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CONFERENCE SUMMARIES**

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**Brad Barber, UC Davis**

*Do (Some) University Endowments Earn Alpha?*

We analyze the returns earned by US educational endowments using style attribution models. For the average endowment, models with only public stock and bond benchmarks explain virtually all of the time-series variation in returns, yield no alpha, and generate sensible factor loadings. Elite institutions perform well relative to public stock and bond benchmarks because of large allocations to alternative investments. We find no evidence that manager selection, market timing, and tactical asset allocation generate alpha.

**Jason Hsu and Vitali Kalesnik,  
Research Affiliates, LLC**

*What Drives the Value Premium? Risk versus Mispricing: Evidence from International Markets*

Value stocks outperform growth stocks. The academic literature provides two competing interpretations on what drives the value premium: exposure to risk factors or mispricing of securities. Existing empirical studies, which are largely

based on U.S. data, have not conclusively rejected one theory in support of the other. Up to this point, large scale studies based on multiple countries have not been conducted. Past studies also employ data which end before 2000 and do not cover the tech bubble, the housing bubble, the global financial crisis and the European debt crisis, when the relative performance of value stocks was extremely volatile. Applying Fama and MacBeth (1973) two-stage cross-sectional regression and Daniel and Titman (1997) double-sorted portfolio methods to 30 years of cross sectional data from 23 developed countries, we find evidence that the value premium is driven by mispricing.

**Ronen Israel, AQR Capital Management, LLC**  
*The Case for Style Investing*

In this paper, we focus on a classic set of strategies, which we call “styles.” Style investing delivers long-term positive returns with little correlation to traditional asset classes. Further, styles can be captured in an intuitive and cost effective manner using liquid securities that allow for more scalability. In essence, investing can be made

much simpler and more effective by focusing on the core foundations of returns building blocks we call styles.

**Mark Kritzman, Windham Capital Management, LLC**

*Risk Disparity*

Policy portfolios are a fixture of institutional investment management, but they may not serve the purposes for which they are intended. A policy portfolio serves primarily as an expression of an investor's return and risk preferences. Secondarily, it serves as a benchmark for determining the success or failure of active management. A clearly defined and easily replicable policy portfolio may indeed provide a useful gauge for judging active management, but it is a poor reflection of investor preferences. Peter Bernstein [2003 and 2007] raised this issue philosophically, arguing that a policy portfolio's risk profile was inconstant and that it changed more radically and frequently than the typical investor's risk preferences. He went on to propose that investors manage their portfolios opportunistically rather than rigidly, but he did not provide specific guidance. This article offers empirical evidence of the inter-temporal disparity of a policy portfolio's risk profile, and it proposes a simple framework for addressing this deficiency.

**Terry Marsh, Quantal International Inc.**

*Stress Testing the CCAR Way*

A key function of financial institutions banks, insurance companies, buy-side investment managers and the "shadow financial system," which here we simply lump together as "banks" is risk management i.e., assessing, pricing, transforming, distributing and hedging risk. For example, banks need to assess the default risk on borrower loans and set a yield premium to cover that risk. While default risk at an individual-obligor level depends on both prevailing economic conditions

and the specifics of each obligor's ability to generate cash flow, default risk at a bank portfolio level reflects (mostly) just the prevailing economic conditions as each obligor's idiosyncratic risk is diversified away. Given that a primary focus of a bank's risk management is managing its financial portfolio, it would be natural for a bank's management to be interested in understanding how the bank's risks increase in the event of macro-economic stress; for financial institutions judged "too big to fail," the regulators are more interested than ever. As a consequence, regulators in major global financial markets now require some kind of capital adequacy assessment. That is, an assessment that evaluates whether a bank's capital supply is sufficient to cover its capital demand in times of stress. In the UK this assessment program is called an internal capital adequacy assessment process (ICAAP) and in the U.S. it is called a comprehensive capital analysis and review (CCAR). In this note, we discuss some of the issues involved in the process of stress-testing bank capital adequacy, particularly in the context of U.S. CCAR requirements.

**Yu (Ben) Meng, California Public Employees' Retirement System (CalPERS)**

*Volatility and Beyond: An Introduction to Liquidity-at-Risk (LaR)*

Conventional asset allocation utilizes the mean-variance-optimization framework where the only undesired investment attribute is the asset return volatility. However, for long term investors the short-term market-to-market volatility is less relevant. Instead, there are many other considerations when we construct the portfolio. These additional risk considerations include liquidity risk and funding risk (in the form of funded status, the level and volatility of contribution rate). This study focuses on liquidity risk and attempts to identify the potential needs and sources of liquidity in the fund. Mapping out this supply and

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demand profile of liquidity will help us better manage the liquidity of the fund.

**Richard Michaud and David Esch,**  
**New Frontier Advisors, LLC**

*Deconstructing Black-Litterman: How to Get the Portfolio You Already Knew You Wanted*

We show that Black-Litterman optimization is the result of a fallacious and critically flawed application of Theil-Goldberger (1961) mixed estimation. The so-called “tau adjustment” is a violation of Bayesian statistical principles. The ubiquitous “reverse return” estimate of expected return has no investment value by definition. The formula has essentially no connection to any economic reality, is inconsistent with basic principles of investment management, and blind to the consequences of estimation error in asset management. The procedure used by 1000s if not tens of 1000s of investment managers with 100s of billions if

not trillions of dollars worldwide under management and taught by academics and professional investors for the last twenty years is demonstrated to be vacuous and not recommendable.

**Rodney N. Sullivan, CFA Institute**

*Investing in the Asset Growth Anomaly Across the Globe*

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