefficient benchmark induces infinitely many zero-beta portfolios at all expected returns. These make market risk premiums empirically unidentifiable and explain empirically found dead betas and negative market risk premiums. We characterize other misspecifications that arise when using inefficient benchmarks with models that require efficient ones. We enhance Roll (1980), Roll and Ross's (1994), and Kandel and Stambaugh's (1995) results by offering a "Two Fund Theorem," and by showing the existence of strict "zero relations" everywhere inside the portfolio frontier.

Effects of Foreign Institutional Ownership on Foreign Bank Lending: Evidence from South America

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Abstract

Using data from five South American countries from 2001 to 2008, this paper examines how foreign ownership affects the loan cost of borrowers. We find that the cost of debt financing is significantly higher for firms whose largest shareholder is a foreign institutional one. The results suggest that due to potential agency conflicts between shareholders and creditors, having block institutional shareholders tend to increase the borrowers' debt burden. We also find that for firms with better information transparency and countries with stronger creditor right protection and less exposure to financial crises, the effects of foreign institutional ownership on costs of bank loans appear to be weaker. More interestingly, our results indicate that for firms whose largest foreign shareholder is from the same country as its lead bank, the effects of foreign institutional shareholders on loan prices become smaller, suggesting milder conflicts between the same-base-county pair of shareholders and creditors. Our findings supplement the existing literature on linkages between corporate ownership structure and cost of capital.

Optimal Capital Structure and Growth Options in Mergers and Acquisitions

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Abstract

We develop and empirically test a dynamic trade-off model for the analysis of the optimal capital structure in mergers and acquisitions. The model captures financial and operational synergies and accommodates growth options resulting from the merger. The model predicts that merging firms that have lower correlation of cash flows, have larger merger gains, reduce debt before the merger and increase leverage more significantly after the merger. We further find that mergers which result in a decrease in volatility and bankruptcy costs due to the merger, are more likely to reduce debt prior to acquisition and have higher increases in leverage after the merger. Moreover, the model predicts that positive changes in growth options of the merged firm relative to the growth options of the acquirer and target firms will monotonically enhance merger gains and that growth opportunities have a U-shaped relationship with leverage. Using a large sample of US acquisitions between 1980 and 2010 we provide evidence in support of the model. Our findings are consistent with a dynamic capital structure theory which endogenizes investment and capital structure decisions under the existence of growth opportunities.

Size Effect, Seasonality, Attitude to Risk and Performance of Egyptian Banks

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Abstract

This paper aims at analyzing the effects of "size", "seasonality" and "attitude to risk" on the performance Egyptian banks. This has been conducted using a sample of 10 banks, and covering the period from the first quarter 2003 to the fourth quarter 2011. Results indicate that, hypotheses regarding the significance of differences between performance indicators, according to "size", "seasonality" and "attitude to risk" on the performance Egyptian banks could be accepted. Also, robustness check assures the significance of these effects, where indicators of both capital adequacy and earnings are affected by both of size and attitude to risk, while asset quality is affected by size and seasonality.

Optimal Active Portfolio Management and Relative

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Abstract

This paper addresses the optimal active-vs-passive portfolio mix in a straightforward extension of the Treynor and Black (T-B) classic model. Such a model allows fund managers to select the mix of active and passive portfolio that maximizes the (active) Sharpe ratio performance indicator. The T-B model, here adapted and made operational as a tool for performance measurement, enables one to identify the sources of fund management performance (selectivity vs markettiming). In addition, the combination of active and passive risk exposures is estimated and fund manager choice is tested against the hypothesis of optimal (active) portfolio design. The extended T-B model is applied to a sample of US dollar reserve management portfolios – owned by the ECB and managed by NCBs – invested in high-grade dollar denominated bonds. The best fund managers show statistically significant outperformance against the ECB-given benchmark. By far, market timing is the main driver. Positive (and statistically significant) selectivity appears to be very modest and relatively rare across fund managers. These results are not very surprising, in that low credit risk and highly liquid securities dominate portfolio selection, thus limiting the sources of profitable bond-picking activity. As far as the risk-return profile of the active portfolio is concerned, it appears that some of the best fund managers' outperformance is realised by shorting the active portfolio (with respect to the benchmark composition). Thus, portfolios that would be inefficient (eg negative excess return) if held long can be turned into positive-alpha yielding portfolios if shorted. The ability to select long-vs-short active portfolio can be seen as an additional source of fund manager's outperformance, beyond the skill in anticipating the return of the benchmark portfolio (market-timing contribution). The estimated measure of fund managers' risk aversion turns out to be relatively high. This seems to be consistent with the fairly conservative risk-return profile of the benchmark portfolio. A relative measure of risk exposure (conditional Relative VaR) averaged across fund managers turns out to be in line with the actual risk budget limit assigned by the ECB. However, a fair amount of heterogeneity across fund managers is also found to be present. This is likely to signal a less-thanefficient use of their risk-budget by the fund managers – eg a deviation from the optimal level of relative risk accounted for by the model. At least in part, such variability might also be attributed to estimation errors. However, proper tests for RVaR statistics are sorely lacking in the risk management literature. Thus, the question remains open. This would warrant further investigation, which is left for future research.

Keep it Simple: Dynamic Bond Portfolios under Parameter Uncertainty

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Abstract

We empirically investigate the importance of parameter uncertainty to bond investors. Using a Bayesian approach, we quantify the expected utility loss due to parameter uncertainty from following seemingly optimal dynamic portfolio strategies. Expected utility losses are increasing in the number of term structure factors and the complexity of the risk premium specification. Even with long data sets to estimate parameters, an investor with typical risk aversion is better off following a portfolio strategy implied by a misspecified but parsimonious model than a correctly-specified but difficult-to-estimate three-factor affine model with time-varying risk premia.

The Causes and Consequences of Going Public. Firm-Level Evidences from Twelve European Countries

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Abstract

Despite the voluminous theoretical work on the listing decision, no comprehensive empirical analysis is available on the causes and consequences of going public, due to the lack of data on private companies. In this paper we empirically take up this issue using a unique international database including 180,000 listed and unlisted companies over 11 years. Contrary to the traditional textbook view, IPOs have little effect on production and investment. The floatation responds instead to financial motivations: it allows the company to reduce financing constraints and leverage and offers the initial owners a convenient way to diversify their portfolio. Managers time the IPO, taking the firm public at the peak of its profitability cycle and when equities are overpriced. The companies going public are larger than private ones, in part as a consequence of adverse selection costs. In fact, this “size effect“ is less pronounced in countries where intermediaries engaged in producing information about firms are more developed and the cost to small investors of evaluating firms is likely lower. The listing firms are also smaller in markets where companies disclose broader and more complete information, mitigating information asymmetries between the IPO firms and their potential acquirers.

The High Volume Return Premium: Evidence from the Australian Equity Market

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Abstract

The relationship between the trading volume and changes in expected future return is investigated in this research. Daily and weekly data are used to examine if trading volumes have predictive power for stock prices in the following days/weeks. Results suggested that stocks experiencing extreme higher (low) volumes are usually followed by relatively higher (low) returns the large firms in Australian market for a short horizon. However, the volume-return premium cannot be found for small companies during the same time period. Possible explanations for this high volume return premium include: return autocorrelation, systematic risk and outliers.

Signaling Quality through Debt-Equity Choice and Investment Timing

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Abstract

In a dynamic setting with an investment opportunity we consider the firm's financing (debt-equity) choice, when there is private information about the firm's project quality and assets-in-place. In order to avoid costs due to asymmetric information, high-type firms can signal their quality through investment timing (early investment) or debt-equity choice (the use of debt). We find that small high-growth firms (i.e., firms without assets-in-place) frequently use equity financing and signal their type by early investment. In contrast, mature firms (i.e., firms with larger assets-in-place) mainly use debt financing in order to signal their type. Thus, our model is able to explain empirical patterns which contradict the static pecking order theory.

A Note on the Vasicek's Model with the Logistic Distribution

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Abstract

The paper argues that it would be natural to replace the standard normal distribution function by the logistic function in the regulatory Basel II (Vasicek's) formula. Such a model would be in fact consistent with the standard logistic regression PD modeling approach. An empirical study based on US commercial bank's loan historical delinquency rates re-estimates the default correlations and unexpected losses for the normal and logistic distribution models. The results indicate that the capital requirements could be up to 90-100% higher if the normal Vasicek's model was replaced by the logistic one.

The Economic Drivers of Time-Varying Commodity Market Volatility

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Abstract

We analyze volatility for the aggregate commodity market and for various commodity groups and find that factors associated with macroeconomic and financial market uncertainty explain subsequent volatility of commodity returns. Variables motivated by commodity pricing theories, such as the futures basis and hedging pressure, are also significant. Economic uncertainty measures based on differences in beliefs of economic agents extracted from survey data provide additional information to that contained in volatility series of current economic fundamentals. Finally, we find evidence of a strong bi-directional causal link between inflation uncertainty and commodity return volatility. Our results have important implications for economic policy making, asset allocation and risk management.

Divergence of Sentiment

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Abstract

We use Facebook's daily sentiment index within 20 international markets and show that the spread of sentiment has a relationship with market characteristics. When the divergence of sentiment is high (low), there is high (low) trading volume and volatility in a market. We use data in the post-2007 period when investors have faced limited short selling constraints and find that the divergence of sentiment is weakly negative related with share returns showing that optimism does not prevail of pessimism as suggested by Miller (1977). Overall, these results show further evidence that irrational sentiment affects investors' trading behavior.

The Influence of Market-Makers on the Behavior of the Bid-Ask Spread: An Econometric Analysis

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Abstract

Information asymmetries are an important element in the functioning of capital markets. An indirect means of measuring information asymmetry is through the spread of stock prices. The purpose of this paper is to identify the explanatory variables and the determinants of the bid-ask spread and to quantify the influence that the actors involved in the brokering of publically offered securities may have over the spread. The methodology used to model the time series for each of the analyzed companies is based on a time series from each of the observed econometric multivariate processes. The analysis shows a significantly negative relationship between the spread and the market-maker size, calculated in terms of both the equity and the stock portfolio; likewise, activity is measured by observing the amount offered for purchase and/or sale.

Trends and Determinants of External Commercial Borrowing in India

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Abstract

External Commercial Borrowing has become a major source of financing growth in India. It is competing with FDI as a source of capital inflows. The policy framework and phenomenon of ECBs is very complex. It is very challenging to model behaviour of ECB. Therefore, its trends and determinants are very complex to measure. This paper studies the trends in ECBs during 2004-2012 in India. A macro-micro model is estimated for finding out the determinants of ECB. Amongst the macro-economic variables money supply mildly influences ECB positively. Foreign exchange reserves are not significant in determining ECBs. Also foreign exchange rate has a positive and large coefficient but is not significant. The impact of both these variables may ambiguous due to a simultaneity problem. Hedging positively influences ECBs but is not significant. The most important micro-economic variables are net cost of borrowing which is significant and negative and production of domestic capital goods which is significant and positive. While there is a decline due to global financial crisis, ECBs recovery after 2009.

Capital Income Taxation Revisited: The Role of Information Asymmetry in the Credit Market

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Abstract

This paper reexamines the role that credit market frictions plays in the classical issue of optimal taxation on capital income, when capital is produced by risky projects which are partially financed externally through a credit market with asymmetric information between borrowers and lenders. We show that the presence of costly state verification by lenders creates inefficiency in the credit market by driving a wedge between the rate of interest and the rate of transformation. In this context, we first show that capital income taxation worsens the credit market distortions and, subsequently, induces greater adverse effects on growth and welfare. Secondly, we find that a greater reliance on external financing gives rise to a higher monitoring probability, lower optimal taxation on capital, and lower economic growth, as the asymmetric information causes greater credit market distortions when the need for external financing is greater. Taken together, our analysis suggests that the presence of informational frictions in the credit market introduces a rationale for more conservative taxation on capital income from both growth and welfare perspectives.

How South Africa adapted after the Global Financial Crisis and changes in South African circumstances

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Abstract

Companies in South Africa faced recent economic crisis. The global financial crisis affected all economies around the world and caused collapses of many markets and economic sectors. Not one country has been spared the effects and outcomes that were created in the economy. The devastating outcome is the psychological affect resulting in a severe collapse of confidence for stakeholders. Management needs to adapt to rapidly changing information and strategic decisions that proved to be successful in the past with not the same effect in the current business environment. The result is management being left with little possibilities to thrive or just survive in economic distress. This discussion is based on an analysis of the changes that occur during the global financial crisis and behaviour of managers in their adaptation to new economic conditions. Most managers did not foresee the trigger of the economic catastrophe or the fact that it will spread so rapidly. Organisations improved management practices and developed new innovative strategies. Managers expected a significant government involvement to neutralise the negative economic reduced by the South African Reserve Bank. Significant changes were made at organisational level in companies to ensure flexibility in responding to the changing economic conditions. Unfortunately beginning of 2012 saw employee strikes affecting the mining industry and eventually an unprotected strike in agriculture. Although it seemed as if South Africa was on the track of improvement, this resulted in a spiral trough.

The Determinants of Government Yield Spreads in the Euro Area

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Abstract

This paper analyses the determinants of sovereign spreads in the euro area from Jan-uary 2002 to May 2012. The objective is to disentangle the role of country-specific funda-mentals, driven by fiscal and macroeconomic factors, from what is referred to as contagion. Following the existing empirical literature, the work estimates a model of the determinants of 10-year yield spreads relative to Germany for ten euro zone countries. The results show that since the eruption of the 2007-2008 financial crisis, sovereign spreads have shown a time-dependent contagion component. On average, such a component explains almost one third of the spreads dynamic in 2009-2010 and almost 10 per cent since 2011. However, results at the country level are quite different between core and peripherals. As shown by the analysis, core countries (excluding Germany, which is our benchmark to measure spreads) were not affected by contagion till 2011; since the worsening of the sovereign debt crisis they seem to have benefited from a flight-to-quality effect. For example, in the first months of 2012, France shows spreads lower than what implied by fundamentals by an amount ranging from roughly 50 to 90 basis points, depending on the model specification, while for Netherlands such a “discount” can be as high as roughly 60 basis point. Peripheral countries, which at the onset of the European Monetary Union took advantage from a mispricing of their actual economic and fiscal fragility, since 2009 have suffered from the abrupt revision of market expectations, showing spreads on average significantly higher than what justified by macroeconomic and fiscal factors. In 2012, for most of these countries contagion has a role comparable to fundamentals in explaining the level of the spreads. For example, it accounts for an amount ranging from roughly 170 to 240 basis points for Spain, while for Italy – probably penalized by its historically highest debt to GDP ratio – contagion explains something between roughly 150 and 180 basis points of the spread, depending on the model specification.

Private Valuation of Compensation Stock Options

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Abstract

In recent years risk-related compensation packages, with stock options have increase in popularity, more grants, and in scope, beyond the executives-only target to a large pool of recipient employees. The divergence between the cost to the firm and the value to the employee, of compensations stock options has always be a polemic issue, moreover when its disclosure and expense becomes mandatory. The employee that receives stock options is bearing more firm-related risk that he would under a portfolio optimization strategy. A diversified investor would optimally distribute his wealth into the risk free rate and the market portfolio. The cost to the firm and the valuation for a diversified investor would coincide. However, the undiversified employee assigns a lower value to the option. The results presented in this paper may help to better understand the preferences for certain types of options over others, from the firm's and from the holder's perspective.

Volatility Downside Risk

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Abstract

This paper derives and tests the cross-sectional predictions of an intertemporal equilibrium asset pricing model with generalized disappointment aversion and time-varying macroeconomic uncertainty. To the contrary of the existing literature, disappointment may result not only from a fall in the market index, but also from a rise in a volatility index. Theoretically, we show that besides the market return and changes in market volatility, three two-asset option-like payoffs, contingent to the disappointing event, are also priced factors: a long binary cash-or-nothing option, a short put on the market index and a long call on the volatility index. Implied measures of market and volatility downside risks similar to those considered in the literature explicitly express as linear combinations of exposures to these options and their underlying instruments. Empirically, we ?nd that the cross-section of stock returns re?ects a premium for bearing undesirable exposures to these options. The signs of the estimated risk premia are consistent with theory, their economic magnitudes show that a long/short strategy on exposure to each of these options pays on average more than 5% per annum, and these rewards are not explained by coskewness, size, value, and momentum factors.

The Maturity Drivers of Corporate Capital Structure

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Abstract

This paper suggests that debt quality matters and that the debt maturity is one of the missed point of the analysis. At corporate level, the maturity mismatch widespread unexpected risk. Shortening the maturity incentivise more liquid investments, usually the less productive ones. At the same time, the shorter is the maturity of debt the higher is the probability of default given a certain duration of the assets. An empirical analysis is made over a sample of Italian companies with the entire set of detailed financial reports in the 2005-09 five year period. Two subset are identified, separating the companies no more included in the source database in 2011. Comparing results from the two subset contributes to better insulate the endogenous bankruptcy proposed by Leland and Toft. We find out: (i) proof of L&T approach but with contributes of creditor to endogenous default; (ii) evidence of debt maturity impacts on business performance by sustaining value of growing options; (iii) significant relation between debt maturity and company size; (iv) a specific contribute of debt maturity to value of the tax shield.

The Effect of Intercompany Transactions in the Value Relevance After the Adoption of IFRS. The Case of the Greek Listed Companies

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Abstract

The present study examines the value relevance of disclosed related party transactions (RPTs) in Greek group of companies. We are based on two types of transactions, exchange of goods-products and exchange of assets, using a value relevance approach. We apply the model of Ohlson(1995) for the period 2004 and 2005 and we observe that the reported earnings of firms selling goods or assets to related parties exhibit a lower valuation coefficient than those of firms in Greece without such transactions. This result is not observed after 2005, when a new fair value measurement rule for related party transactions came into effect. Our evidence suggests that the new RPT regulation in Greece is perceived to be effective at reducing the potential misuse of RPTs for earnings management purposes. Since RPTs have been the subject of numerous scandals, our evidence from the Greek stock markets suggests that new RPT accounting standards could prove an effective solution to this issue.

Growth and Instability in India`s Current Account Balance: A Policy Period Analysis

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Abstract

The policy period analysis can be summed up in terms of the overall BoP. The high growth rate in Period I appears to be a statistical phenomenon. We started at a lower level. During WTO other countries could take full advantage of the new multilateralism, lower tariff and the open access. But India could not do the same. World recovery gave a fillip to trade and we gained but very soon the crisis period set in. Surprisingly the instability is rising constantly. With the help of PCA we created two composite indices – one for internal factors and the other for external factors. The two equations for growth and instability in BoP clearly establish that exchange rate, money supply and GDP (a mix of real and nominal variables) are responsible for escalating instability. Ironically they have a negative impact on growth. The elasticity of internal variables is less than one in both cases. On the whole internal factors have a smaller impact than external factors. Therefore, the composition is a lesser influence than macroeconomic variables.

An International Dynamic Term Structure Model with Economic Restrictions and Unspanned Risks

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Abstract

We construct a multi-country affine term structure model that contains unspanned macroeconomic and foreign exchange risks. The canonical version of the model is derived and is shown to be easy to estimate. We show that it is important to impose restrictions (including global asset pricing, carry trade fundamentals and maximal Sharpe ratios) on the prices of risk to obtain plausible decomposi- tions of forward curves. The forecasts of interest rates and exchange rates from the restricted model match those from international survey data. Unspanned macroeconomic variables are important drivers of international term and foreign exchange risk premia as well as expected exchange rate changes.

The Unfolding of Value in a Decision-making Context

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Abstract

In this paper a philosophy of science approach is used by which the assignment of value in a decision-making context is debated from a trans-disciplinary viewpoint. Value as we perceive it in Finance is distinguished from the process of value. It is conceptualized that the value process (V_un) is unfolding in the mind on a continuous basis assigning value (V_bi) for specific decision-making purposes which is happening at each bifurcation-point. This value is a by-product of the value process. Being a complex adaptive system, the mind engages with matter to create its own reality. Research show that the mind is constantly not only anticipating the future but also "…has an explicit prediction in its genes" (Holland 1992:26). Because of the fact that our value construct is future orientated (benefits to be enjoyed in the future), we need to assign value in the Now (the present) based on anticipations and predictions. Therefore the time-, uncertainty-, risk- and metaphysics-aspects from natural sciences were used to understand how mental and physical happenings are synchronized. Following the research of Kahneman (2002:450) a distinction is made between intuition (generated by our genes) and reasoning to understand the decision-making process.

The Choice Between Informal and Formal Restructuring: The Case of French Banks Facing Distressed SMEs

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Abstract

This empirical paper investigates the path to the resolution of financial distress for a sample of small and medium French firms in default, in particular on the decision between bankruptcy and informal (out-of-court) negotiations. The procedure is depicted as a sequential game in which stakeholders first decide whether or not to engage in an informal negotiation. Then, conditional on opting for negotiations, the debtor and its creditors can succeed or fail in reaching a workout agreement in order to restructure the firm's capital structure. We test different hypotheses which capture i) the coordination vs. bargaining power issues, ii) informational problems, iii) firms' characteristics, and iv) loan characteristics. Using a sequential LOGIT approach, we first find that the probability of an informal negotiation decreases when the bank is the debtor's main creditor and increases with the size of the loan and the proportion of long term debt. In addition, the likelihood of successfully reaching an informal agreement decreases when the management of a badly rated firm is considered as faulty and when the bank is the debtor's main creditor. Finally, we find no evidence for the impact of collateral on the resolution to financial distress.

Corporate Divestitures: Spin-Offs vs. Sell-Offs

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Abstract

This paper investigates the determinants of the choice between two forms of corporate divestitures - spin-offs versus sell-offs. We hypothesize that the choice is driven by the characteristics of divesting firms (their pre-divestiture market valuation relative to intrinsic value and marginal tax rates), the characteristics of assets being divested (their performance under parent firm's management relative to their full potential), and by the prevailing market conditions at the time of divestiture (such as the degree of investor optimism or pessimism). Our hypotheses generate testable predictions regarding the announcement effects of divestitures and the post-divestiture operating and stock return performance of divesting firms. Our empirical findings using a sample of 322 spin-offs and 3,280 sell-offs from 1980 to 2006 are as follows. First, firms with lower market valuations relative to their intrinsic value and higher marginal tax rates are more likely to spin off their assets. Second, assets which underperform relative to their full potential are more likely to be sold off. Third, spin-offs are more likely during periods of investor optimism. Fourth, spin-offs are associated with more positive announcement effects than sell-offs. Finally, firms which sell off their assets exhibit a greater improvement in their post-divesture long-term operating and stock return performance compared to those that spin off their assets.

Why Do Financial Intermediaries Buy Put Options from Companies?

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Abstract

In the 1990s, companies collected billions in premiums from peculiarly structured put options written on their own stock while almost all of these puts expired worthless. Buyers of these options, primarily financial intermediaries, lost money as a result. Although these losses might seem puzzling, by offering to buy put options from better informed parties, intermediaries receive private information about the issuing company. We find that magnitude of changes and structural breaks in the stocks' price trends and volumes around the put sales indicate that the intermediaries were indeed acting on this information and potentially made hundreds of billions of dollars.

Expanded Term Structure Models

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Abstract

We propose a simple expansion of existing affine and quadratic affine term structure models which we refer to as expanded term structure models (ETSMs). Our new no-arbitrage term structure models allow for a very flexible specification of the short rate and the market price of risk but nevertheless lead to closed form solutions of bond prices. Several equilibrium models fall within this class of term structure models. Empirically, we show that the three-factor expanded Gaussian term structure models (EGTSMs) outperform the three-factor Gaussian term structure model (GTSM) in explaining US Treasury yields. Moreover, our three-factor EGTSMs are able to match time variation in excess bond returns and time variation in the volatility of yields. While unconditional Sharpe ratios of Gaussian and expand Gaussian models are very similar the time series properties of conditional Sharpe ratios are very different.

Benchmarking Performance of Foreign Banks in China through Multivariate Efficiency Modeling: How do they Fare When Compared to Domestic Banks?

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Abstract

We employ the efficient frontier methods of data envelopment analysis (DEA) and stochastic frontier analysis (SFA) to estimate efficiency of Chinese bank production in a study that directly compares foreign banks with domestic banks. Both methods reveal that, on average, foreign banks are less efficient than domestic banks. A break-down of the sources of inefficiency identifies non-interest expense among the foreign banks as an area for major potential improvement, whereas the domestic banks appear to suffer mostly from inefficiencies in managing non-interest income. There is a significant positive impact of market share on the efficiency of generating interest income. Interbank and cost-to-income ratios have a negative impact on interest income. DEA and SFA efficiency estimates are significantly positively correlated, thus opening the way for both methods to be used together in a complementary manner; equally gratifying, they are also positively and significantly correlated with key financial performance ratios.

Board Characteristics and Firm Value: Evidence from Colombia

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Abstract

The relationship between a board of director's characteristics and a firm's value in developed economies has been long debated in literature, but little attention has been given to this relationship in emerging markets. Governance laws issued and implemented over the last decade have tried to solve the agency problem by encouraging efficient monitoring by corporate boards of directors. This paper examines the relationship between board characteristics (such as board size and composition) and the implementation of corporate governance law with corporate values in Colombia. Empirical results, which used data from 2001 to 2009, show no relationship between board characteristics such as board size and independence with value for publicly traded Colombian companies. However, corporate governance law implementation for Colombian listed companies is positively related to value.

The Co-movement of Credit Default Swap Spreads, Stock Market Returns and Volatilities: Evidence from Asia-Pacific Markets

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Abstract

The aim of this paper is to study the co-movement of credit and equity markets in four Asia-Pacific countries: Australia, Japan, Korea and Hong Kong. First, we perform a regression analysis to understand the determinants of credit default swap (CDS) spreads. We find results consistent with those obtained for the US. Among the important variables that explain levels as well as changes of CDS spreads is volatility, which we compute using high-frequency data. We analyze this relation at both firm and market level. Second, we focus on lead-lag relationships between CDS spreads, realized volatility and stock returns. Using a vector-autoregressive (VAR) model we study the inter-temporal co-movements between these variables. At the firm level we find results consistent with the literature: stock returns lead the other variables. However, at the index level realized volatility and CDS spreads are at least as important as equity returns. Third, we analyze cross-market volatility spillovers using the volatility spillover measures based on a generalized VAR framework proposed by Diebold & Yilmaz (2011). The results suggest that realized volatility is the main contributor to volatility spillovers between the three asset classes. Overall, our results underline the importance of realized volatility to understand market activity.

The Tragedy of the Lloyd's Names (1985-1995) – Victims of Flawed Institutions and Professions

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Abstract

During the period 1985-2001 Lloyd's of London is believed to have suffered substantial indeed unprecedented "losses". As a consequence of these "losses" calls were made on the then Names to pay real money to make good the "losses". These calls ruined the lives of thousands of Names around the world consequently at least 30 committed suicides. Most Names felt that they were victims of fraud. This paper will re-examine what happened over this period and argue that the Names were victims if not of fraud certainly of flawed institutions and professions. Some of the flaws have become more apparent and more clearly understood since these events of the 1990s occurred, but not all of them. Some serious flaws remain which require urgent attention. One of the flaws is the institution of Names itself. It is totally unsuited for the age in which we now live and should have been abandoned much earlier at least by the mid 1970s. It has in any event died a natural death as Noble Laureate Hayek would have predicted. Lloyd's as the professional manager of the Lloyd's insurance market should have taken steps earlier to abolish the institution of Names. A further flaw lies in the field of insurance accounting where a clear distinction was not and still is not maintained between provisions and reserves. In this regard the accounting profession had failed. Had the correct distinction been made in all probably Lloyd's would have been shown to be profitable during the period. The actuarial profession is shown to be equally flawed since it should have been clear to all that it is not possible to predict a reserve in the absence of any historical data.

Stock Investment Decisions: An Empirical Study of the Impact of Human Asset Valuation Information

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Abstract

The main objective of the study is to find whether the reporting of information of human asset valuation in published financial statements of the companies cause investment decision to be different and to find out whether any background variables have an impact on investment decision. 150 responses were obtained by using the questionnaire developed by the researcher having human asset information (via human resource valuation model Singh, 2002) along with traditional financial information of two companies. To test the hypotheses, non parametric test i.e. MCNemar test has been used. The results show that there is a significant impact of the human asset valuation information on investors' decision regarding their selection of the company. It was reported that there was no significant relationship between the four background variables- age, experience, educational qualifications, & industrial sector and company selection.

Deviations in Institutional Investment: Who Leads in India?

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Abstract

In this study we explore the impact of different institutional investors on firm performance in India. We study the equity holdings by (1) Mutual Funds/ UTI; (2) Banks, FIs and Insurance companies; and (3) Foreign Institutional Investors over 2001-2011 using unbalanced panel data. We find that FIIs lead among the various groups of institutional investors and have a strong influence on firm performance as they possess greater capabilities in generating monitoring incentives. Our findings are robust using different models for FIIs and not so strong for other institutional investors. Hence the impact of reforms in attracting foreign investments has been effective in improving corporate governance among Indian companies.

Entropic Risk Measures and Cost of Equity: Empirical Evidence from Russia.

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Abstract

The choice of appropriate model for estimation of cost of equity in emerging markets is still a very challenging problem. Market inefficiency, limited opportunities for diversification, as well as liquidity issues inspire researches to look for risk characteristics beyond the usual mean variance framework of the classical capital asset pricing model. Various models were developed for the past several decades proposing new ways of risk assessment, however, controversial empirical evidence of these models requires careful consideration. The goal of this study is to determine which of the models has more explanation power for returns in the Russian capital market. We provide a brief description of the recently proposed entropic risk measures which assign greater weight to the downside movements of the asset price and smaller weight to the upside movements. We compare performance of entropic risk measures with different models for several periods in history of the Russian stock market on the dataset of 63 stocks for the period from 2003 to 2012. Empirical results show certain advantages of entropic risk measures over other risk measures in explaining returns on Russia’s equities.

Changes in Mutual Fund Flow-Performance Relationship throughout the Global Financial Crisis: US Evidence

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Abstract

Existing research shows that mutual fund flow is highly correlated with past performance in an asymmetric way, namely flow-performance convexity. Given such convex relationship, fund managers have incentives to manipulate fund characteristics to invoke future fund inflows. The main focus of this study is to conduct an empirical analysis of the impact of fund volatility and fee structures on the flow-performance relationship throughout the global financial crisis (GFC) period for U.S. open-end actively managed equity funds. Using sample data covering the period of 1999 to 2011 (disaggregated into three sub-sample periods), empirical analysis in this study show that mutual funds adopt a low risk strategy resulting in the greatest flow-performance sensitivity, which is convex. An incremental dampening effect is observed on flow-performance convexity due to increasing riskiness of portfolios, more significant in the GFC period but relatively less pronounced in the pre-GFC period. In addition, the results indicate that pure operating expense weakens the flow-performance sensitivity, especially in the post-GFC period. However, advertising effects provided by 12b_1 expense triggers greater investor response to past performance, particularly in the GFC period. It is also found that front-end load is not a statistically significant variable in determining the flow-performance relationship, nevertheless, back-end load on average dampens investor response to past performance and this dampening impact is more evident in the post-GFC period. Key Words: Mutual funds, fund flows, fund volatility, fund performance, GFC. JEL Classification: G01, G12, G23

Financial Crisis and Contagion in Stock Markets: Evidence from G-20 Countries

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Abstract

This paper is among the firsts to investigate the contagion effect of the 2007 financial crises across the 20 most developed countries in the world. We use correlation analysis, pair wise granger causality and VAR causality/ block exogeneity Wald tests to check for contagion effect. We find that during crisis period the transmission of information had been more as it took little longer (3 days) during crisis period. The number of causal relationships also increased significantly during crisis period showing contagion effect of financial crisis among G20 nations. We also find evidence of Central market hypothesis wherein US is found to influence major economies of the world. Further, contrary to general belief, during crisis period, causality also runs from developing markets to developed ones and increased substantially during crisis period in all types of contiguous countries (European, Asian and American). However European and American countries witnessed proportionately higher bi-directional causal relationships than those in Asian markets during crisis period. This might be due to the fact that Asian economies had more strong economic fundamentals during the recent financial turmoil than European countries.

Do Stock Prices Conform to an Absolute Price Level?

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Abstract

We examine nominal and real stock prices and the sequential price pattern of stock dividends, stock splits and Initial Public Offerings (IPOs). Using data for all firms listed in Sweden over the one hundred and twelve year period 1900-2011, we show that the average stock price has been fairly stable over time except for two decades in the beginning and end of the 20th century. Inclusion of these periods yield a decline over time which is generally consistent with the drop in price levels found by Chittenden et al. (2010). In a multivariate setting, the frequency of stock dividends, stock splits and IPOs are positively related to the frequency for these events the prior year and recent market return. In further tests of the price change we find a positive relationship between the price difference to the median price for stock splits and stock dividends and a positive relationship to the market return for stock splits. We conclude that the primary reason for an action such as a stock split, is to fit the "norm" price of the market.

Loan Officer Authority and Small Business Finance: Evidence from a Survey

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Abstract

A vast literature has emphasized that small banks are at a comparative advantage in lending to small businesses. In this paper, we show that, apart from size, bank organizational characteristics affect banks' specialization in small business lending. By using a unique dataset based on a survey of Italian banks, we find that loan officers' authority has a key role in explaining bank specialization in small business lending. In particular, banks that delegate more decision-making power to their loan officers are more willing to lend to small firms than other banks. We use several proxies for measuring loan officers' authority: loan officers' discretion in loan approval and in setting loan interest rates, the amount of money up to which they are allowed to lend autonomously, their turnover, their compensation schemes, and the kind of information (soft versus hard information) used both for screening and monitoring purposes.

Non Interest Income and Availability of Credit

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Abstract

Banks try to avoid resorting to rationing by offering new lines of service. The services income is essentially based on non interest income (commissions and fees) and can compensate the underpayment of risk. The aim of our work is to verify the significance of the relationship, firstly, between credit availability (presented by two variables: the amount of granted loans and the annual growth of granted loans) and the income of services and, secondly, between the net interest margin and this income. To perform our work we used five different samples of banks which are representing four geographical areas (Western Europe, Eastern Europe, North America and Asia) and the total of observations. The collected data covers 10,784 banks during the period 2004-2009. The results of our study show a negative relationship between the non interest income and the amount of granted loans, whereas, the results regarding the relationship between this income and the growth of granted credit were inconclusive. However, the integration of a lag of one year of non interest income gives a significant and positive relationship. The results of the last regression are contrary to our expectations and show a positive relationship between services income and the net interest margin.

Tax Competition and Hidden Tax Discrimination: Firm-level Evidence in Europe

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Abstract

With the ongoing integration of the world economy and the recent accession of low-tax member states to the European Union, this paper investigates whether tax competition for internationally mobile firms can lead to discriminatory tax treatment. Using firm-level data for 17 European countries for the period 2001-2010, this study finds that highly mobile firms tend to experience a substantially lower tax burden than their less mobile counterparts, due to preferential tax treatment. On average, fiscal incentive packages negotiated on a case-by-case basis are estimated to reduce the tax burden of mobile firms by 1.5 percentage points. This hidden tax discrimination is found to be positively related to the level of the statutory tax rate and thus is not present when the wider tax system is more aggressively competitive.

Flow of Islamic Finance and Economic Growth -- An Empirical Evidence of United Arab Emirates (UAE)

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Abstract

Abstract: This paper analyzes empirically the relationship between the development of Islamic finance system and growth of the economy in the United Arab Emirates (UAE). To document the relationship between development of Islamic finance and economic growth, time series data from 1990 to 2010 were used. We use Islamic banks' financing credited to private sector through modes of financing as a proxy for the development of Islamic finance system and Gross Domestic Product (GDP), Gross Fixed Capital Formation (GFCF), as proxies for real economic growth. For the analysis, the unit root test, co-integration test and Granger Causality tests were done. Our empirical results show that there is a strong positive association between Islamic banks' financing and economic growth in the UAE, which reinforces the idea that a well-functioning banking system promotes economic growth. However, our results indicate that a causal relationship happens only in one direction, i.e., from Islamic banks' financing to economic growth, which supports Schumpeter's supply-leading theory. In this case, the development in the Islamic financial sector acts as supply, leading to transfer of resources from the traditional, low-growth sectors to the modern high-growth sectors, and to promote and stimulate an entrepreneurial response in these modern sectors. Furthermore, the results show that Islamic Banks' financing has contributed to the increase of investment in UAE in the long term and in a positive way.

Aspirations, Status, Wellbeing, and Risk Tolerance

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Abstract

Financial well-being is distinct from income. Some people with high incomes suffer low financial well-being, as their incomes fall short of their aspirations. Such people feel propelled to reach their aspirations by taking risk and willing to bear losses. Conversely, some people with low incomes enjoy high financial well-being, as their incomes exceed their aspirations. We find that people whose aspirations exceed their income are less risk-averse than people whose incomes exceed their aspirations. We also find that competitive and status-seeking people are less risk-averse than people who are less competitive and status-seeking and that status-seeking people are less loss-averse than people who are not as status-seeking.

Bank Lending, Liquidity Shocks and Economic Activity: Evidence from the Syndicated loan Market in the U.S.

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Abstract

This paper provides evidence on transmission of the banking sector problems to the real sector economic activity and presents how deterioration of banks' financial health affects bank lending in the U.S.. I exploit the impact of the composition of banks' liabilities prior to the financial crisis of 2007 -- 2009 on banks' lending. In particular, I examine whether banks, relying less on core deposit financing prior to the crisis, decrease lending more than those banks financed mainly by core deposits. Further, I examine whether a decline in bank lending imposes financial constraints on firms and thereby affects their performance. I measure a financial constraint by the average share of core deposit to total assets across all banks financing a particular firm. Alternatively, I employ the average predicted value of change in banks lending to the firm. My results confirm that banks tend to decrease lending due to negative funding shocks. However, banks that relied more on core deposits prior to the crisis reduce lending to a smaller extent. This effect is also economically significant. Banks with a share of core deposits one standard deviation above the mean reduced their lending by 5.1 percentage points, while banks with a share of core deposits one standard deviation below the mean reduced lending by 10.4 percentage points. Therefore, the same firm experienced a lower decline in borrowing from a bank with a higher share of core deposits to total assets, relative to a drop in borrowing from a bank with a lower share of core deposits to total assets. At the same time, firms borrowing from banks with higher core deposit financing prior to the crisis obtained more favorable loan contract terms for new loans in the post-crisis period. They enjoyed lower overall average loan costs and obtained loan contracts with longer average maturity. The drop in bank lending itself yielded a reduction in firms' net leverage, investment rate, profit, employment and accumulation of cash reserves. This indicates that medium and large firms proved not to be immune to the deterioration in banks' financial health and reduction in bank credit.

The Value of Political Connections in the United Kingdom

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Abstract

This paper explores whether political connections are valuable for UK listed firms. We construct two distinct measures of connections: one based on donations to political parties by company directors; and one based on directors who hold political office. Using these measures we distinguish between companies connected to the Conservative party and those connected to the other main parties (Labour and Liberal Democrats). We find that companies with pre-existing connections to the Conservative party experienced positive abnormal returns when there was an increase in the perceived probability of a Conservative win in the run up to the 2010 General Election.

A "new" role for financial intermediaries? The sustain of economic activity during systemic banking crises

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Abstract

Economic literature has revealed the existence of some biases in the identification of the linkage between the supply of credit and aggregate output in periods of financial turbulence. From this perspective, when a banking crisis occurs a contraction of credit offered by banks generally happens, accompanied by a slowdown in economic activity. In these circumstances, there are different directions of causality that explain the coexistence of these two fundamental phenomena, the credit contraction and the economic slowdown. Moving from the most recent dataset of Laeven and Valencia (2010), we created a unique and original dataset, where 76 episodes of systemic banking crises are considered, in order to investigate for the main determinants and effects, which interested with different intensity 54 countries, in terms of credit crunch and economic slowdown. Evidence obtained from this analysis, by considering different components of demand and supply of credit during these crises, lead us to significant findings, supporting the hypothesis that, under specific circumstances, credit contraction during financial crises is more to be ascribed to the reduction of credit demand from household and enterprises, rather than to a voluntary reduction of credit from banks.

Can Investors in the Stock Market Generate Profit from the Analysts? -An empirical analysis of Analysts' signals disseminated from the Bloomberg

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Abstract

Using a large database of Japanese analysts' rating information over the period 2000-2010, we examine short term market reactions to the announcement. We find a significant market reaction to the information contained in analysts' rating. Particularly, market reacts sensitively to the rating changes rather than the rating itself. We also examine whether investors are able to achieve positive net return by taking advantage of the abnormal market reaction to the analysts' signal by constructing a dynamic calendar time equity long-short portfolio. Results indicate that investors are able to capture some abnormal profit trading on such signals, however, large size investment based on the same strategy becomes implausible due to the transaction costs.

Types of Risk Shifting: The US Banking System

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Abstract

This paper is a contribution to the empirical analysis of risk shifting. Specifically, we try to find out whether risk shifting exists in a banking industry, and if it does, then we try to find out its type. The type of risk shifting depends on the group of debt holders to whom risk is shifted; that is, the type rests on whether risk is shifted to depositors, to non-depository creditors or to both. Thus, risk shifting problems can be classified using a typology that comprises four different types. This research strategy is applied to the US banking sector between 1998 and 2011. We also split the sample to analyze risk shifting in banks with and without buffer, and in the pre-crisis period 1998-2007 versus crisis period 2008-2011. Our main results suggest that US banks engaged in moral hazard behavior. Although with different extent, the banks kept this behavior before and during the crisis.

The Effect of Uncertainty and Volatility on Financial Markets, Growth, and Development

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Abstract

This article analyses the effects of uncertainty and volatility on financial markets, growth, and development. Following Aghion et al. (2010), we link the development of financial markets to the realization of a high-return investment, which is threatened by an idiosyncratic productivity shock. When agents foresee this shock, they can share risk and markets are complete. However, imperfect foresight impedes risk sharing and constraints credits, which affects growth in the long term. The government can promote intertemporal saving and international flows of capitals to compensate distortions. The foregoing is crucial for developing countries that need to grow faster for convergence.

Aggregate News Tone, Stock Returns, and Volatility

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Abstract

We examine whether soft information in firm-specific news contains valuable information about aggregate stock returns and volatility. Using a large data set in which the language of millions of firm-specific news items has been quantified, we construct two novel measures: The aggregate level of news tone and the aggregate dispersion of news tone. Our news tone variables are strongly related to economic factors but only weakly related to investor sentiment. The dispersion of news tone is countercyclical, asymmetric, and strongly forecasts aggregate stock returns and realized variance, controlling for a range of hard-information variables. The dispersion of news tone represents a direct measure of aggregate information uncertainty and predicts changes in more indirect measures such as the VIX index and the variance risk premium. Our findings provide a new perspective on why volatility is countercyclical and asymmetric.

On the Welfare Costs of a Liquidity Crunch

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Abstract

In this paper I introduce a real and a financial friction into an otherwise standard decentralized Neoclassical growth model. Agents own both capital and labor but a real friction is present because only some of them become entrepreneurs with the possibility of running investment projects. The financial friction prevent them to entirely borrow against the value of the investment or selling equity on existing capital to finance investment. I find that when these constraints are relatively tight, aggregate outcomes are not Pareto optimal and there exist large costs in terms of output and welfare. I also show that the combination of both types of frictions can lead to substantial wealth inequality, close to the levels observed for the US economy. An exploration of the aggregate dynamics of the model show that there can be substantial welfare costs associated with productivity shocks, liquidity shocks and entrepreneurial or innovation shocks.

Mean-Variance Optimal Portfolios in the Presence of a Benchmark with Applications to Fraud Detection

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Abstract

We first study mean-variance efficient portfolios when there are no trading constraints and show that optimal strategies perform poorly in bear markets. We then assume investors use a stochastic benchmark (linked to the market) as a reference portfolio. We derive mean-variance efficient portfolios when investors aim to achieve a given correlation (or a given dependence structure) with a stochastic benchmrk. We also provide upper bounds on Sharpe ratios and show how these can be useful for fraud detection. For example it is shown that under some conditions it is not possible for investment funds to display negative correlation with the financial market and to have a positive Sharpe ratio. All results are illustrated in a Black-Scholes market.

Performance of Balanced Mutual Funds India: Effect of Asset Allocation, Market Timing and Security Selection

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Abstract

The paper attempts to study the effect of market timing and security selection on balanced mutual funds in India using the Brinson, Hood and Beebower (BHB) framework of determinants of portfolio performance. Research so far on portfolio performance has shown varied results on efficacy of active portfolio management, the objective of this study is to test it on mutual funds in India. The study, based on the returns of 22 balanced mutual funds in India from 2007 to 2012, shows that fund managers have underperformed the benchmark. On the different parameters that determine portfolio performance, fund managers were able to generate excess returns on market timing while they underperformed on security selection. Asset allocation policy was able to explain 73.8% of variability of total returns, and security selection was able to add on to the explanation better than market timing.

The Impact of Co-Location of Securities Exchanges' and Traders' Computer Servers on Market Liquidity

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Abstract

This study examines the impact of allowing traders to co-locate their servers near exchange servers on the liquidity of futures contracts traded on the Australian Securities Exchange. It documents that trading volume, the order to trade ratio, message traffic, and depth increase, while bid ask spreads decreased following co-location. Consistent with Chaboud et al [2011], we do not observe any change in volatility in interest rate futures contracts following the introduction of co-location. The economic significance of the increase in market liquidity after co-location is assessed. We conclude that the introduction of co-location enhances liquidity.

Competition and dynamics of takeover contests

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Abstract

The paper investigates the impact of competition on the outcomes of takeovers. Competition is characterized by a) bidders with different attitudes towards the target; and b) different modes of completing the deal such as private negotiations, auctions, or tender offers. This paper uses a bargaining model with alternating offers where calling an auction represents an outside option for each bidder at each stage of the game. The model aims then to answer three main questions: who wins the takeover? when? and how? Additionally, the richness of the model enables us to derive predictions on the resulting takeover premia as well as to draw conclusions on how other dimensions of the takeover process, such as termination fees and tender offer costs, affect its dynamics and outcome.

Joint Affine Term Structure Models: Conditioning Information in International Bond Portfolios

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Abstract

In this paper, we propose a simple model for international bond investment. The investor can optimize a government bond portfolio in a discrete time horizon conditional on the common and local factors in international bond returns. The variation in the cross section and time series of treasury yields is captured by a joint affine term structure model (ATSM). Easy closed form solutions for the returns and variances are given. We test our model in an empirical study of US and UK government bonds in the period of 1983 to 2012. An interpretation of the common factors as 'level', 'slope' and 'spread' not only helps to interpret the cross section and time series of the treasury yields but also to understand the evolution of our conditional portfolio weights. Our empirical study shows that common factors in international bond returns are not only an empirical phenomenon. The empirical findings can be supported by the proposed model and the model can link the investor's decision conditional on the common factors in international bond returns.

Long/Short Equity Hedge Funds and Systematic Ambiguity

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Abstract

This study first presents an optimal hedge fund portfolio choice model for an investor facing ambiguity or Knightian uncertainty. In the empirical section, we measure ambiguity as the cross-sectional dispersion in the macroeconomic forecasts and in the stock market return forecasts from the Livingston Survey and construct the ambiguity factors for the universe of S&P500 stocks. We estimate ambiguity betas for long/short equity hedge funds strategies and document significant ambiguity exposures for directional L/S hedge funds. We compare the out-of-sample performance of portfolios constructed based on the L/S hedge funds alpha rankings with and without ambiguity exposures and find that the former outperform. These results are robust with respect to alternative ambiguity measures, holding periods and performance measurement models.

Some Evidence on Intraday Volatility Patterns of Indian Market

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Abstract

This study examines the ‘intraday’ volatility patterns of NSE’s Nifty Index from January 2004 to December 2005. The tick by tick index returns are categorized into three groups – opening price to thirty minutes after opening price (morning sample), thirty minutes after opening price to fifteen minutes before closing price (mid-day sample) and fifteen minutes before closing price to closing price (evening sample). Defining the tick by tick index returns as a measure of deviation between successive prices, new volatility estimates are constructed to compute intraday volatility. The volatility patterns across the samples suggest high volatility during the initial trading period which sustains till 30 opening minutes and further increasing volatility during the last 15 minutes of a trading day. Information bunching and presence of private information are attributed to morning and evening period volatilities respectively. The volatility of intraday returns of Nifty follows a crude U shaped curve.

HarVa: A Case on Harnessing Value for Sustainable Development and Inclusive Growth in Rural India

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Abstract

The paper is an attempt to write a case study on a for- profit rural enterprise uniquely named and adequately positioned as 'HarVa', Harnessing value of rural India.HarVa means Green for the villages and stands for "Harnessing Value" of rural India. Harva aims to assist rural India to access and harness the opportunities that urban India/local environment offers for a better quality of life. It includes supporting various projects that create value for villagers. It intends to create farming groups and rural BPO'S that foster and engender greater investments from the corporate world into the rural sector. The two major grueling issues in the Indian economy today are Sustainability of our Economy, culture and Environment and Inclusivity of the people at the bottom of the pyramid.HarVa specializes in finding the right approach to achieving maximum social, economic and environmental sustainability through appropriate development in rural India. At the same time, it focuses on enhancing the capacity of the villagers who then become HarVa brand ambassadors and implement these sustainable development changes. Harva aims to take up the challenge of economic and social upliftment by blending both a profitable and social model. Harva's Economic Aims are of Inclusive growth, Improved bottom line and increased aggregate product. Harva's Social Aim are focused towards women empowerment and stopping migration to cities and improving the life style in rural India. The case study thus attempts to study the unique business model of HarVa and how this rural for profit organization is able to Harness Value from rural India and in return how it is effectively contributing towards economic, cultural and environmental sustainability and inclusive growth of rural population in India.

Active Hot Hands Investors, Support Quality and Allocation of Control Rights in Entrepreneurial Finance

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Abstract

We focus on trading off the benefits and disadvantages of active hot hands and passive investors. We set up a two staged model where an innovative entrepreneurial venture requires external equity for start-up and expansion financing. The entrepreneur can select among two types of financial ressources: from passive long term or active hot hands investors. The active hot hands investor provides a higher quality of support but has a shorter investment horizon than the long term investor. He does not want to or cannot provide the expansion capital and rather exits at the interim state. We search the NPV maximizing contract for the entrepreneur taking into account that the active hot hands investor might have a moral hazard. He would try selling his claim after the seed phase to an uninformed outside investor as a claim in a successful venture even if it is a failure and rather should be abandoned. The likelihood for being successful depends on the entrepreneur's effort which is boosted by the support quality of the investor while the decision to abandon can be taken either by the financier or the entrepreneur, contingent on who holds the controlling majority. There exist several equilibria in this game and we show that entrepreneurs can trade-off several parameters when seeking external financing. Contingent on the allocation of the control rights, on the investor's support quality and investment horizon, on the success by chance, and on the venture's expected liquidation value either investor is the more appropriate.

Disinvestment: Out of the Deep Freeze

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Abstract

Governments, especially of the developing economies, including India have long used State Owned Enterprises (SOEs) as instruments to achieve their social and economic developmental goals. For India, the size of governments kept enlarging until the 1980s. Thereafter, there was an increasing disillusionment with the SOEs, primarily on account of its burgeoning losses. Protection from competition, bankruptcy and takeover allowed them to become inefficient. Increasingly, policy makers in India felt that the private sector could probably do better than public sector, since property rights would ensure greater productivity and bankruptcy laws would weed out the unproductive enterprises. Thus, the theory of market failure was overtaken by the theory of non-market or bureaucratic failure (Stiglitz, 1989). Resultantly, India promoted privatization. This paper focuses on Disinvestment (whereby private ownership is inducted in publicly owned enterprises) as a means for improving the efficiency of SOEs. An important policy implication of the paper is that if disinvestment is not accompanied by adequate competition, change of ownership per se may not enhance efficiency.

SMEs' Constrained Access to Finance and Their Investment Level During Economic Crisis

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Abstract

Numerous evidence show firm’s growth is determined by a plethora of factors, most frequently mentioned are size, age, and availability of external finance. The latter is particularly important as SMEs investment demand is constrained by the availability of external finance. Access to financing and the level of financial development (and efficiency) is therefore a very important economic policy challenge. However when it comes to SMEs one cannot ignore their ironic position: on the one hand, most countries are aware of their key impact on employment, GDP and economic growth. On the other hand, policy makers are typically engaged with problems of large companies only, despite the fact SMEs have been more severely hit by the current financial crisis. This has happened not just because of their impaired access to appropriate financing due to their uncompetitiveness compared to large companies seeking for external funds – which is a problem for SMEs even outside the current crisis – but also because large companies increasingly intimidated SMEs into providing them trade credit. This paper analyzes how micro, small, medium-sized and large companies in Slovena, member of the Eurozone with highly impaired access to external financial resources, have been able to ‘cope’ and ‘adjust’ their investments to worsened financial conditions (credit crunch, and related impaired access to finance), as well as economic conditions (pressures related to inventory, liabilities and net working capital) in the period between 2007 (pre-crisis) and up to 2010 (during crisis). We estimated 2008 global financial and economic crisis’ effects with robust regression panel data analysis. The results indicate that even before the crisis (in 2007) micro and small companies had a lower investment level compared to large companies. Part of the reason can surely be attributed to the fact that micro and small firms are virtually cut-off from bank loans. Consequently, micro and small companies could use trade credit only (beside internal sources of finance, e.g. sales) to finance investments. Since trade credit is costly source of finance, only few projects are lucrative enough to cover financing costs, which results in lower investment level in micro and small companies even if they are less financially distressed compared to large companies. Overall, results suggest SMEs have been more severely hit by the current financial crisis. SMEs access to external sources of finance and the level of financial development (and efficiency) is therefore a very important economic policy challenge. As long-term financing represents a foundation for SMEs future growth, this implies a greater need for long-term SME financing should be met: either by the state institutions and/or by commercial banking sector.

On the Determinants of the Sensivity of the Yield Spread of Corporate Bonds to Changes in the Level and Slope of the Yield Curve

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Abstract

5,500 US corporate bonds from six credit rating categories were analysed. Contrary to previous research, we find heterogeneity in yield spread sensitivities across and within bond rating categories, across maturity and economic sectors. Credit rating, bond liquidity, and the issuer's return on invested capital are factors which reduce yield spread sensitivity. The bond's remaining time to maturity and the issuer's dividend payout ratio produce positive sensitivity. An economic sector divide is found. Further analyses illustrate the power of the averaging process inherent in using broad bond indices to hide variation in sensitivities within bond rating categories.

Social Capital and Financial Decisions in Norwegian Private Firms

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Abstract

I use a natural experiment that took place in Norway on 1st January 2006 in the form of a reform in the taxation of dividends, to show that three social capital variables, namely trust, altruism and sociability play an important role in explaining the financial decisions of Norwegian private firms. Trust, sociability and altruism are shown to diminish the tendency to take money out of the firm in form of dividends previous the reform. In addition, trust and sociability are shown to have an interaction effect, reinforcing each other. Altruism and sociability have a positive effect on the amount of long-term debt borrowed by firms.

Mutual Fund Flow and Past Information: Is the Brazilian Investor Smart?

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Abstract

This article shows evidence of the Smart Money Effect in Brazil. The evidence is located in funds for qualified investors and managed by independent companies not banks. This is the first study to separate the SME among different types of money managers.

Conditional Return to Bidding Firms Shareholders: an Australian Study

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Abstract

This study examines the importance of the self-selection problem in event related studies in evaluating return to bidding firms around bid announcements. Management gives extensive thought to takeover decisions before making such decision public. Consequently firms that make a bid announcement are not random since such firms self-select themselves to be a subsample of firms within the population of firms. The selection process of bidding firms makes the sample non- random and using normal tests of significance under OLS estimates will be biased. OLS estimates are misspecified since sample firms residual are not independent across the firm's population. This paper shows that after controlling for self-selection bias, the significant negative or positive return to bidding firms reported in the prior literature disappears and that bidder's shareholder make normal returns around bid announcements. The results are consistent with conventional equilibrium theory that states return should be at least zero under equilibrium conditions. Thus failing to account for sample selection bias in event studies and using unadjusted OLS standard errors will give substantial downward biased results which can lead to erroneous conclusions about bidder's true wealth effects around announcement.

The Meiselman Forward Interest Rate Revision Regression as an Affine Term Structure Model

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Abstract

We adapt the Meiselman (1962) OLS forward rate revision framework to obtain the discrete time analogue of the Heath, Jarrow and Morton (1992) specification and use it for estimating and testing term structure models. Our framework is based upon the Wold representation of the factor dynamics and combines the flexibility of the `no arbitrage' approach used by practitioners for pricing with the time series domain econometrics used in the `equilibrium approach' by academic researchers. It allows us to estimate the no-arbitrage term structure under the risk-neutral measure without adopting any specific model of the factor dynamics. Using three different datasets we find that our discrete time Heath et al (1992) no-arbitrage model is not rejected against the unrestricted OLS model of Meiselman (1962). We then develop a dynamic term structure model by specifying a model of a risk premium to link the risk neutral dynamics of the cross section to the real-world factor dynamics. We analyse several different models of the dynamics from the ARFIMA class and find that the more flexible models allowing for long memory outperform short memory models and are not rejected against the Heath et al and Meiselman specifications.

Beyond Austerity: an SPV to Save the Eurozone?

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Abstract

There is evidence of 'creditor panic' in European markets for sovereign bonds as investors fly to safety whenever they think others will; and the ECB has offered a 'put' for sovereigns willing to accept further fiscal stringency. But how, and how soon, this will promote economic recovery for European countries struggling to service their debts? In addition to unilateral action by the ECB, some have proposed the consolidation of sovereign debt into Eurobonds backed by a supranational agency. For debtor countries, others have argued that some restructuring of their liabilities by a switch to GDP bonds or growth bonds could alleviate their immediate fiscal problems. As the market is not ready for such financial innovation on the requisite scale, we explore the idea of tackling the problems of creditor panic and of debtor illiquidity simultaneously. Specifically, we propose the creation of an SPV which issues Eurobonds and holds both plain vanilla sovereign debt and newly created state-contingent bonds. This offers, we believe, a desirable complement to the 'Draghi put'.

Is Imperfection Better? Evidence from Predicting Stock and Bond Returns

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Abstract

We investigate the short-horizon stock and bond return predictability in a predictive regression and a predictive system using a Bayesian framework. In contrast to the predictive regression where the expected returns are modeled as a linear function of predictors, in the predictive system this assumption is relaxed, and predictors do not account for the entire variance in expected returns. We argue that a fair comparison of these two models has not been drawn yet. We propose an approach whereby priors on parameters in the predictive system are chosen to match the prior on R^2 in the predictive regression. We allow for various levels of optimism about the degree of predictability in terms of different R^2, and evaluate their effects on the model performance. More specifically, we look at the out-of-sample certainty equivalent returns implied by an asset allocation strategy and show that relaxing the assumption of perfect predictors does not seem to pay off out-of-sample.

The Poor Man's IPO: Reverse Takeovers in the UK

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Abstract

Reverse takeovers (RTOs) have been referred to as the poor man's IPO as it offers an alternative route to go public that is marketed as cheaper and faster than an IPO. However, not only is the cheaper and faster claim disputed in recent literature, RTOs have also attracted significant negative public and regulatory attention of late – particularly in the US but recently also in the UK – with particular questions raised related to their motivation, quality, viability and aftermarket performance. Using for the first time a sample of RTOs from the London Stock Exchange (LSE), that applies a significantly different regulatory framework from US on such transactions in that it allows for operating public firms be the acquirer-cum-target, we find that RTOs are used by three broad but distinctively different groups of firms. These three groups differ in terms of their financial characteristics and size at the time of the RTO, as well as their maturity and motivation for going public in the first place. In sharp contrast to the US experience, we find that a significant proportion of the UK RTOs are undertaken by firms looking for expansion through a simultaneous synergetic acquisition (59% of our sample) and a public listing and are often actively involved in acquisitions and SEOs, soon after their public listing. Again, in contrast to the US findings, the UK sample of RTOs display significantly better viability compared to the US, with a significant proportion surviving the first three years after the listing (ranging from 83% to 89% between the three groups). Furthermore, there is no evidence to suggest that their aftermarket performance for RTOs in the UK is fundamentally different from their peers which opt for a traditional IPOs listing.

A Test for Monotonicity of the Sensitivity of Corporate Investment to the Cash Fl?ow

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Abstract

This paper proposes a test for monotonicity of the investment-cash ?flow sensitivity with respect to the degree of ?financing constraints. Our framework builds upon the investment-cash fl?ow sensitivity estimated for the entire sample of observations and upon testing the joint null hypothesis that 1. this coefficient is monotonic in the given classifying metric and 2. the metric is monotonic in the degree of ?financing constraints. In the case of rejection of the null, we test the hypothesis that subsamples of observations with the same investment-cash ?flow sensitivity face the similar degree of ?financing constraints. Results from a large sample of US ?firms are in favour of the hypothesis that ?firms facing different degrees of ?financing constraints have the same investment-cash ?ow sensitivity and that the investment-cash ?flow sensitivity is non monotonic in the degree of ?financing constraints.

Macroeconomic News and the M/$ Exchange Rate: 1980-1998

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Abstract

Empirical confirmation that the effect of macroeconomic fundamentals on exchange rates is economically important has been scarce. This paper employs a general GARCH specification with asymmetric responses to investigate the effect of 35 U.S. and German macroeconomic news announcements on the daily DM/$ exchange rate over the 1980-1998 period. We conclude that FX rates are strongly connected to real and nominal sector developments in both countries, and that real sector announcements influence the exchange rate more strongly than money or inflation announcements. We find that surprisingly high real growth appreciates the exchange rate and raises yields.

The role of MNEs' Financial Advantage in Shaping FDI: Empirical Evidence on Some Paradoxical Implications

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Abstract

We identify and investigate the implications of the potential financial advantage of multinational enterprises (MNEs) over local firms in shaping foreign direct investment (FDI), using a novel bilateral panel dataset covering greenfield projects. We find that their financial strength plays an important role in the location, sectoral distribution and opportunistic timing of FDI. First, we demonstrate that FDI tends to be higher in countries with weak financial development. Second, we show that FDI is more prevalent in sectors in which financial constraints are particularly binding. Third, we illustrate how FDI in financially vulnerable sectors has been more resilient in those developed countries that were directly affected by the 2007-2010 financial and banking crisis than FDI in other sectors, with strong evidence of bargain-hunting FDI relatively unaffected by the occurrence of a crisis in the country of origin of the investing MNEs. Hence, weak institutions and periods of crises are paradoxically not necessarily synonymous with lower FDI, especially in financially vulnerable sectors. In contrast to the negative effect of improved financial institutions on FDI, and in line with conventional wisdom, we find that better governance institutions attract greater inward FDI. Their impact on outward FDI is however more ambiguous, depending on the income level of the source country.

Investigating the Finite Sample Properties of Causality in Variance Tests

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Abstract

In this paper we examine, through comprehensive Monte Carlo simulations, the finite sample performance of four causality-in-variance test procedures, namely Cheung and Ng?s (1996) cross correlation S test, Comte and Lieberman?s (2000) Likelihood Ratio (LR) test, Hong?s (2001) kernel based cross correlation Q test and Hafner and Herwartz?s (2006) Langrange Multiplier (LM) test. Our results show that Comte and Lieberman?s LR test as well as and Hafner and Herwartz?s LM tests suffer from severe size distortions and demonstrate very low power, under long horizon causality alternatives. The cross correlation function based tests of Hong (2001) and Cheung and Ng (1996) are reasonably well sized. Furthermore, cross correlations based tests are favorably compared to LR and LM tests in terms of empirical power under a sequence of local alternatives. Our results reveal that the power performances of the Q and S tests greatly depend on the choice of bandwidth and lag truncation, respectively. Motivated by these findings, we introduce two methods for automatic bandwidth selection. The simulation results show that the implementation of our procedure ensures high finite sample power. An empirical application on macroeconomic and financial data demonstrates the practical application of our procedure.

Determinants of Foreign Direct Investment in EU-15 and CEE Countries: A Comparative Panel Data Analysis

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Abstract

This paper examines the major determinants of Foreign Direct Investment (FDI) inflows in 26 European countries using panel data. This empirical study takes a different approach by separating European countries into two groups, EU-15 and Central and Eastern European countries (CEECs). Thus, we are able to provide additional evidence on the relative importance of FDI determinants that explain different size of FDI into different countries in Europe. The results from the panel data analysis of FDI inflows to 26 European countries for the period 1994-2010 show that: (i) there is a set of traditional variables (market size, trade openness, unemployment, infrastructure, and tax rate) that affects the attractiveness of both groups of economies as a destination of FDI, (ii) there is a number of specific determining factors (unit labor cost, credit risk and rule of law) that attribute to the different size of FDI flows attracted by these two groups of countries, and (iii) when analyzing FDI flow trends over time (before the financial crisis in 2007 and after that) we find that relevant country-specific characteristics such as unemployment, tax rate and corruption have a significant influence on FDI only in the period 1994-2006. We may conclude that the relative importance of these determining factors decreases significantly during the period of high turbulence when disinvestments are more likely to happen, and macroeconomic and financial stability is expected to play more important role in attracting FDI.

An Investment Betting on Best CEOs?

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Abstract

Investors often seek information of promising firm performance or strong executive leadership for investment decisions. Since 2005, Barron's magazine has identified thirty most respected or best chief executive officers (CEOs) annually around the world on the basis of collective interviews among investors, analysts and executives. This paper examines whether a buy-and-hold investment strategy betting on best CEOs generates, on average, a higher annual stock return than on the matched market. This study compares average ex post performance of best CEOs to their industry rivalries by using matched industry participants and top 25% leaders in the same industry segment and the same calendar year as a benchmark. Results find that newly awarded best CEOs suffer from high turnovers due to their weak firm performance at the subsequent year. While veteran best CEOs seem to enjoy market recognition on higher stock prices and relatively higher returns, other corporate indicators (e.g., earnings changes) do not concur with the market. The best CEOs only beat, on average, the matched market in stock return before controlling for risk and equity return. Neither in current nor in future firm performance do best CEOs outperform the matched top 25% industry leaders. The study suggests that the excessive stock return earned by the firms with best CEOs over the market may largely attribute to risk premium paid to investors who are willing to accept the higher investment risk.

Additional Evidence of the Risk and Return of Stocks

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Abstract

We present additional evidence on the risk and return of stocks in the United States and globally in the 1997 -2009 period. We use a stock selection model incorporating fundamental data, momentum, and analysts' expectations and create portfolios using fundamental and statistically-based risk models. We find additional evidence to support the use of multi-factor models for portfolio construction and risk control. We created portfolios for the January 1997 – December 2009 period. We report three conclusions: (1) a stock selection model incorporating reported fundamental data, such as earnings, book value, cash flow, and sales, and analysts' earnings forecasts and revisions and momentum can identify mispriced securities; (2) statistically-based risk models produce a more effective return-to-risk portfolio measures than fundamentally-based risk models; and (3) the global portfolio returns of the multi-factor risk-controlled portfolio returns dominate United States-only portfolios.

How Do Start-Up Firms Finance Their Assets? Evidence from the Kauffman Firm Surveys

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Abstract

Using Kauffman Firm Surveys of U.S. start-up firms, we find that about 25% of firms report 100% equity financing of their initial assets. For the remaining 75%, we analyze their sources of credit, which we separate into three groups—trade, personal, and business credit. In addition, we examine which firm and owner characteristics explain a start-up's decisions to use credit and, conditional upon using credit, what type to use. We find that, at start-up, the majority of firms (55%) rely upon personal credit, but that a sizable fraction of firms also use business (44%) and trade (24%) credit. As firms develop, they decrease the use of personal and increase the use of business credit. Firms are more likely to use credit at start-up when they are larger, more profitable, more liquid, have more tangible assets; and when their primary owner has more experience and more education. Black-owned firms are less likely to use credit. Among credit-users, larger firms are more likely to use trade and business credit but less likely to use personal credit; corporations and firms with more current and tangible assets are more likely to use trade and business credit but are less likely to use personal credit; firms with better credit scores are more likely to use business credit; multi-owned firms are more likely to use business credit but are less likely to use personal credit; owners with more prior start-ups are less likely, while female owners are more likely to use personal credit.

External Imbalances: Causes Consequences and Cures. The EMU Case.

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Abstract

In this paper we review the most important external imbalances in the industrialized world from the forties to today. In particular we linger over the current imbalance in EMU. We use a very simple and just sketchy two-country model to show how the higher German labour and capital productivities has led to the imbalances in the balance of payments and why these imbalances spread to fiscal policy. In EMU the financing of balance of payments disequilibria ceased to be a real problem, but the adjustment problem remains and perhaps it is more serious. The analysis shows that external imbalances not adjusted are risky for the real and financial stability of a member State and for the union as a whole. Last but not least, the European Commission's policy responses appear , more than inadequate, risky, because once applied to a member State they could push it into economic recession. Keywords: Balance of Payments Disequilibria; European Monetary Union; International Monetary Economics; International Economic History JEL classification:

Do Financial Analysts Restrain Insiders' Informational Advantage?

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Abstract

We investigate the competitive relationship between financial analysts and firm insiders for price-sensitive information. We identify the influence of this competition on trade dynamics by empirically examining the impact of complete analysts' coverage termination on stocks' liquidity, price discovery and insider trading. Termination leads to a deterioration in liquidity and price efficiency, an increase in information asymmetries, and higher profitability of insider trades. Importantly, the magnitude of these effects depends on insiders' presence. Institutional investors alleviate, but do not eliminate, the effects of coverage termination. Overall, this evidence indicates that analysts contribute to market quality through competition with insiders.

Information Asymmetry, R&D Disclosures and the Choice Between Private and Public Equity

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Abstract

In this study, I empirically examine the impact of information asymmetry and monitoring of corporate managers on the choice between private and public equity capital. More specifically, I study the link between R&D disclosures and other measures of information asymmetry as well as ownership measures and firms' choice between rights offerings and private placements. Using a hand-collected sample of product-related R&D disclosures of public biotech firms, I find that firms tend to issue equity publicly rather than privately following credible R&D disclosures. In contrast, I do not find any support for the monitoring hypothesis that private placement investors engage in more monitoring. A detailed analysis by investor type also supports this view and suggests that there is no difference between private placements and rights offerings for either venture capital ownership or pension fund ownership.

Insider Trading in Brazil: Evidence from the Profitability

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Abstract

This study verifies that the operations performed by insider trading with shares of the company earn higher returns than the market average. Therefore, it is important to identify possible movements Insider traders, as well as evidence of abnormal returns. This could help regulators to be more effective in the deterrence of such operations. This research analyzed 38,141 trades realized by insiders of 167 firms during 2006 and 2011. The results show evidence that insider traders earn abnormal returns in Brazil, after an insider selling the average abnormal return of the stock price was -3.73% after 1 month -10.66% after 6 months. On the other hand, after a purchase by insider traders the stock showed positive abnormal return of 5.72% after 1 month and 9.87% after 6 months, indicating that insiders operate with privileged information.

A Tale of tails higher moments and precious metals

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Abstract

The goal of this study is to investigate whether gold provides protection from tail risk. In this paper, I address the issue of asymmetric precious metal behavior conditioned to stock market performance and provide empirical evidence about the contribution of gold and silver to a portfolio's systematic skewness (coskewness) and kurtosis (cokurtosis). I find that gold, unlike silver, has positive coskewness with the market portfolio when the market is skewed to the left (i.e. during bear markets or market turmoil). Moreover, gold shows low cokurtosis with the market returns during volatile periods (gold's returns tend to be higher during periods of high uncertainty). I show that gold is desirable to risk adverse investors since it tends to decrease the probability and the magnitude of extreme bad outcomes.

Capitalization Companies in Development: Brazilian Small Caps

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Abstract

The aim of this study was to demonstrate that the prospect of future small cap companies in development and supply of small cap stocks. The research was qualitative and structured interviews were conducted with four representatives of major institutions that can establish the direction of the market. The research brought as a result of the knowledge expansion potential IPO (Initial Public Offering) for small caps on the perspectives of institutional stakeholders. It was concluded that, in view of the representatives of the institutions surveyed, there is a market to be exploited, but institutions still need to expand their structures, offers business training and investor confidence in the company development. In Brazil, the culture via the stock exchange capitalization is just large companies. To reach the small business market, it must be shown that the IPO can be an important source of capitalization for the development of enterprises.

Multivariate Truncated Moments

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Abstract

We derive formulae for the higher order tail moments of the lower truncated multivariate standard normal (MVSN), Student's t, lognormal and a finite-mixture of multivariate normal distributions (FMVN). For the MVSN we propose a recursive formula for moments of arbitrary order as a generalization of previous research. For the Student's t-distribution, the recursive formula is an extension of the normal case and when the degrees of freedom ? ? ? the tail moments converge to the normal case. For the lognormal, we propose a general result for distributions in the positive domain. Potential applications include robust statistics, reliability theory, survival analysis and extreme value theory. As application of our results we calculate the exceedance skewness and kurtosis and we propose a new definition of multivariate skewness and kurtosis using tensors with the moments in their components. The tensor skewness and kurtosis captures more information about the shape of distributions than previous definitions.

The Separation of Liquidity Constraints and Self-Control Problems in Consumer Credit Borrowing

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Abstract

Newly-acquired, micro-level datasets based on credit bureau information have propagated a body of analytical work by economists to better understand the collateral damage caused by the overinvestment in housing and the unprecedented disregard of risk management on the part of both consumers and financial organizations involved in retail lending. Consumers purchased residential loans at terms that were either not well understood or affordable, and lenders sold residential products to both primary and secondary market participants that did not appropriately price for the inherent default risk (Calem, Henderson, and Liles, 2011). It is clear that during this important period of US economic history, financial innovation in the 1980's and 1990's resulted in lending products and services that markedly increased consumer liquidity well before appropriate technology and control processes could be put in place to limit the systemic risk and the massive accumulation of consumer debt that ensued. Armed with rich consumer credit data, economists can now apply nuances in consumer theory that can have large implications for newly-formed regulatory policy around consumer protection and mortgage lending. Recent work by Mian and Sufi (2011) has showed that one type of innovation, the ability to almost instantaneously assess loan-to-value (LTV) on residential collateral without a full appraisal and electronically extend credit limits on a home equity line of credit (HELOC), led to acceleration in household debt and the means to "over-consume" using mortgage products. What the authors term as the home equity-based borrowing channel where consumers tap home equity to consume more than what the standard life-cycle model or the permanent income hypothesis would predict, a clear puzzle arises as to how this market outcome can happen. Their paper provides convincing results that prove this phenomenon of taping home equity for consumption exists and is particularly strong for distinct borrower types. By building a link between asset prices and household borrowing, these authors also support well-established research regarding the effects on borrowing and real economic activity. Additionally, their use of high frequency consumer credit databases coupled with straightforward merging of economic, geographic, and credit performance provide a rich analytical platform for empirical study of questions previously addressed mainly with analytical methods or simulated data. Their paper does not, for good reasons, address why these outcomes happen, and that is focus of this paper. In particular, the Mian and Sufi (2011) study deploys careful and robust techniques to answer questions such as who extracts equity and what do they do with it. Rich data sets expand the range of answers to these questions. For example, it is also helpful to distinguish if liquidity constraints or self-control issues might have meaningful differences in the type and duration of consumer debt held over different periods in an economic cycle. In their study, consumers are segmented into groups by credit score and utilization rates, and they find homeowners with high credit score utilization and low credit scores have a strong tendency to borrow against an increase in home equity. The authors also find that those with high

credit scores and low credit card utilization do not respond to house price dynamics. The authors cite that either liquidity constraints or self-control could drive these results. It is plausible that liquidity or borrowing constraints among consumers may be distributed in a way that is not fully captured by credit performance. In that case, self- control might have a greater role in the explanation for how consumers respond to changes in asset prices as well as economic and idiosyncratic shocks. Self-control is used here in the traditional sense as pioneered by Strotz (1956) and Laibson (1997). Self-control is characterized by individuals self-imposing constraints on impulses to consume beyond their current means. Commitment mechanisms are the primary restraints on self-control in the context of current period consumption when addressing the time-inconsistency problem of hyperbolic discount functions that lead people to consume and or borrow funds in the near term at the expense of future consumption. By implementing commitment strategies through holding illiquid assets such as homes and consumer durables, the borrower places self-imposed constraints on future consumption in order to increase current consumption in the presence of credit markets (i.e. consumer loans). Liquidity constraints are less binding both in the short- and long-run in the presence of instantaneous credit, and the potential for consumer borrowing to have sizeable real effects is greater. As a result, it is important to identify measures of self-control and to distinguish its impact on borrowers separately from liquidity constraints. Theoretical work has demonstrated the importance of both liquidity constraints and self-control, but no known empirical work to date has attempted to isolate these concepts and measure their impact on consumer leverage. Liquidity constraints must be clearly distinguished from self-control as they can manifest themselves in similar ways as found in Mian and Sufi. Liquidity constraints arise from a “rational” preference to satisfy financial obligations or to consume in the presence of a particular income and wealth threshold. Lack of self-control reflects an “irrational” preference to meet obligations or to consume beyond a particular threshold. Self-control, on the other hand, forces a “rational” consumer to recognize and incorporate the liquidity constraint. In most financial models, the income and wealth threshold can represent a bankruptcy threshold. For simplicity, I ignore the mechanics of financial innovation that allow consumers to exceed the bankruptcy threshold in the first place. The term “irrational” is important because in order to recognize a self-control problem, we must know when self-control is not the problem. In credit markets, a “rational” consumer optimizes an objective function that either minimizes costs or maximizes their welfare subject to some constraints. To that end, a “rational” consumer will attempt to avoid or minimize interest costs and fees whereas an “irrational” consumer is indifferent among higher interest costs and fees as well as the rejection for attempts to acquire new credit. To distinguish between liquidity constraints and self-control problems among consumers without observing explicit preference structures, a sufficient proxy for self-control can be found in observed delinquency behavior. For instance, a borrower with serious delinquency on some credit accounts might still find ways to “over-consume” by acquiring additional credit and at the same time paying off (i.e. partially) creditors with the newly acquired credit. This irrational behavior is used here as a proxy for lack of self-control. A consumer with a liquidity constraint is simply someone with a low credit score that is not acquiring new credit nor consuming existing credit capacity while being current on all obligations. This definition lends itself to a relatively straightforward empirical design that can be addressed with nested econometric techniques in a model of newly acquired credit. Preliminary evidence shows that granular credit bureau data can provide evidence for lack of self-control, as consumers that carry serious delinquent balances (90 days past due) on their credit bureau file are still able to open new credit card accounts and increase overall balances over the sample (2000-2011).

Financial Constraints: an Empirical Application to U.S. Recessions

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Abstract

In this study I utilize existing literature to proxy for financial constraints and measure their behavior over the course of numerous U.S. recessions. I utilize a time measurement method to separate the distinct time periods before a crisis, during a crisis, and following a crisis to capture the difference in certain investment behaviors between constrained and unconstrained firms. I find that constrained firms have a significant, negative and larger in magnitude response to their fixed investment which is an intricate part of GNP and Business Cycle Fluctuations. I further find that constrained firms have a significantly larger contraction in employment numbers during the course of recessions, before, and after, which has implications to aggregate demand. I add to the existing literature of financial constraints by identifying and measuring these responses in a continuous time series.

Liquidity Effects on Momentum and Reversal

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Abstract

This paper investigates how liquidity has effects on momentum and reversal profits that have recently been reduced. We show that the profits are associated with liquidity, employing activities of institutional investors and two components of arbitrage costs-namely, transaction costs and holding costs. Specifically, this paper finds that arbitrage costs deter exploiting momentum and reversal effects; transaction costs limit arbitrage for both the momentum and reversal effects while holding costs prevent only the reversal effect. In addition, we find that as the fraction of a company's shares that are held by institutional investors increases, the momentum effect decreases. Overall, the evidence is consistent with the conjecture that institutional investors, as arbitrageurs, improve the efficiency of prices by momentum trading.

Performance of the Life Insurance Industry Under Pressure

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Abstract

A well-performing life insurance industry benefits consumers, producers and insurance firm stockholders alike. Unfavourable market conditions stress the need for life insurers to perform well in order to remain solvent. Using a unique supervisory data set, this paper investigates competition and efficiency in the Dutch life insurance market by estimating unused scale economies and measuring efficiency-market share dynamics during 1995-2010. Large unused scale economies exist for small and medium-sized life insurers, indicating that further consolidation would reduce costs. Over time average scale economies decrease but substantial differences between small and large insurers remain. A direct measure of competition confirms that competitive pressures are at a lower level than in other markets. We do not observe any impact of increased competition from banks, the so-called investment policy crisis or the credit crisis, apart from lower returns in 2008. Investigation of product submarkets reveals that competition is higher on the collective policy market, while the opposite is true for the unit-linked market, where the role of intermediary agents is largest.

The Interaction between Corporate Bonds Yields, Equity Market and the Macro Economy – A focus on immediacy bias.

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Abstract

The paper argues that bond investors may not necessarily demonstrate the "Investors' Smartness" that some previous studies attributed to large institutional holders, when it comes to pricing-in for economic shocks likely to occur in future. This study compares the credit-equity-macro economy inter-connectivity under various discount rates such as the Long and Short Term Treasury rates and the Average Risk (BAA rated) corporate bond rate. The approach here reflects a multidimensional interaction which is captured by the macro economy's wealth with the credit and equity markets and with investors' interpretation of incoming news in forming expectations. The evidence here suggests that behavioral biases of focusing on the immediate horizon, which we call the "immediacy bias"- which some previous studies have attributed to stock investors, are also applicable to bond investors. The indirect implications of these findings may explain some of the troubles that affected the credit markets in recent years.

Variability of Dynamic Correlation – The Evidence of Sectorial Specialization in V4 Countries

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Abstract

We propose novel methodological approach to identify sectoral specialization in terms of economic cycle synchronization. We use dynamic measurement of comovement via lagged dynamic correlation and its variability. For the empirical evidence we use data of Visegrads countries, Germany and the euro area. The results are discussed in the context of Krugman specialization hypothesis. Our findings show higher specialization of countries which have significant comovements with high variability of dynamic correlation.

Evaluating Alternative Single Factor Short Rate Models: Evidence from United Kingdom 1975-2010

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Abstract

This article compares the performance of alternative short rate models for 1-month UK interbank rate from 1 January 1975 to 1 January 2010 using generalized method of moments (GMM). The result shows that the more restricted model is preferable than the less restricted one (i.e. Merton is preferable to Vasicek; Dothan is superior to GBM; Dothan & GBM better than Brennan). Moreover, the volatility factor plays a more important role than drift factor in explaining the dynamics of UK short rates. I also find mixed evidences that support the inclusion of structural break event (i.e. Black Wednesday) in UK interest rate process. This article also discusses the reliability of Vasicek and CIRSR models to perform zero coupon bond pricing.

Governance and Short Sales

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Abstract

This paper investigates the relationship between short sales and governance. We argue that short sales are reversely linked to the overall level of corporate governance of a firm and that sellers react contemporaneously to changes in such governance. Our results show that short instigators may also be able to forecast changes in governance structure and adjust their portfolios accordingly prior to the said changes. This reaction is asymmetric, with a pronounced increase in short positions for actual and anticipated negative changes in governance and a more subdued repurchase of shorted stock for positive expectations.

Corporate Bankruptcy Detection and Portfolio Selection into Recurrent Neural Networks, Hybrid Neuro-Genetic Recurrent Networks, Hybrid MLPs and Regressions

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Abstract

Price fluctuations reflect the corporate value in real time over the markets, whilst portfolio mangers seek to maximise their profits in an appropriate asset allocation. Accounting data and reports represent valuable hidden information that various models into Artificial Intelligence and Evolutionary Computation, successfully detect. The Multi Layer Perceptron classification is compared to neuro-genetic hybrids of Multi Layer Perceptron, Logistic Regressions classifications to determine efficient methods in Financial Analysis.

Good News Vs. Bad News: Do They Have Similar Effects on Volatility during the Global Financial Crisis?

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Abstract

The recent Global Financial Crisis resulted to increasing price volatility following significant decline of the global stock markets. Based on a study by Black (1976) where he found that bad news had a greater impact on stock market volatility compared to good news of similar magnitude, the purpose of this study is to examine the intensity of asymmetric volatility during the 2007-2008 Global Financial Crisis in the New Zealand stock market. We employ the EGARCH model proposed by Nelson (1991) and the TGARCH model proposed by Glosten, Jagannathan and Runkle (1993) to capture asymmetric effects on NZX50 index from January 2004 to March 2012. Our results provide evidences of the presence of asymmetric volatility in the New Zealand stock market during the whole period of study. In addition, both models indicated a significant increase in asymmetric volatility during the Global Financial Crisis.