ABSTRACTS

1. TO DIVERSIFY OR NOT TO DIVERSIFY: LOSS-AVERSE INVESTORS WITH MULTIPLE BENCHMARKS

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ABSTRACT

This article presents an analysis of investment decisions made by loss-averse investors who simultaneously evaluate their portfolio performance relative to several benchmarks. We show that the multiplicity of benchmarks reduces the desire to diversify and results in equilibrium where investors do not want to diversify all of their unsystematic risk. Thus, even in the economy populated by identical investors with no information asymmetry, the representative investor may not exist. We also discuss the implications that the choice of benchmarks has on asset prices.

Keywords: Regret Theory, Investment, Behavioral Finance

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2. APPLICATION OF THE RESOURCE-BASED VIEW IN THE BRAZILIAN AUTOPARTS SECTOR

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ABSTRACT

Drawing on previous research in the Resource-Based View of the Firm, this study aimed at illustrating the interrelationships between the properties of productive resources and the profitability of firms, in the Brazilian autoparts industry. The inspiration for this study was a research conducted by Rodolphe Durand. In 1999 Durand showed that the knowledge of the properties of the firm's resources - including the properties of the firm's exchange relationships with suppliers and customers - is critical to understanding the firm's performance. It was confirmed that one property of firm’s resources - inimitability - is positively linked to an enhanced market performance.

Keywords: *Resource-Based View, competitive advantage, productive resources.*

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3. TAXABLE BOND FUNDS, EXPENSES, AND RELATIVE RETURNS

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ABSTRACT

The universe of economic agents cannot deliver an excess investment rate of return. Beating *the market is a zero-sum game. After the deduction of investment management costs, investors collectively underperform market averages. Since investors are unlikely to foretell the best-performing mutual funds, they should be alert to a signpost that increases the probability of identifying winners--funds that levy below-average financial intermediation expenses.*

Keywords: *Mutual Funds, Bond Mutual Funds, Investment Expenses, Net Returns*

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4. INTERNAL CAPITAL MARKETS AND CEO POWER

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ABSTRACT

This paper examines the relationship between the organizational hierarchy at the highest management level and the allocation of internal financial resources within a firm. A measure of CEO influence is devised that reflects the extent of CEO power over decisions in the firm. I find that diversified firms where decisions are heavily polarized towards the CEO allocate their resources less efficiently than firms where decisions are made by a coalition of top executives. This finding suggests that a diversified firm headed by one powerful CEO is subject to higher effects of rent-seeking behavior and internal power struggles from lower level management than is a coalition of executives making investment decisions. The implications of this finding are consistent with the argument that the diversification discount is a consequence of agency problems existing between layers of management within the firm.

Keywords: *Internal Capital Market, CEO Compensation, Organizational Hierarchy. JEL Classification: G32, G34, J33*

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5. DO BUDGET DEFICITS REDUCE HOUSEHOLD TAXPAYER COMPLIANCE? PRELIMINARY EVIDENCE USING THE FEIGE DATA

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ABSTRACT

This study empirically investigates the hypothesis that, in the U.S., higher federal budget deficits induce a decrease in the degree of household taxpayer compliance, i.e., induce an increase in the degree of income tax evasion by households. Using the annual data on aggregate personal income tax evasion for the period 1960-1997 compiled by Feige, 1997 being the most recent year for which such data are currently available, and allowing for such factors as federal income tax rates, IRS tax return audit rates, the Vietnam War, and the Watergate scandal, it is found that income tax compliance (evasion) is a decreasing (an increasing) function of the budget deficit. Important policy implications of this finding are provided in the Conclusion.

Keywords: *Tax Compliance; Budget Deficits; Tax Rates*

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6. STOCK MARKET PERFORMANCE AND PARTISAN PRESIDENCY

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ABSTRACT

This paper uses OLS regression and Markov regime switching approaches to investigate the relationship between stock market performance and U.S. presidents from Kennedy to the first term of G.W. Bush's administrations (1961 to 2003). To answering the question whether significant difference exists in stock market performance in general (DJIA or NYSE composite) and partisan presidential changes, results from the OLS approach based on contemporary variables in the economic cycle indicate that only under Republican presidents, real per capita variation exerts positive impact on stock market performance. No significant impact has been found on individual income tax rate, unemployment rate, jobs created, and real government budget deficits. Results from a Markov regime switching approach support the hypothesis that the Democratic presidents made additional positive impact on both the DJIA and the

NYSE composite indexes through changes in real per capita income and changes in unemployment rate. Markov regime switching results also indicate that presidential changes have significant impact on the GDP growth rate.

Keywords: *DJIA, NYSE Composite, Presidency, Markov Regime Switching Approach, Real Per Capita Income, Unemployment Rate, GDP Growth Rate.*

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7. FORECASTING STOCK RETURNS UNDER THE IMPACTS OF UNEMPLOYMENT BENEFITS AND DURATION OF UNEMPLOYMENT

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Winston T. Lin, The State University of New York at Buffalo, Buffalo, New York, USA

ABSTRACT

To forecast future stock returns, a new capital asset pricing model (CAPM) that incorporates the impacts of job search and the duration and benefit of unemployment is developed, tested empirically, and compared to the standard and Mayers' models. The new model is built on two fundamental theoretical concepts regarding the probability distributions of random wages and the conditional expected wages, under the assumptions that labor hours available are not fully employed but are heterogeneous with random wages, and that the investor's wage income is a weighted average of the conditional expected wage and the unemployment compensation, where the weight is the probability of (un)employment and is an unknown decision variable that is determined jointly with other decision variables in the model. The empirical results strongly suggest that the new model is distinguishable from the standard model and its extension of Mayers and improves on both the standard and Mayers models. The nonparametric Wilcoxon signed-rank tests also suggest that the new model differs substantially from a life cycle hypothesis-based dynamic CAPM, depending on the probability of employment (unemployment). Finally, the new model is shown to forecast stock returns more accurately than the standard, the Mayers', and the life cycle hypothesis-based dynamic model.

Keywords: Capital Asset Pricing; Stock Returns; Labor Wages; Unemployment Benefits; Duration of Unemployment; Wilcoxon Signed-Rank Test.

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8. MONEY DEMAND STABILITY AND CENTRAL BANKS

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Daniel Marsh, College of Business, University of Dallas, USA

ABSTRACT

The European Central Bank (ECB) and Federal Reserve take distinctly different viewpoints on the usefulness of the quantity of money. The ECB explicitly incorporates a quantity measure, M3, into their monetary framework and targets an inflation rate. In the U.S., the Federal Reserve ceased publication of its M3 measure in 2006. That decision appears to have made official the Fed's thinking about the usefulness of a quantity measure. Our analysis of the stability of the demand for certain monetary aggregates -- the monetary base and MZM – suggest the approach taken by the ECB is valid, and may have some usefulness in providing the direction of prices in the medium to longer term. Thus it may be worth emulating by the Federal Reserve.

Keywords: *Money, Velocity, Stability, European Central Bank, Federal Reserve*

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9. TRADING VOLUME AND DISPERSION OF THE REALIZED STOCK RETURNS

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ABSTRACT

This paper analyzes the effect of realized stock returns on future trading volume. It shows that for a given group of stocks the increase in the dispersion of their lagged realized returns results in higher trading volume. The paper argues that this effect may be due to the coexistence of two groups of traders on the market: liquidity traders who follow momentum trading strategies and risky arbitrageurs.

Keywords: Trading Volume, Stock Return

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10. SENSITIVITY ANALYSIS IN DECISION MAKING UNDER RISK WITH THREE STATES OF NATURE: A LINEAR PROGRAMMING APPROACH

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ABSTRACT

In decision making under risk, we often resort to sensitivity analysis to understand how the selection of an optimal alternative would be affected by the variations in the probability estimates of the states of nature. If the problem deals with only two states of nature and a limited number of alternatives, the graphical method can be used to determine the optimal alternative for different ranges of the probabilities. But, if we have many alternatives to consider, it becomes very cumbersome to use the graphical method. Further, if we have more than two states of nature, the graphical method is of no help to us in doing the sensitivity analysis. In this paper, we present a Linear Programming (LP) approach to do sensitivity analysis in problems involving many alternatives and two or three states of nature. It is rather a unique and interesting application of the LP methodology in the sense that it makes use of all the extreme points of the feasible region. In addition, we also prove that problems with two or three states of nature can be solved in polynomial time using the LP approach, though the procedure requires the generation of all the extreme points of the feasible region.

Keywords: Managerial Decision Making, Risk and Decision Analysis, Optimization, Linear Programming, Selection of Alternatives, States of Nature.

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11. ARE PRINCIPLES-BASED STANDARDS EFFECTIVE IN THE US?

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ABSTRACT

The Securities and Exchange Commission (SEC) is investigating whether US firms should have the option to use International Financial Reporting Standards ("International Standards") instead of US Standards. IFRS standards are generally more principles-based and so require more judgment to apply them. We explore whether more principles-based standards would be effective in the US by examining disclosures about FASB Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations (FIN 47) on firms' accounting for asset retirement costs. FIN 47 was issued to address concerns that principles in Statement of Financial Accounting Standards Number 143 (SFAS 143), Accounting for Asset Retirement Obligations, a principles-based standard, were not being applied as intended. Because the clarifications in FIN 47 are only reiterations of and references to statements already made in SFAS 143, if *firms were following the principles embedded in SFAS 143, they would not need to change their accounting practices as a result of FIN 47. Therefore, our examination of firms' disclosures about FIN 47 sheds light on the question of whether adopting more principles-based standards would improve financial reporting in the US.*

We find that 40% of our sample firms disclosed information about FIN 47. Fifteen percent of the sample firms reported material effects of adopting FIN 47. This high degree of non compliance with the intent of SFAS 143 suggests that without changes in enforcement and incentives the adoption of principles based standards would result in less reliable financial reporting in the US.

Keywords: *Asset Retirement Obligations, Accounting Standards, International Financial Reporting Standards, Principles-based Standard.*

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12. DETERMINANTS OF PERCEIVED AUDIT QUALITY: THE ROLE OF AUDIT FEES AND AUDIT COMMITTEE COMPOSITION

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ABSTRACT

Arguments proposed in the accounting literature suggest that high audit fees generate an economic bond between the auditor and client that investors may perceive as compromising the integrity of the audit process. Potentially countering this effect may be an increased level of investor confidence resulting from the regulatory requirement of management independence of the audit committee. This paper empirically explores in an experimental setting the impact of both audit fees and audit committee composition on nonprofessional investors' perceptions of audit quality. Its findings suggest that while higher audit fees may generally increase investors' skepticism of the reliability of audited financial statements, independent audit committees may provide significant levels of protection against perceptions of reporting bias.

Keywords: *Audit Quality, Audit Fees, Audit Committee, Independence, Financial Reporting Bias.*

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13. THE ROLD OF MONETARY POLICY IN SOME ANOMALIES

ABSTRACT

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Some investors build investment strategies around stock return patterns, pursuing anomalous returns. Among the patterns documented by researchers are the January effect and the monetary policy effect, which are both pronounced among high book-to-market firms. Our study investigates whether the two effects are actually distinct or simply correlated. Results show that these two effects are strongly present independently in book-to-market sorted quintile portfolio returns. We also find that depending on how returns are measured there is a significant interaction between the two effects. Hence, the results presented here have implications for both investors and researchers when analyzing portfolio performance.

Keywords: *Return Regularity, January Effect, Monetary Policy.*

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14. HOW MUCH DOES THE PRIME INTEREST RATE AFFECT U.S. INVESTMENT

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ABSTRACT

This paper examines (econometrically) which interest rates seem most systematically related to investment and the GDP, and how long the lag time is before changes in these interest rates affect the GDP. The data for the U.S. 1960 - 2000 suggest that the Prime interest rate has the most important and systematic influence on macroeconomic levels of investment and the GDP. The findings suggest the Prime rate affects these variables after a two year lag, probably due to the lengthy periods required to design, bid and build new factories, commercial facilities and some machinery. Other rates examined, but not found related to investment - triggered GDP growth, include the Aaa and Baa corporate bond rates, the mortgage interest rate and the 10 year Treasury bond rate. Our results also suggest the magnitude of the effect of interest rate changes on the economy is relatively modest, and that therefore the Federal Reserve's ability to influence the economy by changing rates may also be somewhat constrained.

Keywords: *Economics, Macroeconomics, Investment, Interest Rates*

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15. PREDICTABILITY AND TRADING EFFICIENCY OF S&P CNX NIFTY INDEX RETURNS USING SUPPORT VECTOR MACHINES AND RANDOM FOREST REGRESSION

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ABSTRACT

This study investigates the predictability of S&P CNX NIFTY index returns using Support Vector Machines and Random Forest Regression. The performance of the two models is compared with neural network and ARIMA model. The four competing are rigorously evaluated in terms of widely used statistical metrics like mean absolute error, root mean square error, normalized mean square error, correctness of sign and direction change, equal forecast accuracy using Diebold and Mariano test, forecast encompassing test and also in terms of various trading performance and economic criteria like annualized return, Sharpe ratio, maximum drawdown, annualized volatility and average gain/loss ratio via a simple trading strategy. The analysis reveals that SVM model achieves greater forecasting accuracy and improves prediction quality compared to other models experimented in the study. SVM outperforms random forest, neural network and ARIMA model both in terms of statistical and financial measures of performance.

Keywords: ARIMA; Artificial Neural Network; Support Vector Machines; Random Forest; Forecasting; Stock Market

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16. THE PRICE-VOLUME RELATIONSHIP AND MISPRICING IN THE MARKET MODEL FOR OTC STOCKS

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ABSTRACT

This paper investigates if the observed price-volume relationship found in prior research has a "dual effect" on prediction errors in the market model. We find that high volume may be associated with lower and higher prediction errors in the market model. On normal volume days, high average volume stocks have lower prediction errors than thinly traded stocks. However, we find a significant shift in this *relationship on abnormally high volume trading days. On abnormally high volume days, the market model's prediction errors are significantly larger. This provides additional evidence that large increases in volume may reflect new and changing market information, making the market model less efficient in estimating returns.*

Keywords: Market Model, Volume, Mispricing

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17. FUNDS FROM OPERATIONS (FFO) AS AN INDICATOR: EVIDENCE OF RATIONAL BEHAVIOR AND EXPLANATORY POWER

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ABSTRACT

Our paper analyzes the effects of financial indicators on stock price. We use 411 firms represented in 1995 and 2005 Standard and Poor's 500 data in a Gordon Dividend Growth framework regression model to examine these effects as well as investigate the effect over an eleven-year period. As expected, investors should also use our key demand variable, funds from operations (FFO), as a financial indicator tool as evidenced in our results. Also, the effect of changes in FFO on changes in share price between periods further represents rational stock market investor behavior, which in turn contributes to investment decision-making. The paper further evaluates how well FFO explains stock price.

Keywords: *ffo, eps, dps, stock price, rational behavior, explanatory power*

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18. DIVIDEND POLICY DETERMINANTS IN THE INSURANCE INDUSTRY

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ABSTRACT

This paper explores the dividend payout policy of firms in the insurance industry using a modification of Rozeff's (1982) agency cost-transaction cost tradeoff model. It appears that a firm's beta and level of insider ownership is directly related to dividend yield. Specific industry classification also appears to be important. Historical revenue growth and the leverage also appear to be inversely related to dividend yield. This study is important since it is the first to apply this model to the insurance industry.

Keywords: *Dividend policy, insurance company, agency cost-transaction cost tradeoff.*

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19. DO EARNINGS ANNOUNCEMENTS OF INDUSTRY LEADERS CONVEY ADDITIONAL INFORMATION ABOUT THEIR INDUSTRY?: AN EMPIRICAL EXAMINATION OF INTEL CORPORATION

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Vincent Richman, Sonoma State University, California, USA
Michael R. Santos, Sonoma State University, California, USA

ABSTRACT

Common stock market wisdom holds that the earnings announcements for industry leaders are important events releasing new information to the investing world about the future performance of the industry. The financial media often attribute daily fluctuations in financial market indexes to the information releases from the industry leaders. We investigate this belief by studying the industry leader Intel Corporation and its impact on the high-tech industry. Utilizing the Seemingly Unrelated Regression methodology, we studied the announcement effects of Intel Corporation's 48 information releases (28 quarterly earnings, 8 revisions and 12 business updates) on a variety of stock market indexes over the seven year period of 1997 to 2003. In only 3 of the 48 cases, were the common stock returns statistically significant at the announcement dates. These results suggest a rethinking of the belief that the market leaders are early barometers of their respective industries.

Keywords: *Intra-industry information transfer, Capital Asset Pricing Model (CAPM), earnings announcement, Seemingly Unrelated Regression (SUR), market leader.*

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20. THE VALUE RELEVANCE OF DIVIDENDS: CANADIAN EVIDENCE

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Imed Chkir, University of Ottawa, CANADA
Abdul Rahman, University of Ottawa, CANADA

ABSTRACT

We formulate and test a hypothesis linking dividend policy and cross-listing of Canadian firms on US stock exchanges. Based on the assumption that cross-listing enhances price discovery as per Eun and Sabherwal (2003), we present new results that suggest that cross-listed firms benefit from a steady state price premium but experience a reduced value relevance of dividends when compared to firms that are listed only on the domestic exchange. We also replicate some of the tests undertaken by Hand and Landsman (2005) and found evidence that not only reject the dividend displacement hypothesis, but also indicate that loss firms in Canada use a stable dividend policy to signal future profitability. These latter results are apparently new for Canadian data and extend those of the US presented by Hand and Landsman (2005) in that we find pricing differences between dividend increasing, dividend decreasing and no-dividend change firms.

Keywords: Ohlson Model; Dividend Signaling; Free Cash Flow; Cross-Listing Effect.

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21. FIRM SIZE AND PRODUCTIVITY: THE CASE OF REITs

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ABSTRACT

Real Estate Investment Trusts (REITs) have experienced numerous operational changes since 1993 because of legislation, structural changes, and consolidations. We employ the Malmquist Index to *examine the impact of these changes on the productivity of REITs of different size categories during 1989-1999. Regardless of the firm size, REITs experience increases in efficiency during the 1994-1999 period. However, results reveal that technological regress leads to productivity loss. The positive trend in scale efficiencies for larger REITs may be related to merger activities occurring after 1993. Finally, higher efficiency measures for smaller firms can be attributed to increased competition.*

Keywords: REITs; Malmquist Index; Productivity Change