7th International Moscow Finance Conference

ICEF, Higher School of Economics

October 26-27, 2018

Day 1. Friday

Session 1. Asset Pricing Empirical I. 10.00-11.50

Chair: **Vladimir Sokolov** (ICEF, HSE)

- "Groomed for Selling and Sold for Grooming: Strategic Behavior Surrounding Sales of Mutual-Fund Management Companies" by Eduard Inozemtsev (Gaidar), Zoran Ivković (Michigan State) and **Andrei Simonov** (Michigan State)
  Discussant: **Miguel Anton** (IESE)

Performance patterns involving funds managed by management companies both to be sold and recently sold suggest their careful strategic management. Intertemporal patterns in cross-subsidization in the year leading to the sale deteriorate the performance of funds from the top of relative rankings ("the stars"). The funds that a year before the sale have been at the bottom of relative rankings ("the dogs") appear to have been at the receiving end of the cross-subsidization. Endogeneity concerns are alleviated by the finding that this pattern is not present in the context of incidental asset management company sales, and is amplified in the context of deliberate asset management company sales. Variation in the extent of active management over time is not at play because it does not vary with the critical variable indicative of cross-subsidization. Allocation of strong stock picks across mutual funds managed by the same management company follow the predicted patterns of cross-subsidization surrounding mutual-fund management company sales. Patterns of cross-subsidization reverse after the sale had been completed. Specifically, stars, having been providing cross-subsidization shortly before the sale, are on the receiving end of cross-subsidization in the period following the sale. Finally, the cross-subsidization results are pronounced only for the star funds highly likely to be delisted shortly after the completion of the management company sale.

- "FX Premia Around the Clock" by Ingomar Krohn (Warwick), **Phillipe Mueller** (Warwick) and Paul Whelan (Copenhagen)
  Discussant: **Albert J. Menkveld** (VU, Amsterdam)

We dissect return dynamics in the foreign exchange market into different components over the 24-hour day and revisit well-known trading strategies such as carry and dollar carry. Using twenty-four years of high-frequency data on G10 currencies we unveil a distinct 'W' intraday pattern of the dollar portfolio. We show that positive average returns for going long foreign currencies are almost entirely generated during U.S. main trading hours. Overnight, currencies collectively depreciate against the U.S. dollar. Further, we document that 75% of the high-minus-low portfolio return from a standard carry trade strategy and almost 80% of dollar carry returns are generated during the day. As the value of the U.S. dollar tends to increase outside of the main U.S. trading hours, both popular strategies generate insignificant positive or negative returns in the overnight period. This new evidence sheds light on our understanding of currency markets and has important implications for future theoretical and empirical work.

Session 2. Asset Pricing Theory I. 12.10-14.00

Chair: **Udara Peiris** (ICEF, HSE)

- "Speculative Trading and Derivative Market Imbalances", by Albina Danilova (LSE), **Christian Julliard** (LSE), Yavor Stoev (Michigan)
  Discussant: **Alexei Boulatov** (ICEF, HSE)

We consider an economy in which some agents do not continuously hedge their position in derivative assets using the underlying assets market – i.e. we study the effects of an imbalanced derivate market. We show that, even in the presence of complete markets, the imbalance significantly alters the equilibrium price process of the underlying assets: risk premia and volatility become stochastically time varying, hence option implied volatility is characterized by smile and smirk patterns, momentum-like price dynamics arise as well as price spillovers across underlying assets. Moreover, the derivative imbalance generates self-fulfilling equilibria, e.g. if the imbalance takes the form of a bet on an increase in asset volatility, then the equilibrium volatility does increase. Finally, since our formulation is extremely general, our results also apply to segmented markets where some investments are achievable only via financial intermediation.

- "Asymmetric Information and Security Design under Knightian Uncertainty" by **Andrey Malenko** (MIT) and Anton Tsoy (EIEF)
  Discussant: **Oren Sussman** (Oxford)

We study optimal security design by an informed issuer when the investor faces Knightian uncertainty about the distribution of cash flows and demands robustness: she evaluates each security by the worst-case distribution at which she could justify it being offered by the issuer. First, we show that both standard outside equity and standard risky debt arise as equilibrium securities. Thus, the model provides a common foundation for two most widespread financialcontracts based on one simple market imperfection, information asymmetry. Second, we show that the equilibrium security differs depending on the degree of uncertainty and on whether private information concerns assets in place or the new project. If private information concerns the new project and uncertainty is sufficiently high, standard equity arises as the unique equilibrium security. When uncertainty is sufficiently small, the equilibrium typically features risky debt. In the intermediate case, both risky debt and standard equity arise in equilibrium. In contrast, if private information concerns assets in place, standard equity is never issued in equilibrium, irrespective of the level of uncertainty, and the equilibrium security is (usually) risky debt.

Session 3. Corporate Finance Empirical I. 15.20-17.10
Chair: **Sergey Stepanov** (ICEF, HSE)

- "Innovation, Investment and the Structure of Employment Contracts" by **Olga Kuzmina** (NES)
  Discussant: **Arkaja Chakraverty** (ICEF, HSE)

We exploit the appealing institutional setting of the Spanish labor market to show that the use of more flexible (shorter and cheaper to terminate) contracts with labor increases firm's innovation and investment. We distinguish between different types of innovation (frontier vs non-frontier, internal vs external, domestic vs imported technology) and investment (core vs non-core) to shed light on the mechanism behind the effect. Our evidence is most consistent

with flexible labor contracts reducing financial constraints of the firm, rather than investment in human capital or skill complementarity stories. We build the identification strategy on the exogenous intertemporal and cross-regional variation in government programs, which aimed at an increase in worker job security, and discouraged firms from using the more flexible ("fixed-term") contracts. This setting, akin to a natural experiment, allows us to identify the effects of interest in the instrumental variables framework, also controlling for unobserved heterogeneity.

- "Ownership Concentration and Firm's Risk: Evidence from the US" by **Silvia Rossetto** (Toulouse) and Raffaele Stagliano (Montpellier)
- Discussant: **Pavle Radicevic** (NES)

This paper investigates empirically the link between mid-sized blockholders and firm risk. Controlling for potential endogeneity problems, we find that the presence of multiple blockholders positively affects firm risk. We also find that the stake of the largest blockholder reduces negatively firm risk only when the firm has no other blockholders. Otherwise, the effect is insignificant. Overall our evidence is consistent with theories showing that firms' decisions are not determined by the largest shareholder alone and highlight the role of mid-sized blockholders. Findings are robust to various model specifications and controls.

Keynote Speech (17:30-18:30) Bernard Dumas (INSEAD and University of Torino)
Chair: **Alexey Boulatov** (ICEF, HSE)

"The Stock Market in an Inflation-Targeting Economy" by Bernard Dumas (INSEAD and University of Torino) and Marcel Savioz (Swiss National Bank)

We construct recursive solutions for, and study quasi-explicitly the properties of the dynamic equilibrium of an economy with three types of agents: (i) household/investors who supply labor with a finite elasticity, consume a large variety of goods that are not perfect substitutes and trade government bonds; (ii) firms that produce those varieties of goods, setting prices in a Calvo manner; (iii) a government that collects an exogenous fiscal surplus and acts mechanically, buying and selling bonds in accordance with a Taylor policy rule based on expected inflation. In this equilibrium, we price the stock market, defined as the present discounted value of firms' profit and simulate the joint behavior of stock returns and inflation. We use the simulated data to gauge the adequacy of the model in comparison with empirical stylized facts.

Session 4. Asset Pricing Empirical II. 10.00-11.50

Chair: **Maxim Nikitin** (ICEF, HSE)

- "Information Revelation in Decentralized Markets" by Bjorn Hagstromer (Stockholm) and **Albert J. Menkveld** (VU, Amsterdam)
  Discussant: **Dmitry Livdan** (UC, Berkeley)

How does information get revealed in decentralized markets? We test several hypotheses inspired by recent dealer-network theory. To do so we construct an empirical map of information revelation where two dealers are connected based on the synchronicity of their quote changes. The tests, based on EUR/CHF quote data including the 2015 crash, largely support theory: Strongly connected (i.e., central) dealers are more informed. Connections are weaker when there is less to be learned. The crash serves to identify how a network forms when dealers are transitioned from no-learning to learning, i.e., from a fixed to a floating rate.

- "Term structure of risk in expected returns" by **Irina Zviadadze** (Stockholm School of Economics)
  Discussant: **Sofya Budanova** (ICEF, HSE)

Return predictability reveals economic variables that drive expected returns. Alternative economic theories relate fluctuations in predictive variables to different sources of risk. I develop an empirical approach that exploits these observations and measures how economically interpretable shocks propagate in the term structure of expected buy-and-hold returns. Shock propagation patterns constitute term structure of risk in expected returns whose shape and level serve as informative moments to test competing equilibrium theories of return predictability. As an application, I examine sources of stock return predictability. I find that equilibrium shocks in the long-run mean of the variance of consumption growth can justify the level and the shape of the term structure of expected stock returns, in contrast to consumption disasters or long-run risk.

Session 5. Asset Pricing Theory II 12.10-14.00

Chair: **Luca Gelsomini** (ICEF, HSE)

- "A Welfare Analysis of Segmented Liquidity Markets" by **Alexander Guembel** (Toulouse) and Oren Sussman (Oxford)
  Discussant: **Vincent Fardeau** (ICEF, HSE)

The 2008 financial crisis heightened concerns about contagion across high leverage investors. Some have suggested that segmenting markets into stand alone units may contribute to financial stability and enhance social welfare. We provide a welfare analysis of segmentation policies in a two country model with endogenous financial crises and cross country contagion due to fire sales externalities. We model a continuous shock to liquidity demand in each country, which allows us to distinguish between crises, depending on their severity and endogenize crisis probabilities. We identify a new trade-off created by segmentation decisions. When countries segment, they are protected from contagion when their shocks are mild, but exposed to crisis when shocks are large and access to a neighbor's liquidity is denied. This trade-off reduces welfare. We also show that segmentation only affects crisis probabilities when governments inject public liquidity. Then and only then can segmentation be welfare

enhancing. Finally, failure to coordinate policies may lead to excessive segmentation when governments are involved in liquidity injection, but not when liquidity is provided solely privately.

- "Asset Pricing with Fund Competition" by Sergei Glebkin (INSEAD) and **Dmitry Makarov** (ICEF, HSE)
  Discussant: **Andrey Malenko** (MIT)

We develop a dynamic general equilibrium model to study how competition among institutional investors affects the stock market characteristics—level, expected return, and volatility. We consider an economy in which multiple fund managers strategically interact with each other, as each manager tries to increase her performance relative to the others. We fully characterize an equilibrium in this economy, and find that a more intense competition is associated with a higher level of the market, lower expected market return, while market volatility is not affected by competition. These findings are broadly consistent with the data.