

SGF CONFERENCE 2018

21st Annual Conference of the Swiss Society for
Financial Market Research

April 6, 2018
SIX ConventionPoint
Zurich

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The Swiss Society for Financial Market Research (SGF)

Publishers of

Financial Markets and Portfolio Management (FMPM)

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EDITORIAL

Dear Participants,

On behalf of the Swiss Society for Financial Market Research (SGF), I would like to warmly welcome you at the SGF Conference 2018. In its 21st year, the conference is facing a few important changes. For the first time, it takes place in Zurich's former industrial district, the popular and up-and-coming quarter Zurich West. Further, with two venues and 91 papers on the program, the SGF Conference 2018 is the largest in its history.

As it has become a tradition over the past few years, SIX acts as our main sponsor. I would like to express my sincerest thanks to SIX for supporting this event by providing the wonderful SIX ConventionPoint conference center as well as for donating the SIX Best Paper Award 2018 which carries a cash prize of 4'000 CHF. My special thanks go to Chris Landis and Daniel Schmucki who made all of this possible.

I am very happy to announce Professor Dr. Claudio Loderer as our distinguished keynote speaker. He is Professor at the Institute of Financial Management at the University of Bern and the Vice-President and Delegate of the Foundation Board of Rochester-Bern Executive Programs. His speech will address the topic "The Corporate Life Cycle".

This year, the SGF Conference received more than 300 submissions resulting in a program that covers a large variety of research topics. My heartfelt thanks go to the members of the Conference Board and to more than 170 reviewers who helped identify the best contributions.

Finally, I would like to thank the Conference Manager Andreas Kanz and his predecessor Tobias Meyer for their efforts in preparing and organizing such a large event.

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

With my best regards,



Dr. Michael Herold
Conference Director

SCHEDULE

TIME	TOPIC									
	<i>Room</i>									
08:00	Registration									
	<i>Front Desk ConventionPoint</i>									
08:30	Welcome of Participants / Opening Speeches									
	Prof. Dr. Matthias Muck (Chairman of the Conference Board)									
	Dr. Michael Herold (Conference Director)									
	<i>Room "Auditorium"</i>									
	SESSION A	SESSION B	SESSION C	SESSION D	SESSION E	SESSION F	SESSION G			
	<i>Room "Auditorium"</i>	<i>Room "Connect"</i>	<i>Room "Create"</i>	<i>Room "Venture"</i>	<i>Room "Link"</i>	<i>Room "Färberei"</i>	<i>Room "Schiffbau"</i>			
09:00	A1 Empirical Asset Pricing I	B1 International Asset Pricing	C1 Derivatives	D1 Asset Allocation	E1 Household Finance	F1 Corporate Finance I	G1 Corporate Governance			
11:00	Coffee Break									
	<i>Foyer ConventionPoint</i>									
11:30	A2 Empirical Asset Pricing II	B2 Theoretical Asset Pricing I	C2 Regulation (Short Selling)	D2 Asset Management I	E2 Market Microstructure I	F2 Corporate Finance II	G2 Financial Intermediation I			
13:00	Lunch Break									
	<i>Foyer ConventionPoint</i>									

SIX ConventionPoint

Sheraton Hotel

TIME	TOPIC									
	<i>Room</i>									
SIX ConventionPoint	14:00	A3 Empirical Asset Pricing III	B3 Financial Economics	C3 Behavioral Finance	D3 Asset Management II	E3 Market Microstructure II	Sheraton Hotel	F3 Mergers & Acquisitions	G3 Financial Intermediation II	
	15:30	Coffee Break <i>Foyer ConventionPoint</i>								
	15:45	A4 Empirical Asset Pricing IV	B4 Theoretical Asset Pricing II	C4 Interest Rates & Term Structure	D4 Asset Management III	E4 Market Microstructure III		F4 Corporate Finance III	G4 Financial Intermediation III	
	17:15	Coffee Break <i>Foyer ConventionPoint</i>								
17:30	Keynote Speech Prof. Dr. Claudio Loderer , Professor at the Institute of Financial Management, University of Bern "The Corporate Life Cycle" SIX Best Paper Award 2018 for the best paper presented at the SGF Conference 2018 ZKB Best Paper Award 2017 for the best professional paper published in FMPM FMPM Best Paper Award 2017 for the best academic article published in FMPM Daniel Schmucki (CFO, SIX) Iwan Deplazes (Head Asset Management Swisscanto Invest by Zürcher Kantonalbank) Prof. Dr. Markus Schmid (Editor Financial Markets and Portfolio Management) <i>Room "Auditorium"</i>									
18:45	Reception <i>Foyer ConventionPoint</i>									

KEYNOTE SPEAKER

We are delighted to announce Professor Dr. Claudio Loderer as our distinguished keynote speaker.

His speech will address the topic: “The Corporate Life Cycle”.

Claudio Loderer is Professor at the Institute of Financial Management at the University of Bern and the Vice-President and Delegate of the Foundation Board of Rochester-Bern Executive Programs.



He was Managing Director at the Swiss Finance Institute (SFI) from 2011 until 2016. Throughout his career, he has contributed to a number of high-ranking scientific journals such as the Journal of Finance, the Journal of Business or Management Science.

Furthermore, he has served on the editorial boards of European Financial Management, the Journal of Banking and Finance, the Journal of Corporate Finance, and the Journal of Empirical Finance.

SESSION A: ROOM “AUDITORIUM”

A1 Empirical Asset Pricing I (p. 20)

Chair: Fabian Hollstein

TIME	AUTHORS AND PAPER	DISCUSSION
09:00	Maik Dierkes, <u>Sebastian Schrön</u> Lottery Characteristics and the Closed-End Fund Puzzle	Alexander Elmar Cochardt
09:30	Zhiyao Chen, <u>Jun Li</u> , Huijun Wang Decomposing the Size Premium	Nitin Kumar
10:00	Gerard Hoberg, <u>Nitin Kumar</u> , Nagapurnanandz Prabhala Buy-Side Competition and Momentum Profits	Sebastian Schrön
10:30	<u>Jun Li</u> , Huijun Wang, Jianfeng Yu Aggregate Expected Investment Growth and Stock Market Returns	Fabian Hollstein

A2 Empirical Asset Pricing II (p. 22)

Chair: Maurizio Michael Habib

TIME	AUTHORS AND PAPER	DISCUSSION
11:30	Florian Nagler, <u>Giorgio Ottonello</u> Structural Changes in Corporate Bond Underpricing	Jonas Nygaard Eriksen
12:00	<u>Tobias Rischen</u> , Erik Theissen Underpricing in the Eurozone Corporate Bond Market	Franz Insam
12:30	<u>Stig Vinther Møller</u> , Jesper Rangvid Global Connectedness Across Bond Markets	Maurizio Michael Habib

A3 Empirical Asset Pricing III (p. 24)

Chair: Judith C. Schneider

TIME	AUTHORS AND PAPER	DISCUSSION
14:00	<u>Tobias Götze</u> , Marc Gürtler The Influence of Sponsor Characteristics and (Non-)Events on the Risk Premia of CAT Bonds	Judith C. Schneider
14:30	<u>Fabian Hollstein</u> , Chardin Wese Simen Variance Risk: A Bird's Eye View	Tobias Sichert
15:00	Nicole Branger, Hendrik Hülsbusch, <u>Frederik Middelhoff</u> Idiosyncratic Volatility, Its Expected Variation, and the Cross-Section of Stock Returns	Jun Li

A4 Empirical Asset Pricing IV (p. 26)

Chair: Matthias Muck

TIME	AUTHORS AND PAPER	DISCUSSION
15:45	Matthias Bank, <u>Franz Insam</u> Return Contributions of Factors and Characteristics in an Integrated Asset Pricing Approach	Tobias Rischen
16:15	<u>Daniel Hoechle</u> , Markus Schmid, Heinz Zimmermann Do Firm Fixed Effects Matter in Empirical Asset Pricing?	Nora Marija Laurinaityte
16:45	<u>Nora Marija Laurinaityte</u> , Christoph Meinerding, Christian Schlag, Julian Thimme Elephants and the Cross-Section of Expected Returns	

SESSION B: ROOM "CONNECT"

B1 International Asset Pricing (p. 28)

Chair: Stig Vinther Møller

TIME	AUTHORS AND PAPER	DISCUSSION
09:00	<u>Regina Hammerschmid</u> , Alexandra Janssen Crash-o-phobia in Currency Carry Trade Returns	Hugues Langlois
09:30	<u>Jonas Nygaard Eriksen</u> Cross-sectional Return Dispersion and Currency Momentum	Regina Hammerschmid
10:00	Ines Chaieb, <u>Hugues Langlois</u> , Olivier Scaillet Time-Varying Risk Premia in Large International Equity Markets	Lukas Kremens
10:30	<u>Lukas Kremens</u> , Ian Martin The Quanto Theory of Exchange Rates	Stig Vinther Møller

B2 Theoretical Asset Pricing I (p. 30)

Chair: Karl Schmedders

TIME	AUTHORS AND PAPER	DISCUSSION
11:30	<u>Olesya V. Grishchenko</u> , Zhaogang Song, Hao Zhou Term Structure of Interest Rates with Short-Run and Long-Run Risks	Jens H. E. Christensen
12:00	Ilya Dergunov, <u>Christoph Meinerding</u> , Christian Schlag Extreme Inflation and Time-Varying Disaster Risk	Olesya V. Grishchenko
12:30	<u>Paul Whelan</u> Heterogeneous Beliefs and Real Yields	Nicole Branger

B3 Financial Economics (p. 32)

Chair: Michael Herold

TIME	AUTHORS AND PAPER	DISCUSSION
14:00	Stephen A. Buser, <u>Bjarne Astrup Jensen</u> Present Value Calculations by Means of First and Second Differences	Friedrich Lorenz
14:30	<u>Gyuri Venter</u> Short-Sale Constraints and Credit Runs	Rüdiger Weber
15:00	<u>Alexis Derviz</u> Credit Constraints and Credit Losses: an Unsteady State Approach	

B4 Theoretical Asset Pricing II (p. 34)

Chair: Bjarne Astrup Jensen

TIME	AUTHORS AND PAPER	DISCUSSION
15:45	<u>Marcel Fischer</u> , Natalia Khorunzhina, Julie Marx Who Buys Homes when Prices Fall?	
16:15	Nikolai Gräber, <u>Friedrich Lorenz</u> Disappointment Aversion and Endogenous Growth - Can Rare Disappointments Explain the Equity Premium Puzzle?	Stephan Jank
16:45	Julian Thimme, Christian Schlag, <u>Rüdiger Weber</u> Implied Volatility Duration and the Early Resolution Premium	Bjarne Astrup Jensen

SESSION C: ROOM “CREATE”

C1 Derivatives *(p. 36)*

Chair: Jens H. E. Christensen

TIME	AUTHORS AND PAPER	DISCUSSION
09:00	Adrian Buss, <u>Lorenzo Schönleber</u> , Grigory Vilkov Option-Implied Correlations, Factor Models, and Market Risk	Ulze Markus
09:30	Andreas W. Rathgeber, Johannes Stadler, <u>Markus Ulze</u> Determinants of Implied Volatility Smiles - An Empirical Analysis Using Intraday DAX Equity Options	Michael Hofmann
10:00	<u>Tobias Sichert</u> Structural Breaks in the Variance Process and the Pricing Kernel Puzzle	Lorenzo Schönleber
10:30	<u>Michael Hofmann</u> , Marliese Uhrig-Homburg Volatility Noise	Jens H. E. Christensen

C2 Regulation (Short Selling) *(p. 37)*

Chair: Peter Limbach

TIME	AUTHORS AND PAPER	DISCUSSION
11:30	<u>Stephan Jank</u> , Christoph Røling, Esad Smajlbegovic Flying Under the Radar: The Effects of Short-Sale Disclosure Rules on Investor Behavior and Stock Prices	Christoph Merkle
12:00	Itzhak Ben-David, Zhi Li, <u>Zexi Wang</u> Financial Constraints and Industry Dynamics	Ettore Crocì
12:30	<u>Nicolas Kube</u> Should We Be Aware of the Control Group? Spillover Effects through the Implementation of Reg SHO	Peter Limbach

C3 Behavioral Finance *(p. 40)*

Chair: Florian Weigert

TIME	AUTHORS AND PAPER	DISCUSSION
14:00	<u>Christian Riis Flor</u> , Mark Raun Moritzen Entering a New Market: First-Mover Advantages and Risk Dynamics Under Market Uncertainty	Mikael Paaso
14:30	<u>Michael Ungeheuer</u> Stock Returns and the Cross-Section of Investor Attention	Gabor Neszveda
15:00	Dimitrios Kostopoulos, <u>Steffen Meyer</u> Disentangling Investor Sentiment: Mood and Economic Expectations	Florian Weigert

C4 Interest Rates & Term Structure *(p. 42)*

Chair: Paul Whelan

TIME	AUTHORS AND PAPER	DISCUSSION
15:45	Martin Andreasen, <u>Jens H. E. Christensen</u> , Simon Riddell The TIPS Liquidity Premium	Olesya V. Grishchenko
16:15	<u>Olesya V. Grishchenko</u> , Sarah Mouabbi, Jean-Paul Renne Measuring Inflation Anchoring and Uncertainty	Alexis Derviz
16:45	<u>Jens H. E. Christensen</u> , Glenn Rudebusch A New Normal for Interest Rates? Evidence from Inflation-Indexed Debt	Paul Whelan

SESSION D: ROOM “VENTURE”

D1 Asset Allocation (p. 44)

Chair: Christoph Meinerding

TIME	AUTHORS AND PAPER	DISCUSSION
09:00	Johannes Bubeck, <u>Maurizio Michael Habib</u> , Simone Manganelli The Portfolio of Euro Area Fund Investors and ECB Monetary Policy Announcements	Luana Zaccaria
09:30	<u>Thomas Dangl</u> , Alex Weissensteiner Long-term Asset Allocation Under Time-varying Investment Opportunities: Optimal Portfolios with Parameter and Model Uncertainty	Christoph Meinerding
10:00	<u>Nicole Branger</u> , An Chen, Nadine Gatzert, Antje Mahayni Optimal Investments Under Linear Sharing Rules	Tobias Götze
10:30	<u>Luiz Felix</u> , Roman Kraussl, Philip Stork Predictable Biases in Macroeconomic Forecasts and Their Impact Across Asset Classes	Björn Tharann

D2 Asset Management I (p. 46)

Chair: Wolfgang Drobetz

TIME	AUTHORS AND PAPER	DISCUSSION
11:30	Vikas Agarwal, Stefan Ruenzi, <u>Florian Weigert</u> The Absolute Return Wedge: A New Measure That Predicts Hedge Fund Performance	Georg Peter
12:00	<u>Sehoon Kim</u> Hedge Fund Activism and Internal Capital Markets	Sebastian Fischer
12:30		

D3 Asset Management II (p. 48)

Chair: David Oesch

TIME	AUTHORS AND PAPER	DISCUSSION
14:00	Benjamin Sahel, Antonio Scalia, <u>Luana Zaccaria</u> Career Concerns and Peer Effects in Tournaments: Evidence from ECB Reserve Currency Portfolios	Luiz Felix
14:30	Manuel Ammann, Christopher Bauer, <u>Sebastian Fischer</u> , Philipp Müller The Impact of the Morningstar Sustainability Rating on Mutual Fund Flows	Daniel Hoechle
15:00	François Degeorge, <u>Giuseppe Pratobevera</u> Neotism in IPOs: Consequences for Issuers and Investors	David Oesch

D4 Asset Management III (p. 50)

Chair: Steffen Meyer

TIME	AUTHORS AND PAPER	DISCUSSION
15:45	Marcel Prokopczuk, <u>Björn Tharann</u> , Chardin Wese Simen Predictability in Commodity Markets: Evidence from Over a Century	Frederik Middelhoff
16:15	Lars Kaiser, <u>Georg Peter</u> Dynamic Indexes: Equity Rotation and Factor Timing	
16:45	<u>Gabor Neszveda</u> Aspiration Level Theory and Stock Returns: An Empirical Test	Steffen Meyer

SESSION E: ROOM “LINK”

E1 Household Finance *(p. 52)*

Chair: Martin Brown

TIME	AUTHORS AND PAPER	DISCUSSION
09:00	Jesse Bricker, <u>Geng Li</u> Credit Scores, Social Capital, and Stock Market Participation	Michael Ungeheuer
09:30	Sven Nolte, <u>Judith C. Schneider</u> How Price Path Characteristics Shape Investment Behavior	Tobin Hanspal
10:00	<u>Tobias Meyll</u> , Thomas Pauls, Andreas Walter The Household Savings Paradox	Geng Li
10:30	Steffen Andersen, <u>Tobin Hanspal</u> , Kasper Meisner Nielsen Experience is the Best Teacher: Did the Financial Crisis Spur White-Collar Crime?	Tobias Meyll

E2 Market Microstructure I *(p. 54)*

Chair: Gbenga Ibikunle

TIME	AUTHORS AND PAPER	DISCUSSION
11:30	Ying Liu, <u>Sebastian Vogel</u> , Yuan Zhang Electronic Trading in OTC Markets vs. Centralized Exchange	Mario Bellia
12:00	<u>Darya Yuferova</u> Intraday Return Predictability, Informed Limit Orders, and Algorithmic Trading	Nikolaos Karagiannis
12:30	<u>Anna Bayona</u> , Ariadna Dumitrescu, Carolina Manzano Information and Optimal Trading Strategies with Dark Pools	Gbenga Ibikunle

E3 Market Microstructure II *(p. 56)*

Chair: Jakub Rojcek

TIME	AUTHORS AND PAPER	DISCUSSION
14:00	<u>Per Östberg</u> , Thomas Richter The Sovereign Debt Crisis: Rebalancing or Freezes?	Giorgio Ottonello
14:30	<u>Benjamin Clapham</u> , Peter Gomber, Jens Lausen, Sven Panz Liquidity Provider Incentives in Fragmented Securities Markets	Sebastian Vogel
15:00	Matteo Aquilina, Ivan Diaz-Rainey, <u>Gbenga Ibikunle</u> , Yuxin Sun City Goes Dark: Dark Trading and Adverse Selection in Aggregate Markets	Jakub Rojcek

E4 Market Microstructure III *(p. 58)*

Chair: Anna Bayona

TIME	AUTHORS AND PAPER	DISCUSSION
15:45	<u>Mario Bellia</u> , Lorian Pelizzon, Subrahmanyam Marti G.; Jun Uno, Darya Yuferova Coming Early to the Party	Benjamin Clapham
16:15	Hans Degryse, <u>Nikolaos Karagiannis</u> Once Upon a Broker Time? Order Preferencing and Market Quality	Darya Yuferova
16:45	<u>Jakub Rojcek</u> A Model of Price Impact and Market Maker Latency	Anna Bayona

SESSION F: ROOM “FÄRBEREI” (SHERATON HOTEL)

F1 Corporate Finance I (p. 60)

Chair: Per Östberg

TIME	AUTHORS AND PAPER	DISCUSSION
09:00	Miguel Garcia Cestona, Ahmed Sewaid, Florina Silaghi Crowdfunding: Backers Rewarded	Christian Riis Flor
09:30	Mikael Paaso It's Always Sunny in Finland: Investment and Extrapolation from Cash Flow Growth	David Florysiak
10:00	David Florysiak , Vidhan Goyal Capital Market Access and Cash Flow Allocation during the Financial Crisis	Giuseppe Pratobevera
10:30	Wolfgang Drobetz , Sadok El Ghou, Omrane Guedhami, Malte Janzen Policy Uncertainty, Investment, and the Cost of Capital	Per Östberg

F2 Corporate Finance II (p. 62)

Chair: Thomas Dangl

TIME	AUTHORS AND PAPER	DISCUSSION
11:30	Hannes Mettler The Real Estate Collateral Channel in SME Finance: Evidence from Switzerland	Florina Silaghi
12:00	Luzi Hail, Maximilian Muhn, David Oesch Do Risk Disclosures Matter When It Counts? Evidence from the Swiss Franc Shock	
12:30		

F3 Mergers & Acquisitions (p. 64)

Chair: Axel Kind

TIME	AUTHORS AND PAPER	DISCUSSION
14:00	Ettore Croci , Mieszko Mazur, Galla Salganik-Shoshan Facilitating Takeovers and Takeover Premia: The Case of Coordinated Monitoring	Marc Frattaroli
14:30	Johannes Kolb, Tereza Tykvova Superstar Financial Advisors: Do They Deliver Superior Value to Their Clients?	Ettore Croci
15:00	André Betzer, Jasmin Gider, Peter Limbach Do Financial Advisors Matter for M&A Pre-Announcement Returns?	Axel Kind

F4 Corporate Finance III (p. 66)

Chair: Tereza Tykvova

TIME	AUTHORS AND PAPER	DISCUSSION
15:45	Umit Yilmaz Foreign Acquisition and Credit Risk: Evidence from the U.S. CDS Market	Hannes Mettler
16:15	Iana Zborshchyk, Axel Kind The Impact of Financial Fraud on Firm Survival	Tereza Tykvova
16:45	Antje Mahayni, Oliver Lubos , Katharina Stein Natural Hedging with Fix and Floating Strike Guarantees	

SESSION G: ROOM “SCHIFFBAU” (SHERATON HOTEL)

G1 Corporate Governance (p. 68)

Chair: Zexi Wang

TIME	AUTHORS AND PAPER	DISCUSSION
09:00	Jie {Jack} He, Jiekun Huang, <u>Shan Zhao</u> Internalizing Governance Externalities: The Role of Institutional Cross-ownership	Sehoon Kim
09:30	<u>Marc Frattaroli</u> Does Protectionist Anti-Takeover Legislation Lead to Managerial Entrenchment?	Nicolas Kube
10:00	Jochen Becker, Josip Medjedovic, <u>Christoph Merkle</u> The Effect of CEO Extraversion on Analyst Forecasts: Stereotypes and Similarity Bias	Sasan Mansouri
10:30	Andreas Barth, <u>Sasan Mansouri</u> , Fabian Woebbecking, Severing Zoergiebel How to Talk Down Your Stock Returns	Zexi Wang

G2 Financial Intermediation I (p. 70)

Chair: Adam Winegar

TIME	AUTHORS AND PAPER	DISCUSSION
11:30	<u>Giulio Bagattini</u> , Falko Fecht, Patrick Weber The Fire-Sale Channels of Universal Banks in the European Sovereign Debt Crisis	Corinna Woyand
12:00	<u>Benjamin Grosse-Rueschkamp</u> , Sascha Steffen, Daniel Streitz Cutting Out the Middleman - The ECB as Corporate Bond Investor	Sebastian Doerr
12:30	<u>Jana Ohls</u> Moral Suasion in Regional Government Bond Markets	Adam Winegar

G3 Financial Intermediation II (p. 72)

Chair: Andre Guettler

TIME	AUTHORS AND PAPER	DISCUSSION
14:00	Christoph Maidl, <u>Corinna Woyand</u> The Effects of Leverage Ratio Adjustment on Banks' Balance Sheet and Risk: Impact of the Risk Measurement Approach	Benjamin Grosse-Rueschkamp
14:30	<u>Sebastian Doerr</u> , Philipp Schaz Banks' Geographic Diversification and Loan Supply: Evidence from the Syndicated Loan Market	Jana Ohls
15:00	Claire C��l��rier, <u>Thomas Kick</u> , Steven Ongena Taxing Bank Leverage: The Effects on Bank Capital Structure, Credit Supply and Risk-Taking	Mahvish Naeem

G4 Financial Intermediation III (p. 74)

Chair: Thomas Kick

TIME	AUTHORS AND PAPER	DISCUSSION
15:45	Elena Beccalli, Laura Chiaramonte, <u>Ettore Croci</u> Does Excess Cash Affect Bank Behavior?	Giulio Bagattini
16:15	Leila Aghabarari, <u>Andre Guettler</u> , Mahvish Naeem, Bernardus Van Doornik Do Firms Benefit from Their Relationships with Credit Unions during Dire Times?	Artashes Karapetyan
16:45	Hans Degryse, <u>Artashes Karapetyan</u> , Sudipto Karmakar To Ask or Not to Ask? Collateral versus Screening in Lending Relationships	Thomas Kick

PAPER AVAILABILITY

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

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Dr. Michael Herold

c/o University of Bamberg

Chair of Banking and Financial Control

D-96052 Bamberg, Germany

Phone: +41 44 586 45 35

E-Mail: sgf-conference@fmpm.ch

For any questions you might have, please do not hesitate to contact the organizing committee by e-mail or by telephone at the number given above.

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PAPER ABSTRACTS

Lottery Characteristics and the Closed-End Fund Puzzle

Maik Dierkes (Leibniz University Hannover)

Sebastian Schrön (Leibniz University Hannover)

We test the impact of lottery features of Closed-End Fund shares and individual stocks in their portfolio on Closed-End Fund premia. Well-accepted proxies for lottery-characteristics include, among others, the previous month's maximum return, a lottery index based on idiosyncratic volatility, idiosyncratic skewness, and prices as well as a quantile-based skewness proxy. Stronger lottery-features of a fund (assets) increase (decrease) monthly fund premia up to 129 (150) basis points, all else being equal. The economic impact interacts with time-varying skewness preference which is related to extreme sentiment. Low skewness preference is tantamount to a desire for diversification and predicts Closed-End Fund IPOs.

Decomposing the Size Premium

Zhiyao Chen (The Chinese University of Hong Kong)

Jun Li (University of Texas at Dallas)

Huijun Wang (University of Delaware)

We decompose firm size into four components: the lagged 5-year component that represents size five years ago, and the long-run, intermediate-run, and short-run components that capture changes in size in each horizon. We find that while the lagged 5-year component explains about 80% of the cross-sectional variation in size, it has little return predictability. In contrast, the long-run change in size component explains only 18% of size, but it completely captures the size premium. Our decomposition also sheds light on the January effect, the disappearance of the size premium since early 1980s, and the return behaviors of new entrants.

Buy-Side Competition and Momentum Profits

Gerard Hoberg (University of Southern California)

Nitin Kumar (Indian School of Business)

Nagapumanand Prabhala (University of Maryland)

We develop a measure of buy-side competition for momentum investing and show that it explains momentum profits. The monthly momentum spread is 139 basis points when competition is low and is negligible when competition is high. These results are stronger in more investible and lower transaction cost strategies such as value-weighted portfolios and larger capitalization stocks. Better alphas are attained with less negative skewness and better Sharpe and Sortino ratios. Several stock characteristics traditionally related to momentum profits do not explain our results.

Aggregate Expected Investment Growth and Stock Market Returns

Jun Li (University of Texas at Dallas)

Huijun Wang (University of Delaware)

Jianfeng Yu (Tsinghua University)

Consistent with neoclassical models with investment lags, we find that a bottom-up measure of aggregate investment plans, namely, aggregate expected investment growth (AEIG), negatively predicts future stock market returns, with an adjusted in-sample R-square of 18.5% and an out-of-sample R-square of 16.3% at the one-year horizon. The return predictive power is robust after controlling for popular macroeconomic return predictors, in subsample periods, as well as in other G7 countries. Further analyses suggest that the predictive ability of AEIG is more likely to be driven by the time-varying risk premium than by behavioral biases such as extrapolative expectations.

Structural Changes in Corporate Bond Underpricing

Florian Nagler (Bocconi University and IGIER)

Giorgio Ottonello (Vienna Graduate School of Finance)

We show that in the aftermath of the financial crisis underpricing of corporate bonds increases because underwriters systematically place bonds to relationship investors. We argue that the post-crisis decrease in inventory-carrying capacities incentivizes underwriters to secure intermediation shares by outsourcing bonds to related investors, who require in exchange increased underpricing. We isolate the strength of underwriter-investor relations by employing a novel empirical identification strategy based on institutional investors' past holdings of underwriters' own bonds. The relationship channel fully captures the increase in underpricing from the pre-crisis to the post-crisis period. Furthermore, it shows that relationship investors are net sellers of newly issued bonds in the post-crisis period. The results are informative about implications of post-crisis regulation.

Underpricing in the Eurozone Corporate Bond Market

Tobias Rischen (University of Mannheim)

Erik Theissen (University of Mannheim)

We conduct the most extensive study of underpricing in the Eurozone bond market so far and find strong evidence of underpricing. In cross-sectional regressions we find patterns that are consistent with bookbuilding-based theories of underpricing and inconsistent with liquidity-based explanations. The underpricing has increased considerably during the financial crisis and has remained at an elevated level since. The European Central Bank's asset purchase programs have led to a decrease in underpricing. We also show that secondary market liquidity in the Eurozone bond markets is significantly lower in the post-crisis period than pre-crisis. The decrease in liquidity is consistent with recent US evidence and may be an unintended side effect of new regulation enacted in the wake of the financial crisis, such as Basel III and the Volcker Rule.

Global Connectedness Across Bond Markets

Stig Vinther Møller (Aarhus University)

Jesper Rangvid (Copenhagen Business School)

We provide first tests of gradual diffusion of information across bond markets. We show that excess returns on bond markets around the world react with a lag to excess returns on a global bond portfolio: high returns on the global bond portfolio signal high expected returns on bond markets in many countries. Results are strong in-sample and out-of-sample, and hold after controlling with variables often used to predict bond returns. Excess returns on a global bond portfolio also predict inflation rates around the world. Investors learn about fundamentals in different countries (inflation rates) that influence expected returns around the world after observing returns on a global portfolio.

Idiosyncratic Volatility, Its Expected Variation, and the Cross-Section of Stock Returns

Nicole Branger (University of Münster)
Hendrik Hülsbusch (University of Münster)
Frederik Middelhoff (University of Münster)

We offer a novel perspective on the negative relation between idiosyncratic volatility (IVOL) and expected returns. We show that the IVOL puzzle is largely driven by a mean-reversion behavior of the stocks' volatilities, which is not captured by a simple historic measure of IVOL. In doing so, we make use of option implied information to extract the expected mean-reversion speed of IVOL in an almost model-free fashion. Together with the current level of IVOL this method allows us to identify stocks' expected IVOL innovations in a very general setting. Under the assumption of IVOL carrying a positive price of risk (Merton (1987)) we resolve the puzzle. In a horse race we show that the mean-reversion speed is superior to the most prominent competing explanations. All our findings are robust to different measures of IVOL and various stock characteristics.

Variance Risk: A Bird's Eye View

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

Prior research using daily returns data documents a significant variance risk premium (VRP) for the S&P 500 index but generally not for the constituent stocks. Using high-frequency data to compute the realized variance estimates, we show that the average VRP of individual equities is economically large and significant. We decompose the index VRP into factors related to the VRP of equities and the correlation risk premium. The former drives the variations in the index VRP while the latter captures the level of the index VRP. These factors predict excess stock returns in the time-series and cross-section, but at different horizons.

The Influence of Sponsor Characteristics and (Non-)Events on the Risk Premia of CAT Bonds

Tobias Götze (Braunschweig Institute of Technology)

Marc Gürtler (Braunschweig Institute of Technology)

This study employs CAT bond secondary market data to investigate the impact of sponsor characteristics and natural and economic events on the CAT bond premium. We identify a CAT bond sponsor's diversification, rating, and vertical integration as significant factors affecting the CAT bond premium. Our results suggest that, especially after experiencing large losses investors demand higher premia for CAT bonds with an indemnity trigger. This finding is supported by evidence for the US insurance sector showing that investors take into account sponsors' loss experience when pricing bonds with an indemnity trigger mechanism. Furthermore, we identify a catastrophic event that led to a reduction of CAT bond premia: Hurricane Sandy. Finally, we find that a second negative shock to CAT bond premia was in fact related to the non-occurrence of an event: the 2009 hurricane season.

Return Contributions of Factors and Characteristics in an Integrated Asset Pricing Approach

Matthias Bank (University of Innsbruck)

Frank Insam (University of Innsbruck)

We extend the standard one-period expected utility model based on exponential preferences with additional preference variables for asset characteristics, which are able to capture cross-sectional return differences. Contrary to the literature we treat characteristics as indicator variables to indicate whether a stock exhibits a certain characteristic or not. These indicator variables can be interpreted as "coloured markers" of stock characteristics. We derive simple empirically testable relationships, from which we dissect portfolio excess returns into return contributions coming from the covariance with common factors (market excess return, HML, SMB) and characteristics. Especially we find the robust results that the characteristics distress and high volatility carry significant and large absolute return contributions. Moreover, the characteristic return contributions exhibit strong return seasonalities and changes over the sample period.

Do Firm Fixed Effects Matter in Empirical Asset Pricing?

Daniel Hoechle (University of Basel and FHNW School of Business)

Markus Schmid (FHNW School of Business)

Heinz Zimmermann (University of St.Gallen)

In empirical asset pricing, it is standard to sort assets into portfolios based on a characteristic, and then compare the top (e.g., decile) portfolio's risk-adjusted return with that of the bottom portfolio. We show that such an analysis assumes the random effects assumption to hold. Therefore, results from portfolio sorts are valid if and only if firm-specific effects are uncorrelated with the characteristic underlying the portfolio sort. We propose a novel, regression-based approach to analyzing asset returns. Relying on standard econometrics, our technique handles multiple dimensions and continuous firm characteristics. Moreover, it nests all variants of sorting assets into portfolios as a special case, provides a means for testing the random effects assumption, and allows for the inclusion of firm-fixed effects in the analysis. Our empirical results demonstrate that the random effects assumption underlying portfolio sorts is often violated, and that certain characteristics-based factors that are well-known from empirical asset pricing studies do not withstand tests accounting for firm fixed effects.

Elephants and the Cross-Section of Expected Returns

Nora Marija Laurinaityte (Goethe University Frankfurt)

Christoph Meinerding (Deutsche Bundesbank)

Christian Schlag (Goethe University Frankfurt)

Julian Thimme (Goethe University Frankfurt)

Standard GMM cross-sectional asset pricing tests are susceptible to a trade-off: They can generate high explanatory power for factor models by allowing the estimated factor means to substantially deviate from the observed sample average of the factor. In fact, by shifting the weights on the moment conditions that identify the factor mean, any desired level of cross-sectional fit can be attained. To substantiate this trade-off, we run placebo tests based on simulated data with factors that by construction do not explain the cross-section of expected returns. Finally, we discuss examples of factor models proposed in the literature that may be prone to the documented effect. To alleviate such concerns, researchers who test cross-sectional models with GMM should always report both the cross-sectional fit and the estimated factor means.

Crash-o-phobia in Currency Carry Trade Returns

Regina Hammerschmid (Swiss Finance Institute and University of Zurich)

Alexandra Janssen (University of Zurich)

The standard Euler equation of a representative agent with rational beliefs and CRRA utility cannot explain currency carry trade returns. We relax several assumptions to allow for crash-o-phobia, which is the combination of belief misestimation, belief distortion and loss aversion. Using non-linear least squares, we estimate this behavioral Euler equation to price a basket of 10 different currencies. The parameter estimates reveal crash-o-phobic beliefs and preferences: carry trade investors exhibit loss aversion and overweight states with low probabilities. These observations are robust across several model specifications and consistent with experimental evidence. Statistically, our behavioural model performs significantly better at explaining currency returns than the standard model. Economically, we find that investing according to crash-o-phobia significantly outperforms the traditional carry trade strategy in particular since 2008. Hence, crash-o-phobia is highly relevant for pricing currency returns.

Cross-sectional Return Dispersion and Currency Momentum

Jonas Nygaard Eriksen (Aarhus University)

We find a strong empirical relation between currency momentum returns and cross-sectional return dispersion in foreign exchange (FX) markets. We find that a dispersion risk factor, which captures unexpected changes to the aggregate amount of heterogeneity in currency returns, is priced in the cross-section of currency momentum returns and that it contains information beyond traditional factors. Currencies with high past returns (winners) load positively on dispersion innovations, whereas currencies with low past returns (losers) load negatively. Our main results are robust to the inclusion of transaction costs, competing risk factors, and various limits to arbitrage.

Time-Varying Risk Premia in Large International Equity Markets

Ines Chaieb (University of Geneva and Swiss Finance Institute)

Hugues Langlois (HEC Paris)

Olivier Scaillet (University of Geneva and Swiss Finance Institute)

We estimate international factor models with time-varying factor exposures and risk premia at the individual stock level using a large unbalanced panel of 58,674 stocks in 46 countries over the 1985-2017 period. We consider market, size, value, momentum, profitability, and investment factors aggregated at the country, regional, and world level. The country market in excess of the world or regional market is required in addition to world or regional factors to capture the factor structure for both developed and emerging markets. We do not reject mixed CAPM models with regional and excess country market factors for 76% of the countries. We do not reject mixed multi-factor models in 80% to 94% of countries. Value and momentum premia show more variability over time and across countries than profitability and investment premia. The excess country market premium is statistically significant in many developed and emerging markets but economically larger in emerging markets.

The Quanto Theory of Exchange Rates

Lukas Kremens (London School of Economics)

Ian Martin (London School of Economics)

We derive a new identity that relates expected exchange rate appreciation to a risk-neutral covariance term, and use it to motivate a currency forecasting variable based on the prices of quanto index contracts. We show via panel regressions that the quanto forecast variable is an economically and statistically significant predictor of currency appreciation and of excess returns on currency trades. Out of sample, the quanto variable outperforms predictions based on uncovered interest parity, on purchasing power parity, and on a random walk as a forecaster of differential (dollar-neutral) currency appreciation.

Term Structure of Interest Rates with Short-Run and Long-Run Risks

Olesya V. Grishchenko (Federal Reserve Board)

Zhaogang Song (John Hopkins University)

Hao Zhou (Tsinghua University)

Interest rate variance risk premium (IRVRP), the difference between implied and realized variances of interest rates, emerges as a strong predictor of Treasury bond returns of maturities ranging between one and ten years for return horizons up to six months. IRVRP is not subsumed by other predictors such as forward rate spread or equity variance risk premium. These results are robust in a number of dimensions. We rationalize our findings within a consumption-based model with long-run risk, economic uncertainty, and inflation non-neutrality. In the model interest rate variance risk premium is related to short-run risk only, while standard forward-rate-based factors are associated with both short-run and long-run risks in the economy. Our model qualitatively replicates the predictability pattern of IRVRP for bond returns.

Extreme Inflation and Time-Varying Disaster Risk

Ilya Dergunov (Goethe University Frankfurt)

Christoph Meinerding (Deutsche Bundesbank)

Christian Schlag (Goethe University Frankfurt)

Low consumption growth tends to occur together with either very high or very low inflation. The probability of low expected consumption growth estimated from a Markov chain for consumption growth and inflation is highly correlated with a measure for the likelihood of consumption disasters suggested by Wachter (2013) and also tracks the evolution of the dividend-price ratio of the S&P500 index very well. A simple asset pricing model with recursive utility and unobservable states also reproduces the time variation in volatilities and correlations of stock and bond returns nicely. Our findings suggest that the disaster risk paradigm can be extended towards an explanation of the time-varying nature of the stock-bond return correlation when the informational role of inflation is taken into account properly.

Heterogeneous Beliefs and Real Yields

Paul Whelan (Copenhagen Business School)

This paper documents that, since the advent of inflation protected markets, there appears to be very little difference between real and nominal bond risk premia. Motivated by this observation, I argue that bond markets are a natural testing ground to understand the properties of the real stochastic discount factor. I study a simple extension to a Lucas tree economy in which agents hold heterogeneous beliefs about the persistence of growth rate shocks. Empirically, I utilise a cross-section of growth rate forecasts reported by professional market participants to show that disagreement about shock propagation is both economically and statistically plausible. Next, I investigate the theoretical importance of this channel in a setting where multiple agents engage in speculative trade based on their beliefs about the future path of consumption growth. Equilibrium term structures deviate from homogeneous economies along important dimensions and can help us understand a number of stylised features of the data. For example, the model can generate low real short rates, positive real Sharpe ratios, upward sloping term structures, and return predictability due to compensation for real risks. Finally, using survey forecasts, I provide empirical evidence for the model's testable predictions that lend support for the role of model disagreement in bond markets.

Present Value Calculations by Means of First and Second Differences

Stephen A. Buser (Ohio State University)

Bjarne Astrup Jensen (Copenhagen Business School)

This paper identifies fundamental relationships between the present value of a given cash flow and the present value of the first as well as second order changes in that cash flow. These relations apply only simple arithmetic operations and avoids the use of differential calculus and advanced series summation in order to derive analytic expressions for present values, duration and convexity of a variety of cash flows; expressions that relate the quantitative outcomes of numerical calculations to the driving forces behind those calculations.

We apply the methods to a variety of nontraditional cash flows, including cash flows with polynomial growth, cash flows that are subject to different tax effects for dividends and capital gain and cash flows that exhibit cyclical variation over time.

Short-Sale Constraints and Credit Runs

Gyuri Venter (Copenhagen Business School)

This paper studies how short-sale constraints affect the informational efficiency of market prices and the link between prices and economic activity. I show that under short-sale constraints security prices contain less information. However, short-sale constraints increase the informativeness of prices to some agents who learn about the quality of an investment opportunity from market prices and have additional private information.

Then I apply this observation when modeling a run on an investment bank by its short-term creditors, who are endowed with dispersed information and also learn from the price of an asset the bank holds. I show that short-selling constraints in the financial market lead to the revival of self-fulfilling beliefs about the beliefs and actions of others, and create multiple equilibria. In the equilibrium where agents rely more on public information (i.e., the price), creditors with high private signals are more lenient to roll over debt, and a bank with lower asset quality remains solvent. This leads to higher allocative efficiency in the real economy. My result thus implies that the decrease in average informativeness due to short-sale constraints can be more than compensated by an increase in informativeness to some agents.

Credit Constraints and Credit Losses: an Unsteady State Approach

Alexis Derviz (Czech National Bank)

The paper investigates behavior of credit demand following from differences in productive capital sources, in economies recovering from an adverse real shock. Beside physical capital, there is another, human, capital available during the catch-up phase. Since a part of new physical capital must be debt-financed whereas production is risky due to uncertain future total factor productivity, defaults happen with positive probability. The latter can be reduced by partially substituting physical capital for human, at a disutility cost. We ask whether a shift away from risky borrowed physical capital by agents with access to human capital is able to generate a reduction in aggregate credit losses that would warrant a corresponding prudential policy. This question is addressed by means of a dynamic stochastic model with feedback decision rules both at the intermediate stage (recovery) and in all subsequent periods (long-term equilibrium). The latter stationary dynamics generalize steady states of deterministic models. We find that unsecured credit in economies with the human capital option may be highly sensitive to the level of initial wealth and legacy debt. In such an environment, prudential policies that penalize unsecured borrowing, while improving private welfare in relatively “poor” initial states, are redundant in “rich” ones.

Who Buys Homes when Prices Fall?

Marcel Fischer (Copenhagen Business School and University of Konstanz)

Natalia Khorunzhina (Copenhagen Business School)

Julie Marx (Copenhagen Business School)

We study the transition to and from homeownership under the recent housing market bust using micro-level data covering the entire Danish population. We document that after controlling for various sociodemographic and market characteristics, younger households and households with negative levels of net worth reduced their likelihood to acquire homeownership during the bust more than other households whereas households with children increased their likelihood. Similarly, younger households increased their likelihood to abandon homeownership during the bust more than other households. This pattern is likely to have contributed to a significant inter-generational shift in homeownership from younger to older households.

Disappointment Aversion and Endogenous Growth - Can Rare Disappointments Explain the Equity Premium Puzzle?

Nikolai Gräber (University of Münster)

Friedrich Lorenz (University of Münster)

This paper studies the implications of generalized disappointment aversion (GDA) preferences in the endogenous growth model of Kung and Schmid (2015). The economy features rare disappointment states which are reflected in high values of the stochastic discount factor occurring on average every ten years. The fear of these unpredictable events drives the risk-free rate down substantially, without altering the production side, consequently the return on equity isn't affected much. Overall, the model produces an equity premium as sizeable as in the data for a countercyclical effective risk aversion of about ten.

Implied Volatility Duration and the Early Resolution Premium

Christian Schlag (Goethe University Frankfurt)

Julian Thimme (Goethe University Frankfurt)

Rüdiger Weber (Goethe University Frankfurt)

We introduce Implied Volatility Duration (IVD) as a new measure for the timing of uncertainty resolution, with a high IVD corresponding to late resolution. Portfolio sorts on a large cross-section of stocks indicate that investors demand on average about seven percent return per year as a compensation for a late resolution of uncertainty. In a general equilibrium model, we show that 'late' stocks can only have higher expected returns than 'early' stocks if the investor exhibits a preference for early resolution of uncertainty. Our empirical analysis thus provides a purely market-based assessment of the timing preferences of the marginal investor.

Option-Implied Correlations, Factor Models, and Market Risk

Adrian Buss (INSEAD)

Lorenzo Schönleber (Frankfurt School of Finance & Management)

Grigory Vilkov (Frankfurt School of Finance & Management)

Implied correlation and variance risk premium stand out in predicting market returns. However, while the predictive ability of implied correlation lasts for up to a year, the variance risk premium predicts market returns only for one quarter ahead. Contrary to the accepted view, implied correlation predicts the market return not through a diversification risk (average correlation) channel, but by predicting a concentration of market exposure, which defines the level of non-diversifiable market risk. Economy-wide implied correlation built exclusively from option prices of nine sector ETFs and the S&P500 efficiently predicts future market returns and systematic diversification risk in the form of market betas dispersion. Newly developed implied correlations for economic sectors provide industry-related information and are used to extract option-implied risk factors from sector-based covariances.

Determinants of Implied Volatility Smiles - An Empirical Analysis Using Intraday DAX Equity Options

Andreas W. Rathgeber (University of Augsburg)

Johannes Stadler (University of Augsburg)

Markus Ulze (University of Augsburg)

In recent years, the importance of high frequency trading and data has enormously increased. Using over one million trade-by-trade DAX equity options from the EUREX in 2012 with corresponding order books a detailed, market-oriented and modern examination of the determinants of the implied volatility smile is performed and the existing high frequency gap in literature is addressed. We confirm former low frequency results like moneyness, time, liquidity, volume and underlying moment dependencies. Additionally, new order book based measures, e.g. a control for buyer-/seller-motivated trades, are developed and a mean-reversion process for implied volatilities is revealed. This study is consequently laying the ground work for further high frequency research.

Structural Breaks in the Variance Process and the Pricing Kernel Puzzle

Tobias Sichert (Goethe University Frankfurt)

Numerous empirical studies agree that the pricing kernel derived from option prices is not monotonically decreasing in index returns, but disagree whether it is U-shaped or S-shaped. This is not only empirically inconsistent, but the two observations also seem theoretically incompatible. In particular, the S-shape is conflicting with most modern asset pricing models. By providing novel time series evidence, this paper reconciles the so far conflicting empirical results. I show that the finding of S-shaped pricing kernels is spurious and is removed by including structural breaks in the data generating process into the estimation. In the sample period from 1992-2015 I identify five different high or low variance regimes. Conditional on the regime, the obtained pricing kernels appear U-shaped, while the S-shaped pricing kernels consistently disappear. The results are statistically significant and robust to numerous variations in the methodology. The empirical results can be explained by a variance-dependent pricing kernel, with structural breaks as a necessary component. Lastly, the results show that the fit of the option pricing model increases substantially when breaks are introduced.

Volatility Noise

Michael Hofmann (Karlsruhe Institute of Technology)

Marliese Uhrig-Homburg (Karlsruhe Institute of Technology)

This study shows that fitting errors of equity option implied volatility surfaces are informative about limits of arbitrage. For each stock and day, we quantify the goodness of fit between the observed implied volatilities of all available options and the corresponding estimates from OptionMetrics' smoothed volatility surface using root-mean-square errors. In the cross-section of stocks, this error metric increases in idiosyncratic stock volatility and several measures of option and stock illiquidity. Based on these insights, we propose a measure for market-wide limits of arbitrage given by the value-weighted average of the stock-specific fitting errors. This measure of volatility noise peaks during episodes of market distress and exhibits sensible correlations to standard economic state variables like the market return, the TED spread, or the VIX. It co-moves as well with both the conceptually similar (treasury) noise measure proposed by Hu, Pan and Wang (2013) and a mispricing measure based on covered interest rate parity deviations in FX markets, but volatility noise still contains unique information. Confirming this view, we find that among these measures only volatility noise constitutes a priced risk factor in monthly returns of managed equity portfolios.

PAPER ABSTRACTS: C2 REGULATION (SHORT SELLING)

Flying Under the Radar: The Effects of Short-Sale Disclosure Rules on Investor Behavior and Stock Prices

Stephan Jank (Deutsche Bundesbank and Centre for Financial Research (CFR))

Christoph Roling (Deutsche Bundesbank)

Esad Smajlbegovic (Erasmus University Rotterdam)

This paper analyzes how newly introduced transparency requirements for short positions affect investors' behavior and security prices. Employing a unique data set, which contains both public positions above and confidential positions below the regulatory disclosure threshold, we offer several novel insights. Positions accumulate just below the threshold, indicating that a sizable fraction of short sellers avoid disclosing their positions publicly. The decision to cross the disclosure threshold appears to be persistent, with investors sticking to their secretive behavior. Short positions held by these secretive investors are associated with stronger negative returns compared to their peers, suggesting that secretive investors possess superior information. Furthermore, we document that negative information is incorporated more slowly into stock prices when a secretive investor is just below the disclosure threshold. Overall, these findings suggest that short sellers' evasive behavior in response to the transparency regulation imposes a negative externality on stock market efficiency.

Financial Constraints and Industry Dynamics

Itzhak Ben-David (Ohio State University, and NBER)

Zhi Li (Chapman University)

Zexi Wang (University of Bern)

Previous studies found that financially-constrained firms scale down their investment activity. The lost investment opportunities, however, could be captured by other firms that are less financially constrained. We test this proposition using the Reg SHO pilot regulation, which relaxed short-selling constraints for about 30% of firms and thus tightened their financial constraints. Following the introduction of the regulation, pilot firms indeed reduced their investments, while direct competitors of the pilot firms increased their investments, expanded their market share, and became more profitable. We conclude that some of the lost opportunities due financial constraints are salvaged by competing firms.

PAPER ABSTRACTS: C2 REGULATION (SHORT SELLING)

Should We Be Aware of the Control Group? Spillover Effects through the Implementation of Reg SHO

Nicolas Kube (University of St.Gallen)

The implementation of a new regulation can cause severe spillover effects due to inequality between treated and untreated firms imposed by the regulation. I show that the introduction of the Reg SHO which randomly exempted about one third of listed firms from short sale price tests also affects the untreated firms. Untreated firms show lower short sale volume and trades because short sellers systematically shift their activities towards the treated firms. This further leads to positive stock returns and less trading of the untreated firms.

Entering a New Market: First-Mover Advantages and Risk Dynamics Under Market Uncertainty

Christian Riis Flor (University of Southern Denmark)

Mark Raun Moritzen (University of Southern Denmark)

The perception that first-movers obtain a long-run competitive advantage is pervasive. However, empirical studies find mixed support for the existence of a first-mover advantage. We address this in a dynamic model with heterogeneous firms in which market uncertainty affects firms' investment timing decision. Market uncertainty induces underinvestment and increases the probability of low-quality firms taking the role of first-mover. By decomposing firm value into a first-mover and a quality component we show that first-mover advantages may be both over- and underestimated. Patents mitigate the underinvestment problem but further increase the incentives for low-quality firms to become first-movers. Finally, we show that risk dynamics of first-movers are sensitive to follower entry leading to a run-up in returns. Patents dampen the run-up and create more stable risk dynamics.

Stock Returns and the Cross-Section of Investor Attention

Michael Ungeheuer (Aalto University)

I analyze the effect of stock returns on investor attention and document a new stylized fact: Stocks ranked as daily winners and losers experience large spikes in investor attention, while non-ranked stocks with extreme returns do not experience any change in attention. Using hourly Wikipedia firm page views to measure investor attention, I show that this relation is not explained by reverse causality, contemporaneous or extreme news, or reporting of news specifically for ranked stocks. The effect of daily stock returns on investor attention seems to be driven by winner and loser rankings themselves. Attention directed to the small set of ranked stocks is followed by economically significant information dissemination and trading.

Disentangling Investor Sentiment: Mood and Economic Expectations

Dimitrios Kostopoulos (Leibniz University Hannover)

Steffen Meyer (Leibniz University Hannover)

In this paper, we disentangle investor sentiment into two components: mood and economic expectations. We apply acoustical analysis to the daily top ten of music downloads in iTunes for Germany to derive a novel and direct measure for mood (MOOD). We match MOOD with trading data of German individual investors. We find that when MOOD is high (positive mood), investors purchase more, particularly trading into risky and out of less-risky securities. To proxy for economic expectations, we use an already existing index (FEARS), which bases on Google search volumes of negative economic terms. We find that FEARS drives trading in the same fashion as in previous studies and that these effects significantly depend on MOOD. We conclude that there are two sources of sentiment driving individual investors, which significantly interact.

The TIPS Liquidity Premium

Martin M. Andreasen (Aarhus University)

Jens H. E. Christensen (Federal Reserve Bank of San Francisco)

Simon Riddell (Amazon)

We introduce an arbitrage-free term structure model of nominal and real yields that accounts for liquidity risk in Treasury inflation-protected securities (TIPS). The novel feature of our model is to identify liquidity risk from individual TIPS prices by accounting for the tendency that TIPS, like most fixed-income securities, go into buy-and-hold investors' portfolios as time passes. We find a sizable and countercyclical TIPS liquidity premium, which greatly helps our model in matching TIPS prices. Accounting for liquidity risk also improves the model's ability to forecast inflation and match surveys of inflation expectations, although none of these series are included in the estimation.

Measuring Inflation Anchoring and Uncertainty: A US and Euro Area Comparison

Olesya V. Grishchenko (Federal Reserve Board)

Sarah Mouabbi (Banque de France)

Jean-Paul Renne (HEC Lausanne)

We use several US and euro-area surveys of professional forecasters to estimate a dynamic factor model of inflation featuring time-varying uncertainty. We obtain survey-consistent distributions of future inflation at any horizon, both in the US and the euro area. Equipped with this model, we propose a novel measure of the anchoring of inflation expectations that accounts for inflation uncertainty. Our results suggest that following the Great Recession, inflation anchoring improved in the US, while mild de-anchoring occurred in the euro area. As of our sample end, both areas appear to be equally anchored.

A New Normal for Interest Rates? Evidence from Inflation-Indexed Debt

Jens H. E. Christensen (Federal Reserve Bank of San Francisco)

Glenn D. Rudebusch (Federal Reserve Bank of San Francisco)

Researchers have debated the extent of the decline in the steady-state short-term real interest rate - that is, in the so-called equilibrium or natural rate of interest. We examine this issue using a dynamic term structure finance model estimated directly on the prices of individual inflation-indexed bonds with adjustments for real term and liquidity risk premiums. Our methodology avoids two pitfalls of previous macroeconomic analyses: structural breaks at the zero lower bound and potential misspecification of output and inflation dynamics. We estimate that the equilibrium real rate has fallen about 2 percentage points and appears unlikely to rise quickly.

PAPER ABSTRACTS: D1 ASSET ALLOCATION

The Portfolio of Euro Area Fund Investors and ECB Monetary Policy Announcements

Johannes Bubeck (European Central Bank)
Maurizio Michael Habib (University of Mannheim)
Simone Manganelli (European Central Bank)

This paper studies the impact of major ECB monetary policy announcements on the portfolio allocation of euro area fund investors, using daily data between 2012 and mid-2016, a period that includes a variety of unconventional measures. We distinguish between active portfolio reallocation, driven by redemptions or injections of investors, and passive portfolio rebalancing, triggered by valuation effects related to changes in asset prices and exchange rates. We find that, for this class of investors, policy announcements work mainly through valuation effects (the signaling channel), rather than via active reallocation (the portfolio rebalancing channel). Notably, since the autumn of 2014, monetary policy shocks triggered large asset price and exchange rate effects and prompted a passive shift of euro area investors into riskier assets, in particular European and Emerging Market equity funds and out of bond funds.

Predictable Biases in Macroeconomic Forecasts and Their Impact Across Asset Classes

Luiz Felix (VU Amsterdam and APG Asset Management)
Roman Kräussl (University of Luxembourg)
Philip Stork (VU Amsterdam)

This paper investigates how biases in macroeconomic forecasts are associated with economic surprises and market responses across asset classes around US data announcements. We find that the skewness of the distribution of economic forecasts is a strong predictor of economic surprises, suggesting that forecasters behave strategically (rational bias) and possess private information. Our results also show that consensus forecasts of US macroeconomic releases embed anchoring. Under these conditions, both economic surprises are predictable as well as the returns of assets that are sensitive to the macroeconomic announcements. Our findings indicate that local treasuries, equities, and currencies markets are more predictable than foreign markets and commodities. Yet, when forecasters fail to correctly forecast the direction of the economic surprises, regret becomes a relevant cognitive bias to explain asset price responses. We find that the behavioral and rational biases encountered in US economic forecasting also exists in Continental Europe, United Kingdom and Japan, however, to a lesser extent.

Optimal Investments Under Linear Sharing Rules

Nicole Branger (University of Münster)

An Chen (Ulm University)

Nadine Gatzert (University of Erlangen-Nürnberg)

Antje Mahayni (University of Duisburg-Essen)

In recent years, defined contribution pension plans have become increasingly important in most developed countries. In these schemes, contributions are pooled and jointly invested in financial assets without terminal payoff guarantees. Investors are thus tied together in their investment decisions, making it necessary to decide about a common portfolio strategy over the investment horizon and a rule how to share the aggregate wealth among investors. The aim of this paper is to address these challenges by studying optimal joint investments that maximize welfare under linear sharing rules, where each investor gets a fraction of the terminal payoff that is equal to the fraction of his initial contribution. We extend previous work by considering a pool of n investors with CRRA utility functions and by using different "fairness" criteria. We show how to determine the joint terminal payoff if the focus is on Pareto efficient payoffs and on payoffs which minimize some function of the loss rate. If investors can choose from a set of contracts with different Merton parameters, we are able to determine the contract menu that minimizes the maximal loss rate, the average loss rate, or the variance of the loss rate.

Long-term Asset Allocation Under Time-varying Investment Opportunities: Optimal Portfolios with Parameter and Model Uncertainty

Thomas Dangl (TU Wien)

Alex Weissensteiner (Free University of Bolzano-Bozen)

We study the implications of predictability on the optimal asset allocation of ambiguity averse long-term investors. We analyze the term structure of the multivariate risk-return trade-off in a VAR model under full consideration of parameter uncertainty, and we decompose the predictive covariance along different sources of risk/uncertainty. We calibrate the model to real returns of US stocks, US long-term government bonds, cash, real-estate and gold using the term spread and the dividend-price ratio as additional predictive variables. While over short periods the model-implied conditional covariance structure of asset-class returns determines the optimal allocation, we find that over longer horizons the optimal asset allocation is significantly influenced by the covariance structure induced by estimation errors. As a consequence, the ambiguity averse long-term investor tilts her portfolio not simply toward the global minimum-variance portfolio but shrinks portfolio weights toward a seemingly inefficient portfolio which shows maximum robustness against estimation errors. Most interestingly, we find that even though time diversification of stock returns vanishes after consideration of estimation errors, real long-term bond returns are even more affected, making stocks an important asset class for the ambiguity averse long-term investor.

The Absolute Return Wedge: A New Measure That Predicts Hedge Fund Performance

Vikas Agarwal (Georgia State University)

Stefan Ruenzi (University of Mannheim)

Florian Weigert (University of St.Gallen)

We propose a new measure of hedge fund's activeness. Our activeness measure is a fund firm's absolute return wedge defined as the absolute value of a fund firm's reported return minus its hypothetical portfolio return derived from its disclosed long equity holdings. Fund firms with a high absolute return wedge outperform fund firms with a low absolute return wedge by more than 6% p.a. after accounting for typical risk factors that explain hedge fund performance. We find that the absolute return wedge is positively associated with measures of managerial incentives and discretion. Moreover, fund firms with greater value of long put options and confidential equity positions disclosed with a delay in their regulatory filings show high absolute return wedges. Taken together, these results are consistent with better incentivized hedge fund managers being more active and delivering superior performance.

Hedge Fund Activism and Internal Capital Markets

Sehoon Kim (University of Florida)

This paper studies the impact of hedge fund activism on target companies' internal capital allocation decisions. Multi-division firms targeted by activist hedge funds increase division level investment while reducing its reliance on the division's own cash flows, especially for divisions with the best investment opportunities within the firm. As a result, the sensitivity of a division's investment to its own cash flow becomes similar to its sensitivity to cash flows generated by other divisions of the firm. Such changes are more pronounced when the firm is ex-ante financially constrained. The results are also stronger when the CEO is replaced or the payout ratio is increased within three years of being targeted. These effects are unlikely to be driven by measurement errors in investment opportunities measured by Tobin's Q or systematic differences between targeted and non-targeted firms, and persist after the typical activist holding period ends. Corresponding with improved efficiency, the diversification discount is alleviated for targeted firms. The overall evidence is consistent with the resolution of inefficiencies in internal capital markets of multi-division firms as a result of hedge fund activism.

Career Concerns and Peer Effects in Tournaments: Evidence from ECB Reserve Currency Portfolios

Benjamin Sahel (European Central Bank)

Antonia Scalia (Banca d'Italia)

Luana Zaccaria (EIEF)

Using data on ECB's reserve currency portfolios, we show that money managers react to relative rankings, i.e. own versus peers' performance, by adjusting portfolio active risk levels as measured ex-ante by actual deviations from their benchmark. This happens in the absence of explicit incentives, as no monetary reward is promised for winning this "tournament" among portfolio managers. We collect information on managers' characteristics, such as age, education, tenure, salary and career path and investigate the role played by implicit incentives. We provide evidence that both career concerns and peer effects contribute to the documented relationship between ranking and risk taking.

The Impact of the Morningstar Sustainability Rating on Mutual Fund Flows

Manuel Ammann (University of St.Gallen)

Christopher Bauer (University of St.Gallen)

Sebastian Fischer (University of St.Gallen)

Philipp Müller (University of St.Gallen)

We examine the effect of the introduction of Morningstar's Sustainability Rating in March 2016 on U.S. equity mutual fund flows. Exploiting this shock to the availability of sustainability information we establish a causal relation between sustainability and fund flows. Using panel regressions, propensity score matching, and an event study methodology we find strong and robust evidence that retail investors shift money away from low-rated and into high-rated funds. An average high-rated retail fund receives between \$4.1m and \$10.1m higher net flows and an average low-rated retail fund suffers from \$1.0m to \$5.0m lower net flows than an average-rated fund during the first year after the publication of the Rating. The effect is caused by the publication of the Morningstar Sustainability Rating and not by a general attractiveness of sustainable funds. Institutional investors react much more weakly to the publication of the Rating.

Nepotism in IPOs: Consequences for Issuers and Investors

François Degeorge (Università della Svizzera italiana, Lugano)

Giuseppe Pratobevera (Università della Svizzera italiana, Lugano)

Potential conflicts of interest arise when IPO underwriters allocate IPO shares to their affiliated funds. We hypothesize that nepotism incentives may affect IPO pricing. Using a novel hand-collected dataset, we find support for this hypothesis in a regression discontinuity design (RDD): a one percentage point increase in affiliated allocations increases underpricing by 5.4 percentage points. Our evidence suggests that nepotism has real monetary costs for IPO issuers. We also use our dataset to revisit a milder version of nepotism analyzed in prior studies, and we find much clearer support for it than prior work: we find a strong positive association between IPO underpricing and affiliated allocations, which strengthens when nepotism incentives are stronger.

Predictability in Commodity Markets: Evidence from More than a Century

Marcel Prokopczuk (Leibniz University Hannover, University of Reading)

Björn Tharann (Leibniz University Hannover)

Chardin Wese Simen (University of Reading)

Using more than 140 years of data, we comprehensively analyze the predictive power of a broad set of macroeconomic variables for commodity prices and volatilities. We find some evidence for short term predictability, while the predictability is much stronger in the long term. The level of volatility and the degree of predictability are affected by the introduction of derivatives trading. A business cycle analysis shows that the degree of predictability is independent of being in a recession or expansion.

Dynamic Indexes: Equity Rotation and Factor Timing

Lars Kaiser (University of Liechtenstein)

Georg Peter (Liechtensteinische Landesbank AG)

It is well-known that factor premiums, identified as contributing to portfolios risk and return, are time-varying and conditional on market phases. Thereon, this paper builds on Fernholz's [1989] diversity-weighted indexing approach to derive a systematic and transparent method to dynamically adjust a portfolios factor exposure over time. The empirical results show that resulting portfolios correspond to a factor rotation, whilst demonstrating favorable after-cost properties regarding risk-adjusted returns, downside deviation, concentration and tracking error. Additionally, introduced method limits extreme positions in certain assets by encompassing portfolios with an implicit active risk constraint such that a natural upper and lower weight bound exists. Given these properties and following the definition by Lo [2016], this approach lends itself for the construction of (dynamic) index funds based on its transparent, systematic and investable outcome.

Aspiration Level Theory and Stock Returns: An Empirical Test

Gabor Neszveda (Tilburg University)

According to aspiration level theory, stocks achieving an aspiration level return in the recent past more frequently earn a lower subsequent excess monthly return on average. To test this hypothesis in the cross-section of stock returns, I construct a measure for each stock as the probability of achieving the aspiration level return. I investigate several specifications for the aspiration level returns such as the zero return, the risk-free rate, the market return, and the industry average return. I find strong supporting evidence for the role of an aspiration level even after controlling for several known factors including size, book-to-market ratio, momentum, and short-term reversal. The results remain significant even among stocks with large market capitalization, with high liquidity, with high institutional ownership, and in both high and low sentiment time periods. Additional tests show that these results are not driven by microstructure effects.

Credit Scores, Social Capital, and Stock Market Participation

Jesse Bricker (Federal Reserve Board)

Geng Li (Federal Reserve Board)

We introduce average credit scores as an indicator of a community's social capital and present evidence that this measure is consistent with, but richer than, those used in the existing literature. As an application of this indicator, we show that households residing in communities with higher social capital are more likely to invest in stocks, even after controlling for a rich set of socioeconomic, preferential, neighborhood, and demographic characteristics. Consistent with the notion that social capital and trust promote stock investment, we find that, first, this association is more pronounced among the lower educated; second, social capital levels of the county where one grew up has a lasting influence on future stock investment; and third, investors have a greater chance of entering the stock market in the years after they relocate to higher-social capital communities.

How Price Path Characteristics Shape Investment Behavior

Sven Nolte (University of Münster)

Judith C. Schneider (University of Münster)

Price paths are oftentimes the only graphical representation of financial products investors receive before making an investment decision. We argue that price paths serve as "graphical" frames, influencing the perceived attractiveness of an asset by highlighting specific asset characteristics. In a controlled experiment we find that price paths have an impact on investment decisions, even if risk-and-return characteristics of an asset are identical. In a regression we test a simple model relating the perception of price path shapes to several heuristics. These heuristics are: focusing on more recent outcomes, deriving implicit reference prices from focal prices, focusing on losses, and estimating risk from the amplitude of the path. We conclude that investment decisions are systematically biased due to the shape of an asset's price path.

The Household Savings Paradox

Tobias Meyll (University of Giessen)

Thomas Pauls (Goethe University Frankfurt)

Andreas Walter (University of Giessen)

Using representative data from Germany, we reveal that more than 27.3% of the population not only restrains from participating in the stock market but also refuse to invest in contractual savings and retirement products. In fact, we find that these households rely on deposits only - an investment strategy usually related to negligible and recently to negative inflation-adjusted returns. Because these households forgo the equity risk-premium, on the one hand, as well as state subsidies associated with comparable safe products on old-age provision, on the other hand, we call this phenomenon the 'household savings paradox'. We provide novel evidence that financial literacy and financial advice strongly decrease the likelihood to save paradoxically. Our results emphasize the important role of financial literacy and financial advice for sound financial decision-making in a rapidly changing and growing landscape of financial products.

Experience is the Best Teacher: Did the Financial Crisis Spur White-Collar Crime?

Steffen Andersen (Copenhagen Business School)

Tobin Hanspal (Goethe University Frankfurt)

Kasper Meisner Nielsen (Hong Kong University of Science and Technology)

Using detailed micro-data on criminal convictions linked to administrative register data we investigate determinants of white-collar crime and analyze its increased prevalence throughout the financial crisis. We hypothesize that negative experiences with fraud affect the perceived costs and returns to individuals' own future criminal activity. Our results show that experience of losing investments from criminally-prosecuted retail banks which defaulted in the financial crisis increases the probability of being charged, and convicted, of a white-collar crime by two to three times. Criminal activity remains constant for a natural control sample of investors who lost assets in bankrupt institutions which were not charged with financial misconduct. Our findings uncover strong effects at the extensive margin: the increase in white-collar crime in the sample is driven almost exclusively by investors who had no prior history of criminal activity. Negative experiences have no effect on other felonies such as property theft or violent crime, supporting a learning hypothesis.

Electronic Trading in OTC Markets vs. Centralized Exchange

Ying Liu (UNIL and Swiss Finance Institute)

Sebastian Vogel (EPFL and Swiss Finance Institute)

Yuan Zhang (EPFL and Swiss Finance Institute)

We model a two-tiered market structure in which an investor can trade an asset on a trading platform with a set of dealers who in turn have access to an interdealer market. The investor's order is informative about the asset's payoff and dealers who were contacted by the investor use this information in the interdealer market. Increasing the number of contacted dealers lowers markups through competition but increases the dealers' costs of providing the asset through information leakage. We then compare a centralized market in which investors can trade among themselves in a central limit order book to a market in which investors have to use the electronic platform to trade the asset. With imperfect competition among dealers, investor welfare is higher in the centralized market if private values are strongly dispersed or if the mass of investors is large.

Intraday Return Predictability, Informed Limit Orders, and Algorithmic Trading

Darya Yuferova (Norwegian School of Economics)

I study the strategic choice of informed traders for market vs. limit orders by analyzing the informational content of the limit order book. In particular, I examine intraday return predictability from market and limit orders for all NYSE stocks over 2002-2010, distinguishing between two sources of predictability: inventory management and information. In contrast to the traditional view in the literature, I find that informed limit (not market) orders are the dominant source of intraday return predictability. The findings further indicate that the advent of algorithmic trading is associated with more informed trading, especially through market orders. Overall, my evidence emphasizes the role of limit orders in informed trading, which has implications for theory, investors, and widely used measures of informed trading.

Information and Optimal Trading Strategies with Dark Pools

Anna Bayona (ESADE Business School)

Ariadna Dumitrescu (ESADE Business School)

Carolina Manzano (Universitat Rovira I Virgili and CREIP)

We study how asymmetric information affects market participants' choice of trading venue (either an exchange or dark pool), and the optimal submission strategies in a sequential trading game. The exchange is organized as a fully transparent limit order book, and the dark pool is an opaque venue where orders are continuously executed at the midpoint of the bid and ask prices that prevail in the exchange. We find that, when the limit order book conveys no information, rational uninformed traders never trade in the dark pool due to price risk. However, price risk may be reduced when the information in the book induces an uninformed buyer (seller) to believe that the value of the asset is high (low) since the order was previously submitted by an informed buyer (seller). Adding a dark pool alongside an exchange may divert the informed trader from the exchange to the dark pool if the execution risk in the dark is sufficiently low. An uninformed trader only goes to the dark if the limit order book is sufficiently informative and price risk is low. We show that adding a dark pool alongside an exchange reduces price informativeness and increases the expected welfare of rational traders. Its effects on market liquidity and trading volume depend on stock market characteristics since these determine whether traders supply, demand or do not provide liquidity in the exchange when the dark pool is unavailable.

The Sovereign Debt Crisis: Rebalancing or Freezes?

Per Östberg (University of Zurich)

Thomas Richter (University of Zurich)

Using high-frequency data we document that episodes of market turmoil in the European sovereign bond market are on average associated with large decreases in trading volume. The response of trading volume to market stress is conditional on transaction costs. Low transaction cost turmoil episodes are associated with volume increases (investors rebalance), while high transaction cost turmoil periods are associated with abnormally low volume (market freezes). We find suggestive evidence of market freezes in response to shocks to the risk bearing capacity of market makers while investor rebalancing is triggered by wealth shocks. Overall, our results show that the recent sovereign debt crisis was not associated with large-scale investor rebalancing.

Liquidity Provider Incentives in Fragmented Securities Markets

Benjamin Clapham (Goethe University Frankfurt)

Peter Gomber (Goethe University Frankfurt)

Jens Lausen (Goethe University Frankfurt)

Sven Panz (Goethe University Frankfurt)

We study the introduction of single-market liquidity provider incentives in fragmented securities markets. Specifically, we analyze the introduction of the Xetra Liquidity Provider Program at Deutsche Boerse from two perspectives: First, we investigate whether fee-rebates for liquidity providers enhance liquidity on the specific venue thereby increasing its competitiveness and market share. Second, we analyze whether single-market liquidity provider incentives increase overall market liquidity available for market participants in a fragmented market. For this purpose, we consolidate high-frequency order book information of the most relevant lit venues and measure the specific liquidity contribution of individual markets to the aggregate liquidity in the fragmented market environment. Our empirical results show that single-market liquidity provider incentives in fragmented markets result in increased liquidity on the respective market, a higher contribution of that market to consolidated liquidity and gains in market share in terms of trading volume. However, we find no significant effect for turnover and liquidity of the fragmented market as a whole but a redistribution to the venue offering the incentives.

City Goes Dark: Dark Trading and Adverse Selection in Aggregate Markets

Gbenga Ibikunle (University of Edinburgh, ECMCRC)

Matteo Aquilina (Financial Conduct Authority, London)

Ivan Diaz-Rainey (University of Otago)

Yuxin Sun (Queens University Belfast)

We present the first evidence of the impact of dark trading on adverse selection in an aggregate market. At moderate levels of dark trading, a positive liquidity effect dominates an information acquisition disincentive effect, such that dark trading induces reductions in both adverse selection risk and pricing noise, while enhancing liquidity. However, there is a trading value-based threshold when dark trading starts to induce adverse selection. We estimate this threshold to vary between 9% for the most liquid FTSE350 index stocks to 35% for the least liquid stocks in the index. The overall FTSE 350 index average threshold is 16%.

Coming Early to the Party

Mario Bellia (Goethe University Frankfurt and Ca' Foscari University)

Loriana Pelizzon (Goethe University Frankfurt)

Marti G. Subrahmanyam (Stern School of Business, New York University)

Jun Uno (Waseda University)

Darya Yuferova (Norwegian School of Economics)

We examine the strategic behavior of High Frequency Traders (HFTs) during the pre-opening phase and the opening auction of the NYSE-Euronext Paris exchange. HFTs actively participate, and profitably extract information from the order flow. They also post “flash crash” orders, to gain time priority. They make profits on their last-second orders; however, so do others, suggesting that there is no speed advantage. HFTs lead price discovery, and neither harm nor improve liquidity. They “come early to the party”, and enjoy it (make profits); however, they also help others enjoy the party(improve market quality) and do not have privileges (their speed advantage is not crucial).

Once Upon a Broker Time? Order Preferencing and Market Quality

Hans Degryse (KU Leuven, IWH-Halle and CEPR)

Nikolaos Karagiannis (KU Leuven)

We develop a one-tick dynamic microstructure model to study how priority rules determine market quality and investor welfare. We compare order preferencing, modeled as price-broker-time priority (PBT), to price-time priority (PT). Priority rules impact investors' choice between limit and market orders. When the tick is tight, trading rates are higher with PBT whereas investor welfare is higher with PT. The opposite holds for a wide tick. PBT endogenously results when brokers individually choose between PT or PBT. Our model has testable implications regarding systematic patterns in order flow, market depth, trade composition, and market fragmentation.

A Model of Price Impact and Market Maker Latency

Jakub Rojcek (LGT Capital Partners)

Price impact measures the difference between the best quoted price and the realized price as a function of order size. This paper analyzes how price impact depends on the latency that a market maker is subject to. I propose a tractable model which allows incorporating both order size and latency effects as determinants of price impact. The model is solved analytically and is novel in the theoretical microstructure literature. Larger latency increases adverse selection costs to the market maker and reduces his probability of trading with a slow investor. A larger order size decreases the slow trader's outside option, making him susceptible to accept a worse price for his trade. It is shown that the first-order effect of increased latency and increased order size is to increase price impact. Their joint impact is also positive. When the probability of trading is taken into consideration, the utility of the slow institutional investor decreases with increasing latency.

Crowdfunding: Backers Rewarded

Ahmed Sewaid (Universitat Autònoma de Barcelona)

Miguel Garcia-Cestona (Universitat Autònoma de Barcelona)

Florina Silaghi (Universitat Autònoma de Barcelona)

Crowdfunding is becoming a significant source of funds for entrepreneurial startups. Recent literature has theoretically modelled the pre-ordering scheme under crowdfunding in the context where entrepreneurs price discriminate through charging crowdfunders a premium above that of retail consumers. However, more than 50% of total funds raised through Kickstarter, the leading reward-based crowdfunding platform, represent projects that offer a discount to early purchasers. We contribute to the literature by modelling pre-ordering using an advance purchase discount as a price discrimination device, while employing future retail price commitment. Moreover, we derive the entrepreneur's optimal choice between opting for crowdfunding and spot selling for two scenarios: unconstrained and financially constrained entrepreneur. In the latter the entrepreneur is essentially choosing between consumer vs investor financing. We further develop our analysis by discussing welfare and public policy implications.

It's Always Sunny in Finland: Investment and Extrapolation from Cash Flow Growth

Mikael Paaso (Aalto University)

This paper provides causal evidence that managers extrapolate from past growth when making corporate investment decisions. This can lead to overinvestment following good years as well as provide an alternative explanation for the observed correlation between investment and cash flows (investment-cash flow sensitivity). Using rainfall as an instrumental variable for cash flow shocks to firms which are weather sensitive, I find that companies increase investment 43% following a one-standard-deviation drop in summer rainfall, even though the drop is transitory. The excess investment appears to be driven by extrapolation from past cash flows while traditional explanations, such as loosening of credit constraints or agency problems, do not fully explain the result. High levels of investment are not optimal from the point of view of the firms, and the years following the cash flow shock feature an abnormally high number of companies closing down.

Capital Market Access and Cash Flow Allocation during the Financial Crisis

David Florysiak (University of Southern Denmark)

Vidhan Goyal (Hong Kong University of Science and Technology)

To understand how a stock market listing influences corporate policies if external financing is restricted, we examine how European public and counterfactual private firms jointly adjust their investment, financing, payout policies during the global financial crisis---when bank lending tightened. Our findings suggest that a stock market listing provides better access to external debt financing during the crisis as public firms, on average, net issue more long-term debt. Excess debt financing is, however, not allocated to investments but mostly to payouts to shareholders. Thus, a stock market listing relaxes financial constraints but induces managers to cater to shareholders during the crisis. Independent of a country's financial market structure (bank-based vs. market based) in our European firm sample, a stock market listing always provides a firm with more long-term debt during the crisis. In bank-based economies, this excess debt is mostly allocated to maintain investments while in market-based economies, inducing higher short-termist pressures, a stock-listing leads to lower investments and excess debt is used to maintain payouts.

Policy Uncertainty, Investment, and the Cost of Capital

Wolfgang Drobetz (University of Hamburg)

Sadok El Ghoul (University of Alberta)

Omrane Guedhami (University of South Carolina)

Malte Janzen (University of Hamburg)

We examine the effect of economic policy uncertainty on the relation between investment and the cost of capital. Using a novel news-based index developed by Baker, Bloom, and Davis (2016) for 18 countries, we find that the strength of the negative relation between investment and the cost of capital decreases in times of high economic policy uncertainty. For the subsample of U.S. firms, we find similar effects for CPI and tax-related policy uncertainty. Our results further suggest that an increase in policy uncertainty reduces the sensitivity of investment to the cost of capital the most for firms that are financially constrained and for industries that depend more strongly on government subsidies and government consumption. We conclude that economic policy uncertainty distorts the fundamental relation between investment and the cost of capital.

The Real Estate Collateral Channel in SME Finance: Evidence from Switzerland

Hannes Mettler (University of St.Gallen)

I examine to what extent small businesses owners use residential real estate as collateral for investments in their firm. The analysis is based on annual financial statements of small firms in Switzerland over the period 2002-2014. In a first step I compare credit growth and investments of firms in high versus low price growth regions and hereby compare firms who hold residential real estate collateral to those which do not. In a second step, I compare firm funding by owners (equity and shareholder liability) and firm investments of firms in high versus low price growth regions. I find evidence that firms that experienced a substantial increase in collateral value - either directly or indirectly through their owners - experience an increase in firm funding and business investments. The results show that these collateral channel effects predominantly stem from the period after the financial crisis of 2008.

Do Risk Disclosures Matter When It Counts? Evidence from the Swiss Franc Shock

Luzi Hail (University of Pennsylvania)

Maximilian Muhn (Humboldt University of Berlin)

David Oesch (University of Zurich)

We examine the long-term transparency effects of past risk disclosures following an exogenous shock to macroeconomic risk. In 2015 the Swiss National Bank (SNB) abruptly announced to discontinue the longstanding minimum euro-Swiss franc exchange rate. We show that firms with more transparent disclosures regarding their foreign exchange risk exposure ex ante exhibit significantly lower information asymmetry ex post. The gap in bid-ask spreads appears within 30 minutes of the SNB announcement and persists for three weeks. We confirm the informational role of past risk disclosures by surveying three groups of market participants: (1) Sell-side analysts emphasize existing disclosures to evaluate the translational and transactional effects of the currency shock. (2) For smaller unlisted firms, existing disclosures were the only resource available to lending banks' credit officers in the immediate aftermath of the shock. (3) Existing financial filings were a key information source for investor-relations managers when communicating with external stakeholders. In sum, the results imply that risk disclosures continue to attenuate information asymmetry and the costs of adverse selection well beyond their initial publication date.

PAPER ABSTRACTS: F3 MERGERS & ACQUISITIONS

Facilitating Takeovers and Takeover Premia: The Case of Coordinated Monitoring

Ettore Croci (Università Cattolica del Sacro Cuore)

Mieszko Mazur (ISEG School of Management)

Galla Salganik-Shoshan (University of the Negev)

This paper shows that coordinated monitoring by institutional investors affect how firms behave in the M&A market. We employ the spatial dimension of geographic links between major institutions as a proxy for interaction and information exchange – a process which determines the effectiveness of investor monitoring over firm management. Using US data over 25 years, we show that the gains for acquiring shareholders are significantly higher and M&A activity is significantly more intense, when institutions coordinate better their monitoring efforts. We also find that this effect is particularly prominent for firms with weakened shareholder rights and for those whose information environment is more opaque. Our results are robust to an array of controls, various econometric specifications, and alternative measurements of the main variables.

Superstar Financial Advisors: Do They Deliver Superior Value to Their Clients?

Johannes Kolb (University of Hohenheim)

Tereza Tykvova (University of Hohenheim)

We contribute to the empirical literature on the relationship between advisor characteristics and value creation in acquisitions. We investigate whether bidders realize more favorable stock market reaction and greater synergies at the acquisition announcement when they involve advisors that won an award and, if so, whether the outperformance endures in the long term. We find that winner clients tend to realize three percentage points higher CARs than other bidders and they also outperform in the long term. Winners are associated with greater synergies, but not with faster deals or a higher probability of deal completion. We show these results are unlikely to be driven by unobserved advisor heterogeneity, non-random matching between advisors and bidders, and outliers.

Do Financial Advisors Matter for M&A Pre-Announcement Returns?

André Betzer (University of Wuppertal)

Jasmin Gider (University of Bonn)

Peter Limbach (University of Cologne and Centre for Financial Research (CFR))

This study provides evidence that financial advisors matter for runups in targets' stock prices shortly prior to takeover announcements. For the period 1990-2014, we document significant fixed effects for bidders' financial advisors in the pre-announcement returns of U.S. takeover targets. For $CAR(-10,-1)$, the interquartile range of advisor fixed effects is 3.9%, compared with a full-sample average return of 4.8%. Differences across advisors are persistent over time. A difference-in-differences analysis suggests that advisors are associated with significantly lower target runups after their senior staff were defendants in SEC insider trading enforcement actions. Regarding observable advisor characteristics, we find that the number of past advised deals and advisors' location explain differences in target runups, while bank type or public status do not.

Foreign Acquisition and Credit Risk: Evidence from the U.S. CDS Market

Umit Yilmaz (Swiss Finance Institute and Università della Svizzera italiana)

This paper empirically analyses the effect of foreign block acquisitions on the U.S. target firms' credit risk as captured by their CDS. The involvement of foreign investors triggers a major increase, about 42 basis points, in the target firm's CDS. This effect is mostly pronounced for firms with majority control transactions, with acquirers from developed markets, and for diversifying deals. The findings are consistent with an asymmetric information hypothesis. Indeed, foreign block purchases are significantly associated with an increase in the target exposure to idiosyncratic stock volatility.

The Impact of Financial Fraud on Firm Survival

Iana Zborshchyk (University of Konstanz)

Axel Kind (University of Konstanz)

This paper examines the impact of financial fraud on firm survival. More specifically, we investigate how the involvement in financial fraud influences the probability of bankruptcy, delisting, and the likelihood of a takeover in a sample of 170 fraud firms and 170 control firms matched on the propensity scores in the year before the initiation of a fraud. Cox models with time-varying covariates indicate that the engagement in illegal accounting manipulation increases firm survival. Competing-risks regressions and survival analysis suggest that this puzzling finding is the result of lower takeover probabilities among the fraud firms in comparison to the control firms. At the same time, financial fraud significantly raises the risk of delisting and bankruptcy. The further analysis indicates that involvement in financial fraud affects a broad spectrum of firm characteristics and institutional ownership.

Natural Hedging with Fix and Floating Strike Guarantees

Antje Mahayni (University of Duisburg-Essen)

Oliver Lubos (University of Duisburg-Essen)

Katharina Stein (University of Duisburg-Essen)

The paper analyzes minimum return rate guarantees (MRRGs) including fixed guarantee rates prevailing for the whole contract horizon as well as floating guarantee rates which are linked to the interest rate evolution. In a complete arbitrage free market where the asset and bond price dynamics are given by Gaussian processes, we obtain closed form pricing solutions for both guarantee schemes. Differences in the guarantee costs are then explained by the difference of the arbitrage free values of the fix and floating rate guarantees and the difference between cumulated volatilities resulting from forward and simple volatilities. We then consider the perspective of the asset liability management, i.e. we analyze the sensitivities of the asset and liability side against changes in the interest rate. We show that a combination of fix price and floating strike guarantees enables a natural hedge against changes in the interest rate.

PAPER ABSTRACTS: G1 CORPORATE GOVERNANCE

Internalizing Governance Externalities: The Role of Institutional Cross-ownership

Jie (Jack) He (University of Georgia)

Jiekun Huang (University of Illinois at Urbana-Champaign)

Shan Zhao (Grenoble Ecole de Management)

We analyze the role of institutional cross-ownership in internalizing corporate governance externalities using data on mutual fund proxy voting. Exploiting the variation in cross-ownership across institutions within a proposal as well as the variation in cross-ownership across firms within a given institution's portfolio, we show that an institution's holdings in peer firms increase the likelihood that the institution votes against management in shareholder-sponsored governance proposals. This relation is stronger for firms whose managers are likely to have more outside opportunities. Consistent with a causal interpretation of our results, we find that increases in cross-ownership induced by financial institution mergers lead to a higher likelihood that the acquirer institution votes against management. We further show that high aggregate cross-ownership positively predicts management losing a vote. Overall, our evidence suggests that institutional cross-ownership improves governance by alleviating the inefficiency resulting from corporate governance externalities.

Does Protectionist Anti-Takeover Legislation Lead to Managerial Entrenchment?

Marc Frattaroli (Swiss Finance Institute and École Polytechnique Fédérale de Lausanne)

I study a protectionist anti-takeover law introduced in 2014 that covers a subset of all firms in the economy. The law had a negative impact on shareholder value and substantially reduced affected firms' likelihood of becoming a takeover target. There is no evidence that management of those firms subsequently altered firm policies in its interest. Investment, employment, wages, profitability, financial leverage and distributions to shareholders remain unchanged. The share of annual CEO compensation consisting of equity instruments increased by 9.4 percentage points, suggesting that boards reacted to the loss in monitoring by the takeover market by increasing the pay-for-performance sensitivity.

PAPER ABSTRACTS: G1 CORPORATE GOVERNANCE

The Effect of CEO Extraversion on Analyst Forecasts: Stereotypes and Similarity Bias

Jochen Becker (German Graduate School, Heilbronn)

Josip Medjedovic (German Graduate School, Heilbronn)

Christoph Merkle (Kühne Logistics University)

We conduct an experiment with 191 professional analysts to investigate their reliance on CEO personality information when producing financial forecasts. Drawing on social cognition research, we suggest analysts apply a stereotyping heuristic believing that extraverted CEOs are more successful. The results of a between-subjects experiment with CEO personality (high vs. low extraversion) as treatment variable confirms that analysts issue more favorable forecasts (annual earnings per share, long-term earnings growth, and target price) for firms led by extraverted CEOs. Increased forecast uncertainty leads to an even stronger reliance on stereotyping. Additionally, personality similarity between analysts and CEOs has a large effect on financial forecasts. Analysts issue more favorable forecasts for CEOs similar to themselves comparable in extent to the treatment effect.

How to Talk Down Your Stock Returns

Andreas Barth (Goethe University Frankfurt)

Sasan Mansouri (Goethe University Frankfurt)

Fabian Woebbecking (Goethe University Frankfurt)

Severin Zoergiebel (Goethe University Frankfurt)

We analyse how senior management's ability to convey financial information affects the financial performance of large corporates. More specifically, we assess the effect of management blathering on abnormal stock returns during earnings conference calls. Using a measure for management blathering on a data set of S&P 500 firms in the period from 2005 to 2016, we show that higher blathering decreases cumulative abnormal stock returns. This result is robust to controlling for management tone and earnings surprises. Hence, implying that a concise transmission of information is valued higher by stock investors than a lengthy sales pitch.

The Fire-Sale Channels of Universal Banks in the European Sovereign Debt Crisis

Giulio Bagattini (Frankfurt School of Finance & Management)

Falko Fecht (Frankfurt School of Finance & Management)

Patrick Weber (Deutsche Bundesbank)

We use a unique security-level data set to analyze whether German banks use their customer portfolios and affiliated mutual funds as an exit channel for risky sovereign bonds in the European sovereign debt crisis. Matching banks' proprietary holdings with the holdings of their funds and their retail customers for the period 2009-2016 at the security level, we find evidence that banks sold off risky Euro area sovereign bonds to both their retail customers and their affiliated mutual funds during the European sovereign debt crisis. For the mutual funds, the sell-offs were more pronounced to public funds compared to special funds dedicated to institutional investors. Overall, this enabled banks with affiliated mutual funds to sell off larger amounts of their risky sovereign bond holdings, while bank-affiliated mutual funds acquired more risky sovereign bonds compared to their unaffiliated peers.

Cutting Out the Middleman - The ECB as Corporate Bond Investor

Benjamin Grosse-Rueschkamp (ESMT European School of Management and Technology)

Sascha Steffen (Frankfurt School of Finance & Management)

Daniel Streitz (Copenhagen Business School)

We propose a novel mechanism how central bank interventions can affect the real economy: direct corporate bond purchases by central banks increase firms' demand for bonds relative to loans mitigating banks' regulatory or economic constraints. This in turn increases the effectiveness of the bank-lending channel. We test this conjecture in the context of the European Central Bank's Corporate Sector Purchase Programme (CSPP), launched in June 2016, which increases the supply and lowers the cost of capital for eligible, i.e., investment-grade rated, firms. These firms substitute bank term loans with bond debt. Banks with a high share of CSPP-eligible firms in their loan portfolio increase lending to private but not public firms after the announcement of the CSPP. The increase in lending is driven by previously weakly capitalized banks – with low Tier 1 ratio, high non-performing loans and banks from GIIPS countries. Private firms who receive new loans have above median return on assets and interest coverage ratios and increase capital expenditures and sales growth following the CSPP announcement.

Moral Suasion in Regional Government Bond Markets

Jana Ohls (Deutsche Bundesbank)

In the context of the German regional government bond market, this paper studies the hypothesis that governments use moral suasion to persuade home government-owned banks to hold more home government debt. The empirical approach makes use of German banks' ownership structure, heterogeneity in the states' fiscal strength and detailed bank-level panel data on German banks' state bond portfolio on the security- and bank-level for the time period Q4:2005-Q2:2014. Results show that home state-owned banks hold a significantly higher amount of home state bonds than other home banks when fiscal fundamentals of the home state are weak. Banks located in other German states hold fewer state bonds in these situations. These findings are in line with moral suasion by state governments and are robust against controlling for observed and unobserved alternative incentives for banks' (home) state bond holdings such as risk-shifting by banks, lending opportunities or information asymmetries.

The Effects of Leverage Ratio Adjustment on Banks' Balance Sheet and Risk: Impact of the Risk Measurement Approach

Christoph Maidl (University of Münster)

Corinna Woyand (University of Münster)

This paper analyzes the effects of introducing a leverage ratio requirement, as proposed by the Basel III framework, on banks' balance sheets and risks. The unweighted leverage restriction aims to backstop existing risk-weighted capital requirements that are subject to regulatory arbitrage. We empirically examine the interaction between risk-based and non risk-based constraints and find an adverse impact of the leverage ratio dependent on the risk measurement approach applied. We show that (i) banks exhibit an internal target leverage ratio that increased on average after the announcement, (ii) banks adjust balance sheet positions in order to approach towards those targets and simultaneously raise risk-weighted assets when reducing leverage, (iii) the adjustment process differs significantly between banks applying the internal ratings-based approach and banks using the standardized approach. The need to increase capital seems to be more pronounced for standardized approach banks being more strongly restricted by the risk-based capital ratio. While the stronger capital increase lead those banks to become more stable, the effect is less clear for banks using internal models.

Banks' Geographic Diversification and Loan Supply: Evidence from the Syndicated Loan Market

Sebastian Doerr (University of Zurich)

Philipp Schaz (Humboldt University of Berlin)

This paper provides first cross-country evidence on loan supply by geographically diversified banks during banking crises. We use data on worldwide syndicated lending to classify banks according to the geographic diversification of their international loan portfolio. Our results show that diversification leads to higher loan supply during banking crises in borrower countries. The positive loan supply effects translate into higher investment and employment growth for firms. Diversified banks are stabilizing due to their ability to raise additional funding during times of distress, which also shields connected markets from spillovers. Further distinguishing banks by nationality reveals a pecking order: diversified domestic banks are the most stable source of funding, while foreign banks with little diversification are the most fickle. Our findings suggest that the decline in financial integration since the recent crisis increases countries' vulnerability to local shocks.

Taxing Bank Leverage: The Effects on Bank Capital Structure, Credit Supply and Risk-Taking

Claire Célérier (Rotman School of Management)

Thomas Kick (Deutsche Bundesbank)

Steven Ongena (University of Zurich)

We investigate whether taxation can be used to contain bank leverage, while leaving the supply of credit unaffected. We exploit the staggered introduction between 1996 and 2012 across Europe of tax reforms that increase the fiscal cost of leverage. Employing both bank- and loan-level data, we estimate the impact of the reforms on the leverage of banks and their supply of credit. We find that tax reforms that increase the cost of leverage lead banks to rely more on equity, to shift the composition of their assets towards loans, and to expand their lending to firms without incurring more risk.

Does Excess Cash Affect Bank Behavior?

Elena Beccalli (Università Cattolica del Sacro Cuore)

Laura Chiaramonte (Università Cattolica del Sacro Cuore)

Ettore Croci (Università Cattolica del Sacro Cuore)

In light of the regulatory changes and the increase in cash reserves after the crisis of 2007-08, we examine how excess cash affects the behavior of US banks between 2002 and 2014. Investigating several bank business policies, we show that excess cash does not exacerbate agency problems, inducing banks to take more risks. We find evidence that banks hoard cash mostly for precautionary motives. The listing status of the bank holding companies affects its liquidity risk management. While the effect of excess cash on bank policy decisions is similar, the two groups create cash buffers in response to different risks.

Do Firms Benefit from Their Relationships with Credit Unions during Dire Times?

Leila Aghabarari (World Bank Group)

Andre Guettler (Ulm University)

Mahvish Naeem (Ulm University)

Bernardus Van Doornik (Central Bank of Brazil)

Credit unions (CUs) are unique financial intermediaries because of their membership-based governance structure. We exploit the financial crisis of 2008/09 as a negative shock to Brazilian banks and analyze the variation in the lending behavior of CUs versus non-CUs and the subsequent effects on the commercial clients' labor force. We find evidence that during the financial crisis, CUs tightened access to credit to their members to a lesser extent (insurance effect) than did other bank types. Moreover, compared to non-CUs during the crisis, CUs provided credit with longer maturities and required less collateral, albeit at higher interest rates. Notwithstanding, CUs did not display higher risk on their credit portfolios in comparison to other banks in the crisis period. However, CUs faced relatively higher future default frequencies. Notably, the labor market impact of the insurance effect of CUs is positive for very small firms in the form of an increase in employment and wages in the crisis period.

To Ask or Not to Ask? Collateral versus Screening in Lending Relationships

Hans Degryse (KU Leuven and CEPR)

Artashes Karapetyan (BI Norwegian Business School)

Sudipto Karmakar (Bank of Portugal and UECE)

Using a comprehensive loan-level dataset, we study the impact of bank-firm relationships on collateral requirements both at the beginning of the relationship and over time. First, we document that when a borrower is loyal and has a long relationship potential, the bank is more likely to offer unsecured credit at the beginning of the relationship, complementing existing evidence that collateral requirements decline over the course of the relationship. Second, we study the impact of the EBA capital exercise, a quasi-natural shock that required increased capital requirements for a number of banking groups in the European Union. This experiment *ceteris paribus* makes secured lending cheaper vis-a-vis unsecured lending for the affected banks, since secured loans require less regulatory capital. We find that relative to the control group, the affected banks engaged in more collateralized lending, but less so both for borrowers with long relationship potential at the beginning of relationship, and for relationship borrowers over the course of their relationship. The results suggest that relationship banks are important for alleviating credit access, especially for young, collateral-constraint businesses, and during times of economic distress.

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Professor Markus Schmid
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Unterer Graben 21, 9000 St.Gallen, Switzerland
fmpm@unisg.ch – www.fmpm.ch

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**E-Mail: sgf-conference@fmpm.ch
Web: www.fmpm.ch**

**Schweizerische Gesellschaft für Finanzmarktforschung
(Swiss Society for Financial Market Research)
CH-8000 Zurich
c/o University of St.Gallen**

**Swiss Institute of Banking and Finance
Unterer Graben 21
CH-9000 St.Gallen
Switzerland**