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FALL JOIM CONFERENCE SERIES
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CONFERENCE SUMMARIES

The Fall, 2012 JOIM Conference was co-sponsored by the Kellogg School of Management, Northwestern University. A distinguished group of presenters and discussants addressed topics of special interest to plan sponsors, foundations, endowments and sovereign wealth funds.

Clifford Asness, AQR Capital Management, LLC, ***Speaker***
"*The Devil in HML's Details*"
Discussant: Ronald N. Kahn,
BlackRock, Inc.

We propose two simple alternatives to standard book to price (B/P) that use more timely price data while retaining the necessary lag for measuring book. We construct portfolios based on the different measures for a US sample (1950–2011) and an International sample (1983–2011). Value portfolios based on the most timely measures earn statistically significant alphas ranging between 305 and 378 basis point per year against a 5-factor model itself, which contains the standard measure of value, as well as market, size, momentum and a short term reversal factor.

Ravi Jagannathan, Kellogg School of Management, Northwestern University, ***Speaker***
"Tail Risk in Momentum Strategy Returns"
Discussant: Bob Litterman,
Kepos Capital, LP

Momentum strategies have historically generated high positive returns but also experienced infrequent but severe losses. We demonstrate that a hidden Markov model, in which the market moves between turbulent and calm states in a stochastic manner, captures these high-loss episodes. The turbulent state is infrequent in our sample: the probability that the hidden state is turbulent is greater than one-half in only 20% of the months in our sample. Yet in each of the 13 severe loss months, the ex-ante probability that the hidden state is turbulent exceeds 70 percent. This strong forecastability accentuates the price momentum puzzle.

Kent Daniel, Columbia University, ***Speaker***
"Behavioral Finance: A Selective Survey for Owners of Money"
Discussant: Tony Elavia, Mackenzie Investments Corp.

Behavior biases suggest explanations for the financial market behavior. While aggregating results from the anomalies literature, from the experimental psychology and neuroeconomics literature, and models from financial economics, I link return patterns to models based on the behavioral biases. Understanding how behavioral biases make their way into market prices can help generate new investment strategies.

David A. Hsieh, Duke University/**William N. Goetzmann,** Yale School of Management, ***Speaker***
"*Exploring Uncharted Territories of the Hedge Fund Industry: Empirical Characteristics of Mega Hedge Fund Firms*"
Discussant: William N. Goetzmann, Yale School of Management

We investigate mega hedge fund management companies that manage over 50% of the industry's assets, incorporating previously unavailable data from companies that do not report to commercial databases compared to those that do. We show that the largest divergences between the performance reporting and non-reporting can be traced to differential exposure to credit markets. Thus, the performance of the hard-to-observe mega firms can be inferred from the observable data. This conclusion is robust to the delisting bias and the presence of serially correlated returns.

Bhaskaran Swaminathan, LSV Asset Management, ***Speaker***
"***Predicting Stock Returns Using the Implied Cost of Capital"***
Discussant: Ramu Thiagarajan, Alliance Bernstein, LP

This paper estimates expected stock returns using the dividend discount model. In efficient markets, stock prices are the sum of expected, discounted dividend payments. The discount rate used to discount these cash flows is the expected return on the stock or the "implied cost of capital." This paper uses analyst forecasts of earnings to construct expected dividend payments, and then uses realized prices to back out expected equity returns using the dividend discount model. The methodology is attractive because it does not assume a specific model such as the CAPM to determine expected returns, though it does require accurate forecasting of dividend payments. The author's measure of expected returns has substantial forecasting power for realized equity market returns for horizons ranging from one month to several years and outperforms other commonly used predictors of stock returns.

Sergio Rebelo, Kellogg School of Management, Northwestern University, ***Speaker***
"*Carry Trade and Momentum in Currency Markets*"
Discussant: Ludger Hentschel, MSCI

This paper studies two easily implementable strategies in currency markets: the carry trade and momentum. The carry trade borrows in low interest rate currencies and lends in high interest rate currencies. The momentum trade goes long currencies which earned previously high returns (past winners) over the last month and goes short currencies which earned low returns over the past month (past losers). The authors form portfolios based on these two strategies in currency markets. The authors find that both strategies earn large Sharpe ratios and have high returns that are not explained by standard risk factors or risk-based explanations such as peso events.

However, these strategies are also largely uncorrelated with each other, and uncorrelated with the aggregate stock market, meaning there are large diversification benefits to combining the carry and momentum currency strategies both with each other and with stocks. The authors attribute these results to price pressure. Taking advantage of these seemingly good opportunities requires a large amount of trading. The resulting price pressure can potentially eliminate the marginal profits to these strategies.

Robert McDonald, Kellogg School of Management, Northwestern University, ***Speaker***
"***Ratings and Asset Allocation: An Experimental Analysis"***
Discussant: Roger Stein, Moody's Corporation

Ratings are common in financial markets and have the potential to be either helpful or harmful. We experimentally assess the effect of ratings in a setting where subjects repeatedly make investment decisions and have full information about the characteristics of the investments. Ratings supply no additional information. We find that ratings affect investment decisions, but that the effect largely vanishes when ratings no longer appear. Subjects scoring higher on a test of financial knowledge are less influenced by ratings and less prone to naively diversify, behavior which is harmful in our setting. Our conclusion is that ratings can affect decisions, and that they have less of an effect on more sophisticated subjects.

Jules van Binsbergen, Stanford University, ***Speaker***
"***Equity Yields***"
Discussant: Torben Andersen, Kellogg School of Management, Northwestern University

Stocks are claims to long lived assets that pay a stream of future dividend payments. This paper studies the pricing of the individual payments by studying the prices of dividend futures which are claims to the individual dividend payments at horizons up to ten years. The paper uses these asset prices to construct "equity yields," which are analogous to bond yields. The authors decompose the term structure of equity yields into expected dividend growth and risk premia, and hence decompose the equity risk premium by maturity. The risk premia for short maturity equity is surprisingly large and volatile, and is substantially larger than typical asset pricing models would imply. The slope of the term structure of expected dividend growth is found to be counter-cyclical while the slope of the term structure of risk premia is pro-cyclical.