Investment Management Research

CONFERENCE

Thursday & Friday, 28&29 September 2017 | University of Technology Sydney

THURSDAY 28 SEPTEMBER 2017

8.30am

Welcome – Professor Glen Wightwick, PhD., Deputy Vice-Chancellor & President (Research), University of Technology Sydney

8.40am

- **Practical pricing** – Professor Michael Brennan, PhD., UCLA Anderson School of Management **Corporate**
- **Corporate Governance and Share Market Transparency** – Professor Philip Brown, PhD., University of Western Australia
- **Sensation Seeking, Sports Cars, and Hedge Funds** – Professor Stephen Brown, PhD., Monash University

10.40am

Break

11.00am

- **Panel: The Contributions by Empirical Finance Research: Past Successes and Future Challenges**
  Chair: Jack Gray, PhD., University of Technology Sydney (Chair);
  Panel: Henk Berkman, PhD., University of Auckland; Professor Michael Brennan, PhD., UCLA Anderson School of Management; Professor Philip Brown, PhD., University of Western Australia; Professor Stephen Brown, PhD., Monash University; Professor Robert Faff, PhD., University of Qld; Professor Talis Putnin, PhD., University of Technology Sydney

12.00pm

- **CEO Overconfidence and Corporate Debt Maturity** – Professor Robert Faff, PhD., University of Qld
- **News, Noise, and Private Information: What moves stock prices?** – Professor Talis Putnins, PhD., University of Technology Sydney

1.10pm

Lunch

1.45pm

- **Analyst Recommendations and International Stock Market Returns** – Henk Berkman, PhD., University of Auckland
- **When Gambling for Resurrection is Too Risky (A Paper on the Investment Behaviour of Insurance Companies)** – Divya Kirti, PhD., International Monetary Fund
- **Asset Market Responses To Conventional And Unconventional Monetary Policy Shocks In The US** – Leo Krippner, PhD., Reserve Bank of New Zealand

3.30pm

Break

3.50pm

- **Bank Stress Testing** – James Vickery, PhD., Federal Reserve Bank of New York
- **A Network Analysis of the Australian Interbank Market During the Global Financial Crisis** – Anthony Brassil, PhD., Reserve Bank of Australia

5.00pm

Close

Investment Management Research CONFERENCE

Thursday & Friday, 28&29 September 2017 | University of Technology Sydney

FRIDAY 29 SEPTEMBER 2017

8.45am

- **Welcome** – Professor Ron Bird, University of Technology Sydney

8.55am

- **Roundtable 1: Fool's Paradise Has Ended. The Historic Aberration In Balanced Fund Returns Is Over** – Brett Gillespie, Ellerston Capital;
- **Roundtable 2: High GDP Growth IS Not A Good Reason For A Permanent Allocation to Emerging Market Equities** – Graeme Shaw, PhD., Orbis Investments

10.45am

Break

11.05am

- **Roundtable 3: In The Interests Of Their Financial Health, Retail Investors Should Eschew Trading VIX ETPs** – Simon Ho, Triple3 Partners

12.00pm

Lunch

12.50pm

- **Do Hedge Funds Add Value?** – John Crosby, PhD., University of Technology Sydney
- **The Impact of Corporate Governance Guidelines on Sustainability Reporting** – Robert Czernkowski, PhD., University of Technology Sydney
- **The Impact of Benchmarks on Portfolio Composition and Performance** – Danny Yeung, PhD., University of Technology Sydney

2.35pm

Break

3.05pm

- **Uncertainty, Reputation and Analyst Coverage** – Marco Navone, PhD., University of Technology Sydney
- **Ambiguous Market Making** – Nihad Aliyev, University of Technology Sydney
- **Experiences of Current and Formers Members of Self-Managed Superannuation Funds** – Professor Ron Bird, University of Technology Sydney

5.00pm

Close

UTS UNIVERSITY OF TECHNOLOGY SYDNEY

Portfolio Construction Forum

ABSTRACTS

Practical Pricing

– Professor Michael Brennan, PhD., UCLA Anderson School of Management

Asset pricing models play an important role in estimating the cost of capital and so the value of investments. The CAPM works reasonable well in the US over short time horizons. In many other countries the case for using the CAPM is less compelling which suggests that we discard it and apply a more empirical approach.

Corporate Governance and Share Market Transparency

– Professor Philip Brown, PhD., University of Western Australia

A great deal of effort has been expended—by lawmakers, market providers and regulators, by members of the business community, and by international organizations such as IOSCO, the OECD and the World Bank—to establish sound principles of corporate governance that countries should adopt and companies should follow. One aim has been to improve the transparency of publicly-traded companies to those who finance them. First, I will consider the meaning of the term 'corporate governance' and explain why it is important we have a clear understanding of it. I will then discuss how a company's transparency in the eyes of its shareholders is affected, in principle, by its governance and disclosure policies, and how transparency can be measured. I will then report on what research has uncovered on the association between a company's corporate governance and the extent to which it is transparent to its shareholders.

Sensation Seeking, Sports Cars, and Hedge Funds

– Professor Stephen Brown, PhD., Monash University

Do hedge fund managers take risk to enhance returns or for non-pecuniary reasons? We argue that sensation seeking, a salient example of the latter, is captured by the attributes of the vehicles they purchase. In line with that view, managers who own powerful sports cars take on more investment risk but do not deliver higher returns, resulting in lower Sharpe ratios. Moreover, funds managed by performance car owners exhibit higher operational risk and are more likely to fail. Performance car owners demonstrate other attributes associated with sensation seeking, such as a preference for lottery-like stocks, unconventional strategies, and active trading.

Panel: The Contributions by Empirical Finance Research: Past Successes and Future Challenges

Chair: Jack Gray, PhD., University of Technology Sydney (Chair);
Panel: Henk Berkman, PhD., University of Auckland; Professor Michael Brennan, PhD., UCLA Anderson School of Management; Professor Philip Brown, PhD., University of Western Australia; Professor Stephen Brown, PhD., Monash University; Professor Robert Faff, PhD., University of Qld; Professor Talis Putnin, PhD., University of Technology Sydney

CEO Overconfidence and Corporate Debt Maturity

– Professor Robert Faff, PhD., University of Qld

A great deal of effort has been expended—by lawmakers, market providers and regulators, by members of the business community, and by international organizations such as IOSCO, the OECD and the World Bank—to establish sound principles of corporate governance that countries should adopt and companies

should follow. One aim has been to improve the transparency of publicly-traded companies to those who finance them. First, I will consider the meaning of the term 'corporate governance' and explain why it is important we have a clear understanding of it. I will then discuss how a company's transparency in the eyes of its shareholders is affected, in principle, by its governance and disclosure policies, and how transparency can be measured. I will then report on what research has uncovered on the association between a company's corporate governance and the extent to which it is transparent to its shareholders.

News, Noise, and Private Information: What moves stock prices?

– Professor Talis Putnins, PhD., University of Technology Sydney

The issue of what drives stock price movements is arguably one of the most fundamental questions in finance, with implications for understanding risk, informational efficiency, and asset pricing. To shed new light on this issue, we develop a return variance decomposition that disentangle four components of returns: market-wide information, private firm-specific information revealed through trading, firm-specific information revealed through public sources, and noise (pricing errors driven by illiquidity, price pressures, and other frictions). We find that both information and noise are significant drivers of firm-specific returns. Since the mid-1990s, there has been a dramatic decline in the noise component, consistent with market efficiency increasing. Our results help reconcile the mixed results in the R^2 literature and provide deeper insights into the roles of cash flow / discount rate information in price discovery.

Analyst Recommendations and International Stock Market Returns

– Henk Berkman, PhD., University of Auckland

This study shows that analyst recommendations aggregated at the country-level predict international stock market returns. A trading strategy based on country-level recommendations yields an abnormal return of around 1% per month. Aggregate analyst recommendations also help to predict changes in gross domestic product, but there is no evidence that country-level recommendations predict changes in discount rates. Overall, our evidence indicates that analyst recommendations aggregated at the country-level provide useful information to predict future aggregate cash flows and associated market returns across different countries.

When Gambling for Resurrection is Too Risky (A Paper on the Investment Behaviour of Insurance Companies)

– Divya Kirti, PhD., International Monetary Fund

Rather than taking on more risk, US insurers hit hard by the crisis pulled back from risk taking, relative to insurers not hit as hard by the crisis. Capital requirements alone do not explain this risk reduction: insurers hit hard reduced risk within assets with identical regulatory treatment. State level US insurance regulation makes it unlikely this risk reduction was driven by moral suasion. Other financial institutions also reduce risk after large shocks: the same approach applied to banks yields similar results. My results suggest that, at least in some circumstances, franchise value can dominate, making gambling for resurrection too risky.

Asset Market Responses To Conventional And Unconventional Monetary Policy Shocks In The US

– Leo Krippner, PhD., Reserve Bank of New Zealand

We quantify the responses of United States asset markets to domestic monetary policy shocks over conventional and unconventional monetary policy environments, and also gauge the potential usefulness of shadow short rates as a metric across those periods. Our results show that asset market responses to policy shocks have been larger since short-maturity nominal interest rates reached the zero lower bound. While short-maturity interest rates no longer provide a useful metric in that environment, appropriately robust shadow short rates are useful over both environments. The increased responses of asset markets in the

unconventional period seem due to larger policy shocks rather than a change to their transmission.

Bank Stress Testing

– James Vickery, PhD., Federal Reserve Bank of New York

Stress testing has become an important financial stability tool, and is used by banking regulators around the world. This presentation provides an overview of how supervisory stress testing is conducted in the United States by the Federal Reserve, and presents results from the 2017 Dodd-Frank-Act stress tests. It also highlights results from the growing academic literature on stress testing.

A Network Analysis of the Australian Interbank Market During the Global Financial Crisis

– Anthony Brassil, PhD., Reserve Bank of Australia

We use the core/periphery network model to analyse the Australian overnight interbank market, focusing on the 2007-08 financial crisis. Our results suggest that the crisis had a large and long-lasting impact on this market. In particular, we find that the typical core size fell from eight to five banks during the crisis, owing to large reductions in the lending/borrowing relationships of some non-major banks. The crisis also led to a substantial reduction in the core's exposure to the periphery, and an increase in the periphery's lending to the core (consistent with models of precautionary liquidity demand).

Roundtable 1: Fool's Paradise Has Ended. The Historic Aberration In Balanced Fund Returns Is Over

– Brett Gillespie, Ellerston Capital

The last 10 years has seen unprecedented accommodation from central banks globally. The result has been bubble conditions in bonds and arguably stocks, along with flipping the correlation of bond performance to equity performance. Investors in traditional balanced funds heavily weighted to equities and bonds are dangerously exposed as central banks reverse course. Moving away from negative/zero rates and winding down some 13 trillion of bond holdings of central banks is unlikely to be smooth. Low inflation allows some grounds for optimism that balanced fund returns will be low rather than negative. But the risk of large negative returns is very real.

Roundtable 2: High GDP Growth IS Not A Good Reason For A Permanent Allocation to Emerging Market Equities

– Graeme Shaw, PhD., Orbis Investments

It has been common in the past for the promoters of Emerging Market (EM) funds to imply that investors should get higher returns in these markets because they benefit from favourable rates of economic growth. This proposition has been backed up by the observation that since its inception, the MSCI EM Index has outperformed its Developed Market (DM) counterpart. Many institutional portfolios have a permanent allocation to Emerging Markets for similar reasons.

But when you look at long-term historical data they do not support the link between economic growth and superior stock market performance. It is also the case that when you look at performance over periods exceeding 100-years, it is very possible Emerging Markets have underperformed Developed Markets.

Together these observations create something of a problem for investors. If they cannot rely on long held beliefs about EMs, how do they decide whether or not to invest in these markets? We believe that such a decision can be made in the same way any other investment decision can be made: invest in them if they are offering bargains otherwise look elsewhere.

And when you look today Emerging Markets appear to be offering bargains. They are cheaper than DMs on both PE and Price/Book, despite having achieved a similar average RoE to DMs. Active stock pickers will be further encouraged by the fact that valuation dispersions within EMs have widened.

So why are these investing opportunities being left on the table? There are two common reasons for worrying about EMs: (1) the belief they under perform in a rising rate environment and (2) the belief the EMs underperform if there is a global bear market. We provide data showing that these concerns might be over blown.

Roundtable 3: In The Interests Of Their Financial Health, Retail Investors Should Eschew Trading VIX ETPs

– Simon Ho, Triple3 Partners

Do Hedge Funds Add Value?

– John Crosby, PhD., University of Technology Sydney

Do hedge funds add value, and, more specifically, provide utility gains to investors? How can this be reliably measured? We present an approach, based on the concept of ambiguity aversion, to measure performance of hedge funds in the presence of opaque investment strategies and short histories. We find that hedge funds do not provide utility gains to investors. Instead, investors would gain from choosing an investment strategy based around a broad-based, diversified market portfolio

The Impact of Corporate Governance Guidelines on Sustainability Reporting

– Robert Czernkowski, PhD., University of Technology Sydney

A majority of larger companies claim to disclose information (voluntarily) on key aspects of sustainable performance. Based on the hypothesized relationship between the quality of sustainability reporting and firm characteristics, we seek to compare the sustainability disclosure practices of listed companies before and after the promulgation of ASX Corporate Governance Principles and Recommendations (3Ed) issued by ASX Corporate Governance Council in March 2014.

The Impact of Benchmarks on Portfolio Composition and Performance

– Danny Yeung, PhD., University of Technology Sydney

The imposition of tracking error (to benchmark) constraints on portfolios very much influences the portfolio holdings of fund managers. The focus of this paper is using simulations combined with real data to identify the implications on these constraints for both the characteristics of the portfolio holdings and the performance of the funds. This will enable us to better identify whether such constraints are in the interests of investors and also the impact that they have on markets.

Uncertainty, Reputation and Analyst Coverage

– Marco Navone, PhD., University of Technology Sydney

In this paper we investigate the link between uncertainty about firm prospects and analyst's coverage. Specially, we argue that, due to reputational concerns, analysts avoid covering firms with uncertain prospects. Using exogenous changes in uncertainty related to CEO turnover events we show that analysts coverage drops after an exogenous increase in uncertainty. We confirm our findings using alternative sources

of uncertainty related to filings of securities class actions and industry-related shocks. By studying individual analyst's characteristics, we show that the probability of dropping coverage is higher for younger analysts, analysts with lower reputation and lower risk aversion, factors that indicate higher reputational and career concerns.

Ambiguous Market Making

– Nihad Aliyev, University of Technology Sydney

This paper investigates the impact of the market maker's ambiguous beliefs about the security payoff on the prices in an otherwise standard microstructure model. In our model, the equilibrium quotes and the bid-ask spread in the presence of ambiguity can be decomposed into the standard probabilistic component and the ``ambiguity premium/discount'' component characterizing the varying degrees of ambiguity aversion of the market maker. The illiquidity arises naturally in highly ambiguous market episodes because ambiguity directly influences the market maker's perceived adverse selection risk. This provides an explanation to drying liquidity and price inefficiency during the extreme market stress. Finally, the model suggests that the presence of ambiguity leads to the separating equilibrium, in which the informed traders trade only large quantities, to prevail more in financial markets, and in extreme, it becomes the only equilibrium.

Experiences of Current and Formers Members of Self-Managed Superannuation Funds

– Professor Ron Bird, University of Technology Sydney

The number of self-managed superannuation funds (SMSFs) continues to grow rapidly. The net annual growth has over the past five years has been 5% with 7% new SMSFs and 2% closures. Despite SMSFs being the largest component of superannuation both in terms of numbers of funds and asset holdings little is known about the experiences of members. We survey 854 current and 147 former members to find out their aspirations for their fund, how they operate their fund and how they rate the experience. We find that members of SMSFs maintain a high level of general interest in superannuation, which continues even if the member departs. Despite this interest, the number of "detractors" of SMSFs exceeds the number of "promoters", among both current and former members. Many express frustration with administrative and compliance responsibilities. Although SMSF members say they enjoy "control", the majority delegate or share most investment and operational tasks with financial professionals. Despite (or because) most SMSF members inadequately measuring the performance of their fund, three as many members rate the performance of their fund as above average, compared with other SMSFs, than below average. The probability of closing a SMSF is significantly higher if members use net returns to judge performance rather than other indicators such as account balance or asset allocation