The Department of Finance in the Faculty of Business and Economics at The University of Melbourne presents

The 2018 FIRN Asset Pricing Research Group Meeting

October 29 and 30, 2018

at

The University of Melbourne, Department of Finance

198 Berkeley St ("The Spot"), Carlton VIC 3053

Room: Level 2 Multi-function Room

Meeting Program

All Sessions, coffee breaks and lunch are in the Level 2 Multi-function Room

Monday, 29 October

1:00pm	Registration
1:15pm	Welcome
1:20pm	**Paper**: "Real-time Portfolio Choice Implications of Asset Pricing Models" By Francisco Barillas and Jay Shanken **Presenter**: Francisco Barillas, Emory University **Discussant**: Stephen Thiele, Queensland University of Technology
2:25pm	**Paper**: "Restrictions on Asset-Price Movements Under Rational Expectations: Theory and Evidence" By Ned Augenblick and Eben Lazarus **Presenter**: Eben Lazarus, MIT **Discussant**: Juan Sotes-Paladino, University of Melbourne
3:30pm	Coffee Break
4:00pm	**Paper**: "Production Networks and Stock Returns: The Role of Vertical Creative Destruction" By Michael Gofman, Gill Segal, and Youchang Wu **Presenter**: Gill Segal, University of North Carolina, Chapel Hill **Discussant**: Neal Galpin, Monash University
5:05pm	**Paper**: "Dealer Inventory, Short Interest and Price Efficiency in the Corporate Bond Market" By Antje Berndt and Yichao Zhu **Presenter**: Antje Berndt, Australian National University **Discussant**: James Brugler, University of Melbourne
5:40pm	End of Day 1
6:00pm	Dinner at Epocha 49 Rathdowne Street, Carlton, Victoria 3053 (20 mins on foot, 6 mins by car)

(continued)

Tuesday, 30 October

9:30am	Coffee, Tea and Breakfast
10:00am	**Paper**: "Investment Shocks and Asset Returns: International Evidence" By Ruchith Dissanayake, Akiko Watanabe, and Masahiro Watanabe **Presenter**: Ruchith Dissanayake, Queensland University of Technology **Discussant**: Joakim Westerholm, University of Sydney
10:35am	**Paper**: "What Moves Stock Prices? The Role of News, Noise, and Information" By Jonathan Brogaard, Huong Nguyen, Talis J. Putnins, and Eliza Wu **Presenter**: Talis J. Putnins, University of Technology Sydney **Discussant**: Binh Do, Monash University
11.10am	**Paper**: "Can illiquidity be priced in an active secondary market? Theory and evidence" By Pallab Dey and Peter L. Swan **Presenter**: Peter L. Swan, University of New South Wales **Discussant**: Zhuo "Joe" Zhong, University of Melbourne
11:45am	Lunch
12:00pm	**Keynote address: "Asset Pricing under Computational Complexity"** By **Peter Bossaerts**, University of Melbourne
12:45pm	Closing remarks

Detailed Meeting Program

Meeting Program

All Sessions, coffee breaks and lunch are in the Level 2 Multi-function Room

Monday, 29 October

1:00pm	Registration
1:15pm	Welcome
1:20pm	**Paper**: "Real-time Portfolio Choice Implications of Asset Pricing Models" By Francisco Barillas and Jay Shanken **Abstract:** There is a plethora of asset pricing factors that have been proposed in the literature. We study the problem of an investor who is confronted with this \zoo of factors" and wishes to find an optimal portfolio. We propose a Bayesian asset allocation framework that accounts for uncertainty about the correct pricing model. This entails an optimal degree of economic shrinkage that is benecial for portfolio performance. Under a wide range of beliefs about the extent of mispricing, we nd that considering all asset pricing models that can be formed from a given set of factors leads to real-time performance that is superior to that of the sample tangency portfolio. The superiority in out-of-sample performance is even stronger when some of the factors are redundant, as might be the case when a factor has been data mined. **Link:** http://bit.ly/2OrPi7A **Presenter**: Francisco Barillas, Emory University **Discussant**: Stephen Thiele, Queensland University of Technology
2:25pm	**Paper**: "Restrictions on Asset-Price Movements Under Rational Expectations: Theory and Evidence" By Ned Augenblick and Eben Lazarus **Abstract:** How restrictive is the assumption of rational expectations in asset markets? We provide two contributions to address this question. First, we derive restrictions on the admissible variation in asset prices in a general class of rational-expectations equilibria. The challenge in this task is that asset prices reflect both beliefs and preferences. We gain traction by considering market-implied, or risk-neutral, probabilities of future outcomes, and we provide a mapping between the variation in these probabilities and the minimum curvature of utility — or, more generally, the slope of the stochastic discount factor — required to rationalize the marginal investor's beliefs. Second, we implement these bounds empirically using S&P 500 index options. We find that very high utility curvature is required to rationalize the behavior of risk-neutral beliefs, and in some cases, no stochastic discount factor in the class we consider is capable of rationalizing these beliefs. This provides evidence of overreaction to new information relative to the rational benchmark. We show further that this overreaction is strongest for beliefs over prices at distant horizons, and that our findings cannot be explained by factors specific to the option market. **Link:** http://bit.ly/2EsLU7Y **Presenter**: Eben Lazarus, MIT **Discussant**: Juan Sotes-Paladino, University of Melbourne
3:30pm	Coffee Break

(continued)

Detailed Meeting Program (continued)

Monday, 29 October

4:00pm	**Paper**: "Production Networks and Stock Returns: The Role of Vertical Creative Destruction" By Michael Gofman, Gill Segal, and Youchang Wu **Abstract:** We study the relation between firms' risk and their upstreamness in a production network. Empirically, firms' average stock returns and productivity exposures increase monotonically with their upstreamness. We quantitatively explain these novel facts using a multi-layer general equilibrium model. These patterns arise from vertical creative destruction -- innovations by suppliers devalue customers' assets-in-place. We confirm several model predictions, and document additional new facts consistent with vertical creative destruction: a diminished value premium among downstream firms and a negative relation between downstream firms' returns and their suppliers' competitiveness. Overall, vertical creative destruction has a sizable effect on cross-sectional risk premia. **Link:** http://bit.ly/2pXkVHB **Presenter**: Gill Segal, University of North Carolina, Chapel Hill **Discussant**: Neal Galpin, Monash University
5:05pm	**Paper**: "Dealer Inventory, Short Interest and Price Efficiency in the Corporate Bond Market" By Antje Berndt and Yichao Zhu **Abstract:** We propose a model of trading in the over-the-counter corporate bond market where investors buy and sell bonds through dealers, and investors and dealers short bonds by borrowing them in the securities lending market. The model predicts that higher dealer inventory costs are associated with lower short interest for bonds, particularly for high-credit-quality bonds. We construct bond-level proxies for inventory costs and provide empirical evidence in support of the model's prediction. We find that much of the dramatic decline in short interest observed since the Great Financial Crisis (GFC) can be explained by an increase in proxies for inventory costs. We document that implicit short-sale constraints imposed by higher dealer inventory costs have a negative impact on price efficiency in the corporate bond market. Our findings suggest that tighter post-GFC regulation may have had unintended consequences for bond market quality. **Link:** http://bit.ly/2pZhhN3 **Presenter**: Antje Berndt, Australian National University **Discussant**: James Brugler, University of Melbourne
5:40pm	End of Day 1
6:00pm	Dinner at Epocha 49 Rathdowne Street, Carlton, Victoria 3053 (20 mins on foot, 6 mins by car)

(continued)

Detailed Meeting Program (continued)

Tuesday, 30 October

9:30am	Coffee, Tea and Breakfast
10:00am	**Paper**: "Investment Shocks and Asset Returns: International Evidence" By Ruchith Dissanayake, Akiko Watanabe, and Masahiro Watanabe **Abstract:** Using a large cross section of stocks from over thirty countries, we examine the implications of investment-specific technological shocks for asset prices and macroeconomic quantities. We find that the negative risk premium associated with the investment shock is stronger and often significant in developed markets with greater access to capital, superior financial institutions, and stronger product market competition. The investment premium is related to, but not subsumed in, the value premium. The results underscore the importance of allocative efficiency in the pricing of technological advances, and help reconcile the conflicting existing evidence from the U.S. market with different sample periods. **Link:** http://bit.ly/2OsuWeh **Presenter**: Ruchith Dissanayake, Queensland University of Technology **Discussant**: Joakim Westerholm, University of Sydney
10:35am	**Paper**: "What Moves Stock Prices? The Role of News, Noise, and Information" By Jonathan Brogaard, Huong Nguyen, Talis J. Putnins, and Eliza Wu **Abstract:** We develop a return variance decomposition model to separate the role of different types of information and noise in stock price movements. We disentangle four components: market-wide information, private firm-specific information revealed through trading, firm-specific information revealed through public sources, and noise. 31% of the return variance is from noise, 37% from public firm-specific information, 24% from private firm-specific information and 8% from market-wide information. Since the mid 1990s there has been a dramatic decline in noise. During this period firm-specific information is increasing, consistent with increasing market efficiency. Our findings help reconcile the mixed results in the $R2$ literature. **Link:** http://bit.ly/2RTee5Q **Presenter**: Talis J. Putnins, University of Technology Sydney **Discussant**: Binh Do, Monash University

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Detailed Meeting Program (continued)

Tuesday, 30 October

11.10am	**Paper**: "Can illiquidity be priced in an active secondary market? Theory and evidence" By Pallab Dey and Peter L. Swan **Abstract:** Commencing with a Lucas (1978)-type representative investor but with differing endowments, we develop a new theoretical model of counterparty trading inclusive of frictions to show that no type of symmetric liquidity costs, arising either from exogenous costs or from order-flow asymmetric information, can be priced. This is because seller costs cancel out the buyer costs correctly identified in Amihud and Mendelson's (1986a) seminal theoretical model. We test our generalization of the Lucas model utilizing NYSE (US) equity market microstructure data to show that we cannot reject our main hypothesis that buyer and seller preferences are identical. In doing so, we question extant theories of illiquidity pricing which treat the buyer and seller asymmetrically in active secondary markets. We split up contemporaneous measures of transaction costs into their buy (upside) and sell (downside) components to find they are priced with similar magnitudes and opposite signs. **Link**: http://bit.ly/2QTuJOg **Presenter**: Peter L. Swan, University of New South Wales **Discussant**: Zhuo "Joe" Zhong, University of Melbourne
11:45am	Lunch
12:00pm	**Keynote address: "Asset Pricing under Computational Complexity"** By **Peter Bossaerts**, University of Melbourne **Abstract:** We often think of investments as playing roulette, with "laws" that somehow can be discovered using statistics or machine learning, and optimal policies that can be acquired through reinforcement learning. Yet many investment problems actually fall in a completely different category. Firm valuation, determining what to look for when predicting markets, even portfolio construction, are not statistical problems, but computationally complex decision problems. These require methodic approaches that resonate with the theory of computation, and individuals do tend to follow those. But what about markets? I show that markets ought to treat these problems as if they were statistical ones, and as a result, should underperform the average investor. Experiments confirm this prediction. Still, markets help individuals make better decisions, and the improvements appear to depend on security design. This suggests a novel aim for markets, that of transmitting crucial, even if limited, information, rather than that of revealing all available information (the Efficient Markets Hypothesis).
12:45pm	Closing remarks