swiss:finance:institute

Press release, Zurich, Switzerland, June 2009

Swiss Finance Institute PhD program rejoices over record Academic Placement

The Swiss Finance Institute is proud to announce that 5 of its PhD candidates have secured professorships at top institutions in Europe and the United States.

Following what is probably the most successful placement campaign ever for a European institution, the Swiss Finance Institute PhD graduates have obtained assistant professor positions at leading institutions such as Carnegie Mellon and Rochester universities in the USA, McGill university in Montreal as well as the London School of Economics and the University of Amsterdam.

With a PhD student body numbering more than 75 students across its 5 partner academic institutions, the Swiss Finance Institute (SFI) has become one the largest PhD programs in finance worldwide. The Swiss Finance Institute's presence on the doctoral scene was made clear when SFI graduates were solicited for nearly 100 job interviews at the San Francisco ASSA meeting in January 2009! "More than anything else student placement is the hallmark of success for a PhD program. We are extremely proud with placing five candidates in top schools. This definitely shows that the quality of the PhD training provided by the Swiss Finance Institute and its partner institutions is recognized by leading researchers around the globe." said Professor Jean-Pierre Danthine, Swiss Finance Institute Managing Director.

Following are the placements:

Laurent Barras, a SFI PhD graduate of the University of Geneva, will start in September at **McGill, Desautels Faculty of Management**. Laurent's thesis addresses a long-standing and fundamental issue in the mutual fund industry: how many funds in the population are truly able to deliver superior performance?
(*Laurent.Barras@sfi-phd.ch)*

Maria Cecilia Bustamante, a SFI PhD student at the University of Lausanne, will start in August at the **London School of Economics.** Maria Cecilia elaborates on how real and financing frictions affect corporate decision making under uncertainty, and explores how firms time their investment and financing decisions given such frictions.(*Maria-Cecilia.Bustamante@sfi-phd.ch)*

Jens Martin, a SFI PhD student at the University of Lugano, will start in August at the **University of Amsterdam.** Jens has studied conflicts of interest among financial analysts in financial markets. In his research he finds that analysts help insiders to exit at favorable terms in equity offerings. He has also investigated whether behavioral biases, such as overconfidence, can explain the phenomenon of long-run underperformance after equity issues.
(*Jens.Martin@sfi-phd.ch)*

Boris Nikolov, a SFI PhD graduate from the University of Lausanne, will start in July at the **University of Rochester.** Boris's research investigates the effects of real market frictions and agency costs on firms' financing, cash holdings, and investment policy.
(Boris.Nikolov@sfi-phd.ch)

Emilio Osambela, a SFI PhD graduate of the University of Lausanne, will start in July at the **Tepper School of Business, Carnegie-Mellon University.** In his dissertation, Emilio uncovers the frictions that generate (i) the observed dynamics of stock market volatility in the time-series, and (ii) the existence of multiple volatility factors, which are priced in the cross-section of expected stock returns. He shows that persistent regimes of high and low volatility are driven by changes in firms' default prospects. (*Emilio.Osambela@sfi-phd.ch)*

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The Swiss Finance Institute is a private foundation created in 2006 by Switzerland's banking and finance community in cooperation with leading Swiss universities. It supports and advances research, doctoral training and executive education in banking and finance. The Institute is supported by Swiss banks, the Swiss Stock Exchange, Swiss universities and the Swiss Federal Government.

Additional Student Information

Laurent Barras

My dissertation proposes an in-depth empirical analysis of active portfolio management. It focuses on the study of predictability-based strategies, and on the performance of actively-managed mutual funds. The central result of my thesis is that while some active strategies and mutual funds are able to generate superior performance, they are extremely difficult to detect in real-time. Therefore, using active portfolio management to produce a consistent performance over time remains a challenging task.

Predictability-based strategies attempt to predict the evolution of asset prices in order to tilt the portfolio towards assets with high predicted returns. In my first paper (published in the Journal of Empirical Finance), I examine the impact of specification uncertainty on the performance of international predictability-based strategies. Specification uncertainty is defined as the uncertainty faced by the investor regarding the specification choices necessary to implement the strategy. To assess the impact of this phenomenon, I measure the performance of a group of strategies that the investor could reasonably consider. The strong performance variability across the strategies indicates that specification uncertainty has a strong impact on performance, and implies that the gains previously documented are overstated.

My mutual fund paper (published in the Journal of Finance) develops a simple technique that controls for "false discoveries," or mutual funds that exhibit significant performance by luck alone. This approach precisely separates funds into (1) unskilled, (2) zero-alpha, and (3) skilled funds. The results show that the majority of U.S. funds (75.4%) pick stocks well enough to cover their trading costs and other expenses, producing a zero alpha. Further, there is a significant proportion of skilled funds prior to 1996, but almost none by 2006, accompanied by a large increase in unskilled fund managers--due both to a large reduction in the proportion of fund managers with stockpicking skills and to a persistent level of expenses that exceed the value generated by these managers.

Maria Cecilia Bustamante

While the macroeconomics literature has focused on the impact of real frictions on investment decisions assuming all equity financed firms, the financial economics literature has focused on the study of financing frictions abstracting from other effects instead. My job-market paper therefore assesses the join interaction of real and financing frictions in firms' dynamic investment and financing decisions. The paper provides a rationale for the documented poor empirical performance of neoclassical investment models based on the joint effect of real and financing frictions on investment. A major observation relies in how the infrequency of corporate decisions may affect standard empirical tests. My paper suggests that the book to market sorts commonly used in the empirical asset pricing literature have economic content, as they control for the lumpiness in firms' optimal investment policies.

My work also elaborates on the effects of asymmetric information and strategic interaction on firms' investment and financing decisions. I study how firms time their decision to raise public equity when outside investors lack information about their future investment prospects. I derive a real-options model that predicts either cold or hot markets for new stock issues conditional on adverse selection, and I provide a rational approach to study jointly the market timing of corporate decisions and announcement effects in stock returns.

My doctoral dissertation therefore contributes to our understanding of how under real and financing frictions may bias standard empirical tests, elaborates on how adverse selection may induce hot and cold markets in new issues' markets, and suggests how the underlying economic behaviour of firms may induce alternative patterns in stock prices.

Jens Martin

My research seeks to help to shed light on the managerial behavior, asymmetric information as well as the flow of information in the financial markets. This topic is of particular interest given the recent events in the financial markets. I study these questions in the setting around equity offerings. An Initial public offering represents an especially fertile testing ground for these topics as this event constitutes a major structural change in the life of a company. At the time of the offering date, data on past firm performance is very limited and the estimation of future cash flows very difficult. This is especially true in a dynamic environment of a young and fast growing company. Consequently, the asymmetric information, in this context the difference in knowledge of the firm and its expected future performance between managers and insiders on the one hand and potential investors / the market on the other hand, are very pronounced. My thesis project is divided into three parts. Each one focuses on a special aspect and a specific time period in relation to the equity offering.

In my job market paper "Prop Ups During Lockups" I test the hypothesis that shareholders pressure analysts to support the share price until the end of the lockup period[1]. Insiders refrain from selling shares during the IPO itself as they fear it will convey a negative signal to the market (Brau and Fawcett (2006)). Thus, the end of the lockup period of initial public offerings generally constitutes the first time corporate insiders sell significant numbers of shares on the market. I develop and subsequently test the hypothesis that shareholders pressure analysts to support the share price until the end of the lockup period. In a sample of U.S. initial public offerings from 1996 up to 2006, I find that analysts issue overly optimistic recommendations until the end of the lockup period. Furthermore, I find a significant downward revision of recommendations for the whole sample of firms as soon as the lockup period ends.

In the second part of my thesis I investigate if and to which extent managerial behavior, its private information and potential behavioral biases can account for the underperformance of companies in IPOs as well as SEOs. Indeed, several models from traditional as well as behavioral finance can be found to offer very similar predictions, which seem plausible examined on their own. However, I find these rivaling models standing in stark contrast in their reasoning to each other, while trying to explain the same economic context. I test as a behavioral explanation the optimistic manager hypothesis and as rational theories the window of opportunity hypothesis as well as empire building. Using data on U.S. IPOs and SEOs going public from 1990 to 2003, I find evidence that optimistic managers as well as privately informed managers seem to drive the long run underperformance of equity offerings. I furthermore investigate the investment decisions taken by these groups of managers after the share issuance. I see distinct investment behavior by each type of manager in terms of capital expenditures, debt rebalancing and cash holdings.

The third part of my thesis, a project in collaboration with Richard Zeckhauser, investigates firm behavior in the time period leading up to the IPO. In particular, we investigate cash dividend payments of companies prior to their IPOs. Our data sample consists of U.S companies conducting an IPO between 1980 through 2006. Dividend payments in the two years prior to the IPO are significant both in number and size. We find support for the hypothesis that insiders seeking to exit use dividends as a means to avoid selling a large number of secondary shares in the IPO, which would send a negative signal to the market. Furthermore, we find that managers actively manage their cash holdings prior to the IPO. They try to avoid very high cash holdings. We reject the hypothesis that insiders try to strip the company off its hard assets in order to bring the overvalued part to the market.

[1] The lockup period is a voluntary agreement between the underwriter and corporate insiders not to sell shares without the consent of the underwriter during a set time period, in general 180 days, after the IPO.

Boris Nikolov

My research investigates the determinants of corporate financing and cash holding policies. The first essay of my PhD thesis aims to shed light on why firms issue debt so conservatively. In particular, it examines the effects of shareholder and creditor protection on capital structure choices. The analysis demonstrates that investor protection is a key determinant of firms' financing choices. In addition, it shows that conflicts of interests among firm claimholders may help explain the level and cross-sectional variation of observed leverage ratios.

The second essay focuses on the practical relevance of manager-shareholder conflicts. Despite the theoretical development of the literature on agency conflicts, the magnitude of manager-shareholder conflicts is still an open question. This essay proposes a methodology for quantifying these agency conflicts on a firm specific basis. The analysis provides economically reasonable estimates of the magnitude of manager-shareholder conflicts and shows that these conflicts vary with variables that one expects to determine managerial incentives.

The third essay is concerned with the documented time trend in corporate cash holdings (cash holdings double from 10% to 20% of total assets over the 1980 to 2005 period in the US). This essay provides an explanation of this phenomenon by examining the effects of product market competition on firms' cash holdings in the presence of financial constraints. It shows that the time trend in cash holdings can be at least partly attributed to a competition effect.

Emilio Osambela

Through my thesis I extend conventional models by introducing frictions inherent to real financial markets, such as changing prospects of default and differences of opinion amongst market participants. I show that once these frictions are considered, several anomalies or puzzles in financial markets can be resolved.

In a closed economy, my job-market paper shows that changing prospects of default and differences of opinion can reproduce several previously unexplained features of stock market return volatility: (i) volatility persistence, (ii) the fact that bad news increase volatility more than good news and (iii) the coexistence of a transitory and a permanent component of volatility, both priced in the cross-section of expected stock returns. The novel relation between changing prospects of default and volatility is of particular interest under current market conditions.

In an international financial market, I construct models where investors from one country interpret information about their home country differently from the way it is interpreted by investors in foreign countries. In a single-good economy, this friction makes the model consistent with several previously unexplained anomalies in international finance: (i) the fact that local investors tend to tilt their portfolio towards domestic investments, (ii) the imperfect correlation of aggregate consumption across countries (iii) the dependence of firm returns on local and foreign factors, (iv) the co-movement of stock market return and international capital flows and (v) the abnormal returns around foreign firm cross-listing in the local market. In a multiple-good economy, the fact that investors misinterpret foreign information introduces a risk factor that generates a wedge between the expected exchange rate depreciation and the differential of interest rates. This is shown to be consistent with the empirical observation that relatively high domestic interest rates predict an appreciation of the domestic currency.

In summary, my doctoral dissertation makes a contribution to our understanding about how changing prospects of default and different beliefs held by financial market participants affect equilibrium asset pricing relationships. Applications to stock market return volatility and international finance anomalies show the importance of introducing reasonable frictions in the modeling of financial markets in order to match observed empirical properties and resolve so called anomalies or puzzles. In addition, optimal portfolio strategies derived in the setup with frictions will allow practitioners to optimally exploit the underlying risk factors generating observed asset pricing anomalies, as well as their predictability.