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PRACTITIONER'S DIGEST

The "Practitioner's Digest" emphasizes the practical significance of manuscripts featured in the "Insights" and "Articles" sections of the journal. Readers who are interested in extracting the practical value of an article, or who are simply looking for a summary, may look to this section.

COMPLETE AND INCOMPLETE FINTECH PLATFORMS PAGE 4

Vasant Dhar and Roger M. Stein

The "FinTech" arena is a hotbed of activity in banking and finance with many market participants focusing on specialized parts of the financial landscape. Like other areas of commerce, Finance is seeing the emergence of FinTech "platforms" that serve specific needs—traditionally performed inside large, complex financial institutions—ranging from payments, lending and investing to advice and compliance.

In "FinTech Platforms and Strategy," Dhar and Stein examine the potential trajectories and impacts of Fintech innovation on incumbent and new business models in the finance industry. The authors provide both a framework for understanding the value created through various types of platforms in financial services, and an explanation of the possible strategies that innovators, incumbents, and the currently dominant Internet players can pursue to manage or exploit the resulting disruption.

The authors' framework describes the essential components of successful digital platforms: openness of access, functionality embedded in an IT system, and domain-specific business processes. They call the degree to which a platform offers one or more of this these components, it's "completeness," and argue that this key to adding and sustaining value for clients. In other industries, "complete" platform have proven very difficult to displace. The authors also highlight reasons why the financial services industry has additional hurdles for new-entrants, or, conversely, where incumbents may enjoy advantages. This leads the authors naturally to consider what types of partnerships and joint ventures may make sense in FinTech.

An intriguing question that arises from this framework is whether the dominant platforms of the day offered by the Internet giants such as Google and Amazon will be more prevalent in consumers' financial lives than traditional banks. Why not buy everything through them if regulators allow it?

COMMON FACTORS IN CORPORATE BOND RETURNS — PAGE 17

Ronen Israel, Diogo Palhares and Scott Richardson

A disciplined, systematic approach to over/underweight securities based on well-known factors such as value, momentum, carry and defensive (sometimes called "quality") can offer alternative sources of outperformance not only within equities but also within fixed income markets. We find that characteristics have positive risk-adjusted expected returns in corporate bond markets. These returns are not subsumed by traditional market premia or respective equity anomalies. The returns are economically significant and are not explained by macroeconomic exposures. A systematic investing approach to corporate credit has the potential to be a powerful diversifier for an investor's portfolio.

To date little academic research has examined cross-sectional drivers of returns within credit markets, primarily due to lack of 'good' data and a natural skepticism of something 'new'. Our analysis suggests the possibility of a novel approach to harvest active returns within credit markets. As (i) data quality improves, (ii) more market participants and academics gain access to good data, (iii) market conventions evolve to embrace electronic trading, and (iv) there is a greater awareness of the possibility of systematic investment approaches within fixed income, we see a great potential for a disciplined, systematic approach based on well-known factors.

The finding that well known factors are applicable outside of equities, where much of the original research occurred, not only leads to profitable opportunities in other asset classes (including fixed income), but also greatly enhances our belief that these factor's efficacy is the result of real forces and not random data mining. That factors work in fixed income is both a potential boon to fixed income investors and a wonderful "out-of-sample" test of the original equity-centric results.

EVALUATION AND RANKING OF MARKET FORECASTERS — PAGE 47

David H. Bailey, Jonathan M. Borwein, Amir Salehipour and Marcos López de Prado

Market forecasts are widely read in the investment community. Many investors rely on market experts and forecasters when making investment decisions, such as when to buy or sell securities. Some of these forecasts turn out to be uncannily accurate, while others lead to significant losses. Ranking and grading market forecasters provides investors with metrics on which they may choose forecasters with the best record of accuracy for their particular market exposure.

We develop a novel ranking methodology, which analyzes and ranks the market forecasters by including the time frame and specificity of the forecasts. Across a dataset including 6,627 forecasts made by 68 forecasters, we observe that only about 6% of forecasters have their accuracy values between 70% and 79%, whereas two-thirds of forecasters have an accuracy level below 50%. In total, the accuracy is around 48%. Our analyses revealed that the majority of forecasters perform at levels not significantly different than chance, which makes it very difficult to tell if there is any skill present.

THE DIRTY DOZEN OF VALUATION RATIOS: IS ONE BETTER THAN ANOTHER? **PAGE 65**

Eero Pätäri, Ville Karell, Pasi Luukka and Julian Scott Yeomans

This paper contributes to the current literature on value anomalies in several ways: For a comprehensive sample data of U.S. stocks over a 42-year period, we test and compare the discriminatory power of portfolio-formation criteria formed on a larger number of individual valuation ratios than in any of the earlier studies. Our analysis includes 12 different individual valuation ratios, of which four are enterprise value (EV) multiples. To the best of our knowledge, one of these four (i.e., *sales*-to-*enterprise value* (S/EV)) has not been examined before in this context, and the other three only very seldom, although the results of few such studies have been encouraging, and despite the fact that these EV multiples are commonly used by portfolio practitioners.

Our results show that there are remarkable differences in the characteristics between the valuation ratios. We find evidence of strong relative efficacy of three EV multiples (EBIT/EV, EBITDA/EV, and S/EV) in comparison with the most frequently used price-based multiples, such as B/P and E/P, indicating that these EV multiples used commonly by corporate acquirers are also useful for value investors. In particular, the evidence for the unique characteristics of S/EV contributes to the existing literature. We show further that value portfolios formed on different criteria have remarkably different exposures to style factors, such as size (SMB), value (HML), momentum (WML) and volatility (SMV) factors. As a practical implication of this study, investors could take these different style exposures into account when choosing the value criteria that fit best to their portfolio-selection purposes.

Although the potential benefits of combining individual valuation ratios have been foreseen in several recent academic papers, the topic has not so far been examined extensively. Therefore, we calculate the decile portfolio performance for all feasible 2-, 3-, and 4-combinations created from 12 valuation ratios to find out whether the performance of value portfolios, or the value premium stemming from combining value indicators, can be enhanced from those generated by the best single selection criteria. Interestingly, the inclusion of D/P in the best combinations shifts the aggregate SMB exposure of the constituent stocks towards larger-cap stocks to the extent that the negative SMB exposure for such combinations is even stronger (and more significant) than it is for the top-decile D/P portfolio. The top-decile D/P portfolio has also defensive characteristics, as its volatility is lower than that of any other decile portfolio being compared. It also generates the smallest losses during the bearish months within the same peer-group.