



INQUIRE UK
Institute for Quantitative Investment Research

15th Inquire UK Business School Seminar

Hosted and organised with Cass Business School,
200 Aldersgate Street, EC1A 4HD (Room N201)

Friday 6th of December 2019

The 15th Inquire UK Business School Seminar will take place within the 3rd Corporate Policies and Asset Pricing Conference. The COAP conference series is the only one to focus specifically on the intersection between the two main fields of Finance: Asset Pricing and Corporate Finance. Many important developments in research in Finance over the last 15 years are results of studying decision making within corporations, the implications of these decisions on the prices of traded securities, and the feedback to corporate policies from securities markets. The intersection of Asset Pricing and Corporate Finance produces some of the most practically relevant financial research with the clearest implications for industry professionals, such as the explanation of hundreds of asset pricing anomalies using merely two factors with clear roots in theoretical corporate finance: profitability and investment.

The program for the 15th Inquire UK Business School Seminar includes the three most important submissions to the COAP, as well as two keynote presentations by leading experts in the field: Professors Stefan Nagel and Ray Ball from the University of Chicago.

Keynote Speakers

Professor Stefan Nagel, University of Chicago

Professor Nagel's research focuses on asset pricing, investor behavior, and risk-taking of. Among his most recent work is a study of the application of machine learning techniques to understand the risk and return of investment strategies in the stock market. Professor Nagel currently serves as the Executive Editor of the Journal of Finance. He is also a research associate at the National Bureau of Economic Research (Cambridge, MA) and a research fellow at the Centre for Economic Policy Research (London, UK) and CESifo (Munich, Germany).

Before joining Booth, Nagel taught at the University of Michigan's Ross School of Business (2013-17), Stanford Graduate School of Business (2004-13) and in the Economics Department at Harvard University (2003-04). He received his PhD from the London Business School in 2003 and his Diploma (M.S. equiv.) in Business Economics from the University of Trier (Germany) in 1999.

Professor Ray Ball, University of Chicago

Ray Ball studies corporate disclosure, earnings and stock prices, international accounting and finance, market efficiency and investment strategies. His research revolutionized the understanding of the impact of earnings releases on share prices, laying the foundations for much of the modern accounting literature. Ball is a member of the Board of Trustees of Harbor Funds and Chair of its Audit Committee. He also serves on the Advisory Group for the Financial Reporting Faculty of the Institute of Chartered Accountants in England and Wales (ICAEW). He has served on the Financial Accounting Standards Advisory Council (FASAC) of the Financial Accounting Standards Board (FASB), and on the Shadow Financial Regulation Committee.

Ball served as the Wesley Professor in Business Administration at the William E. Simon Graduate School of Business Administration at the University of Rochester prior to rejoining Chicago Booth in 2000. He received a bachelor's degree in accounting from the University of New South Wales in Australia, and an MBA in 1968 and a PhD in economics in 1972 from Chicago Booth. In 2015, the Institute of Chartered Accountants in England and Wales made him its eighth Honorary Member.

Invited Papers

1. *“Estimating the Anomaly Baserate,”* by Alex Chincio (University of Illinois), Andreas Neuhierl (University of Notre Dame), and Michael Weber (University of Chicago).

Speaker: Michael Weber

Abstract: The academic literature contains literally hundreds of variables that seem to predict the cross-section of expected returns. This so-called ‘anomaly zoo’ has caused many to question whether researchers are using the right tests for statistical significance. But, here’s the thing: even if a researcher is using the right tests, he will still be drawing the wrong conclusions from his analysis if he is starting out with the wrong priors—i.e., if he is starting out with incorrect beliefs about the ex ante probability of discovering a tradable anomaly prior to seeing any test results.

So, what are the right priors to start out with? What is the correct anomaly baserate?

We propose a new statistical approach to answer this question. The key insight is that, under certain conditions, there’s a one-to-one mapping between the ex ante probability of discovering a tradable anomaly and the best-fit tuning parameter in a penalized regression. When we apply our new statistical approach to the cross-section of monthly returns, we find that the anomaly baserate has fluctuated substantially since the start of our sample in May 1973. The ex ante probability of discovering a tradable anomaly was much higher in 2003 than in 1990. As a proof of concept, we construct a trading strategy that invests in previously discovered predictors and show that adjusting this strategy to account for the prevailing anomaly baserate boosts its performance.

2. *“Counterparty Risk: Implications for Network Linkages and Asset Prices,”* by Fotis Grigoris, Yunzhi Hu, and Gill Segal (UNC Chapel Hill).

Speaker: Gill Segal

Abstract: Firms with higher receivables-to-sales ratios (R/S) extend more trade credit, and thus have greater exposure to risks that impact their counterparties. Surprisingly however, high R/S firms command risk premia that are 6% per annum lower than those of low R/S firms. This novel R/S spread is not explained by common asset-pricing factors or characteristics, and a novel factor based on the spread is priced in the cross-section of returns. We use production network data to show that low R/S firms have shorter-lived (lower duration) links with their customers, and that low link duration firms command higher returns. We embed trade credit into the production-based asset-pricing framework to jointly explain these facts. In the model, receivables act as an insurance policy that suppliers may offer certain customers to hedge their liquidity risks. High R/S firms are endogenously matched with better counterparties, and the hedge they provide makes the links with their customers last longer. Consequently, high R/S firms are less exposed to costly frictions involved in the search for a new counterparty, and are therefore safer. Overall, our empirical and theoretical results show that R/S contains important information for forecasting the duration of supplier-customer links, which in turn impacts firms' riskiness and valuations.

3. *“A Unified Model of Distress Risk Puzzles,”* by Zhiyao Chen (Chinese University of Hong Kong), Dirk Hackbarth (Boston University), and Ilya A. Strebulaev (Stanford University).

Speaker: Zhiyao Chen

Abstract: We build a dynamic model to link two empirical patterns: the negative failure probability-return relation (Campbell, Hilscher, and Szilagyi, 2008) and the positive distress risk premium-return relation (Friewald, Wagner, and Zechner, 2014). We show analytically and quantitatively that (i) the substantial decline in the debt value and procyclical debt financing in highly distressed firms results in a negative covariance between levered equity beta with countercyclical market risk premium; (ii) the negative covariance generates low or negative stock returns and alphas among those highly distressed firms in the conditional CAPM; and (iii) firms with lower distress risk premiums endogenously choose higher leverage, so they are more likely to become distressed and earn negative returns. We provide empirical evidence to support our model predictions.

4. *“A Supply and Demand Approach to Equity Pricing,”* by Sebastien Betermier (McGill University), Laurent Calvet (EDHEC Business School), and Evan Jo (McGill University).

Speaker: Laurent Calvet

Abstract: We develop a parsimonious general equilibrium model in which heterogeneity in a small set of firm characteristics explains a wide range of stockmarket features, including common pricing factors and the security market line. The supply and demand of capital of each firm and equilibrium outcomes are all available in closed form. Even in the absence of frictions, general equilibrium produces a security market line that is less steep than the CAPM predicts and can be nonlinear or downward-sloping. The model also generates the betting-against-beta, betting-against-correlation, size, profitability, investment growth, and value anomalies, while also fitting the cross-section of firm characteristics.