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PROCEEDINGS

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ASSET PRICING THEORY IN LIGHT OF ELLSBERG PARADOX

Peter B. Lerner[1]

Behavioral patterns are frequently contradicting rational expectations paradigm. Yet, quantitative consequences of violation of rational expectations have been so far obscure despite of the frequent assumption that current financial circumstances are attributed to behavioral factors.

In 2008, Epstein and Schneider proposed a theory, which incorporates classical Ellsberg paradox into a rigorous asset pricing model. It is founded on a Knightian distinction between risk as uncertainty of definite but unknown parameters and noise preventing these parameters from being determined, which has no economic interpretation. In 2009, the author pointed out that Epstein-Schneider asset pricing theory might explain an extremely high sensitivity of the market indexes to the changes in a risk free rate, though contribution of the risk free rate to the cost of capital of a high-tech (for instance, a typical Nasdaq firm) can be quite small. In this paper, I subject this statement to an empirical verification using intraday integrated volatility of the Nasdaq-100 index.

MULTI-GROUP ASSET FLOW EQUATIONS AND STABILITY

Mark DeSantis
Chapman University

Gunduz Caginalp
University of Pittsburgh

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CULTURAL FOUNDATIONS OF INDIVIDUAL FINANCIAL DECISIONS

Christo Pirinsky
George Washington University

Hein Bogaard
George Washington University

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OPAQUE TRADING, DISCLOSURE AND ASSET PRICES: IMPLICATIONS FOR HEDGE FUND REGULATION

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Maureen O'Hara
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AGENT-BASED RISK MANAGEMENT -
A REGULATORY APPROACH TO FINANCIAL MARKETS

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This paper provides market risk calculation for an equity-based trading portfolio. Instead of relying on the purely stochastic internal model method, which banks currently apply in line with the Basel regulatory requirements, we propose to include also alternative price mechanisms from the financial literature into the regulatory framework. For this purpose a modified version of the model by Lux and Marchesi (2000) is developed, capturing the realistic feature that parts of the investors do not follow the assumption of no arbitrage, but are motivated by rules of thumb and market psychology instead. Although both the standard stochastic as well as the behavioral model are restricted to 250 trading days, the latter is able to capitalize possible turbulences on financial markets and likewise the well-known phenomenon of excess volatility - even if the last 250 days reflect a calm market for which the efficient-market hypothesis could hold. Thus it is argued that a value-at-risk-based maximum approach in the regulatory framework would create better capital requirements with respect to their level and counter-cyclicality. This in turn could reduce the extent to which (irrational) bubbles arise since market participants would have to anticipate comprehensively the costs of such bubbles bursting. Furthermore a key ratio is deduced from the agent-based construction to lower the influence of speculative derivatives.

A REGULATOR'S EXERCISE OF CAREER OPTION TO QUIT AND JOIN A REGULATED FIRM'S MANAGEMENT WITH APPLICATIONS TO FINANCIAL INSTITUTIONS

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Ryerson University

We introduce a behavioral model in labor markets where, using appropriate signals, regulators create career options that they may later exercise by quitting as regulators, and potentially joining the management of (or consulting with) the firms they formerly regulated. For example, regulations typically define firms' capital adequacy positions. That is opportunity for regulators to affect their career option values through signaling and design mechanism(s) that affect firms' capital structure. Thus we develop several important results.

First, we prove that regulator signals embedded in capital structure induce discrete regimes for the firm's pricing strategy. In that context, agency cost consequences arise. For example, a regulator may induce a substitution of firm profit for consumer welfare, and for the firm or industry involved, such signals might increase the regulator's career option value.

Second, we prove that with involvement of a former regulator, the internal rate of return (IRR) on firm projects is linear in weighted average cost of capital and the regulator's human capital beta. For example, regulated firms can enhance their profitability if ex-regulators secure forbearance such that either of two outcomes is realized:
   a) An increase in IRR for existing, new or expanded projects that the firm is able to undertake under the regulations, holding the WACC constant; or
   b) A reduction in the WACC of such projects, holding constant the IRR

Consequently, regulators with knowledge and interpretation of the history, intent and scope of existing regulations are valuable to the firm. Thus, there are incentives for current regulators to gain expertise that firms desire and signal their potential availability. With such signals, they possess a valuable option regarding the future direction of their career. This human capital is an omitted variable in IRR estimates based solely on net present value.

Third, we prove that the value of a regulator's career option increases with firm leverage. So regulator's have career incentives to embed leverage inducing regulatory signals in the firm's capital structure. And firms have profit incentives to hire former regulators to increase IRR. This symbiotic relationship explains why strategically levered firms obtain better regulatory outcomes.

Fourth, regulator career option vega (price-risk sensitivity) priced under Shepp-Guo information based model compared to that priced under Black-Scholes-Merton model, indicate that firm

value-at-risk, i.e. tail risk and bankruptcy, is greater than it would be in non-regulatory capture regimes. We then identify warning signals for firm bankruptcy.

We find support for several aspects of our theory in a sample of US commercial banks. Institutionally, within established parameters and guidelines, commercial banks meet public credit needs while providing periodic rates of returns to their shareholders. Monitoring and examining the bank "franchises" in the U.S. give rise to a range of regulators – depending on whether the institutions are federally or state chartered. Further, regulations arise with respect to protections for depositors.   Other related considerations of risk and return drive further monitoring and restrictions in banking. For example, financing activities and asset acquisitions also are variously constrained (e.g. no common stock investments); prices may be regulated or not (e.g. Regulation Q); capital adequacy may be proscribed both with respect to quantity and to mix of debt and equity; asset growth may be facilitated or not (e.g. appropriate collateral, and margin requirements on stock purchases). It is normal in banking for regulations to produce push – pull tensions, with management desiring greater degrees of freedom than may ostensibly be allowed within established regulations.

All such tensions generally give rise to opportunities wherein regulators might exercise their significant discretion to support the management "push" or the public "pull" in their reports to bank management, to policy makers and to the public. For example, it is a regulator's responsibility to evaluate management and bank performance on such things as earnings and financial leverage and to assign comparative institutional rankings (e.g. CAMELS scores). In that process, the regulator builds a career whose market value changes with the exercise of their discretion.[2] This process is known, and as a result, costly departure barriers are established to restrain regulators and to minimize conflicts of interest are imposed. However, it is likely that market valuation processes for these regulators subsume any such departure costs.

Empirically, data show that prior to the 2008 financial crisis, the trend in average bank leverage and managerial compensation in commercial banks began to increase. *The banks were heavily engaged in the design and sale of previously prohibited products (which increased bank leverage e.g. sub-prime mortgages). Regulators approved these products. With increased leverage and interest tax deductibility, the value of bank leverage increased, and could be used to finance enhance managerial compensation.*

Keywords: career option, revolving door, mechanism design, capital structure, IRR, WACC
JEL Classification Codes: C02, D60, D81-82, G13, G18, G38, J24, J44-45, L51

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[2] A market exists for the labor of ex-regulators wherein valuation prospects exist in an ongoing manner. One example is in such places as "K Street" in Washington DC.

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NON-CLASSICAL MOTIVATIONS AND THE BEHAVIORAL IMPACT OF NEWS ANNOUNCEMENTS ON STOCK PRICES

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THE JANUARY EFFECT, AN ANOMALY THAT ISN'T AN ANOMALY: AN EMPIRICAL ANALYSIS OF INFORMATION AND SECURITIES MARKETS

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The theoretical underpinnings of why financial markets move the way they do have been the subject of a long debate in financial economics. The emergence of behavioral theories to explain investors' decisions and securities price movements has largely put into question early models of efficient markets. It is however accepted that securities prices move with the arrival of new information. This paper proposes a new approach to quantify "information" and provides insights on how the volume of available information might influence stock prices. A new dataset is created from ProQuest to proxy for the volume of information. The January Effect pricing anomaly is chosen as a case study. Using CRSP portfolios and our new information dataset we empirically test for a January seasonal using monthly data from 1927-2010. Econometric methods are used to estimate several regression models relating index returns, January premiums and the volume of information. Results show statistically significant relationships between the different variables. These findings support our hypothesis that, the volume of information contributes in explaining price variations in the CRSP portfolios. If information is defined in a broad sense, it could encompass both categories of information referred to in efficient and behavioral theories of markets. In this reasoning, "market anomalies" could be explained by available information, if it were quantifiable. By providing a dataset where the definition of information is limited only by its availability online, the main contribution of this paper is to attempt to quantify all published information which could impact securities price movements. The seasonality of the information dataset presented in the paper confirms this hypothesis and contributes to explaining the January effect. This paper has several implications: first, the analysis to the January effect could be expanded to provide insights in markets in general, such as the explanation of bubbles. Second, the findings highlight the need for further research in the application of information research to stock market analysis.

ANALYST RELUCTANCE IN CONVEYING NEGATIVE INFORMATION TO THE MARKET

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THE "IRON CAGE" TURNED INSIDE OUT: EMERGING EVIDENCE OF THE EFFECTS OF "REVERSE LEGITMACY" ON SIX MAJOR BANKS

Arthur J. O'Connor
Pace University

"...we still believe that subprime mortgages are a good product...During the latter part of 2007, we set out to increase our home lending market share....Although we may pay for probably starting this expansion a little too early, we remain committed to the goal."

> - Jamie Diamond, CEO of JP Morgan Chase, 2007 Annual Letter to Shareholders

"We did eat our own cooking, and we choked on it."

> - John Mack, the CEO of Morgan Stanley, reflecting upon the uncontrolled growth of mortgage-related securities in his January 13, 2010 testimony to Congress

This qualitative case study offers an insider's account of financial industry developments and regulatory behaviors starting from 1999 and ending in 2007 – actions which by 2008 necessitated their bail out by the U.S. government in which the six banks received $160 billion of Troubled Asset Relief Program funds and borrowed as much as $460 billion from the Federal Reserve Bank (11/24/2011, Bloomberg)] – as emerging evidence of the effects of "reverse legitimacy" (Riaz, 2009, p. 28), or the undue influence of powerful organizations upon societal institutions.

The study frames the recent (2007-2008) global financial crisis as primarily a failure of institutions, spurred by the confluence of two trends that resulted in the "…broader cultural changes that created the conditions for the credit crisis of 2008" (Stein, 2011. p. 173).

The first trend was the self-interested embrace by the national elite of Wall Street and corporate business interests during in the early part of the first decade of the millennium in an ideology that held that markets were efficient and self-correcting, and in the infallibility of quantitative finance. In this mindset, and consistent with the capital asset pricing theory (French, 2003), taking and managing greater amounts of risk were essential to satisfy institutional investor demand for greater returns. Capital in the new, hyper-competitive global economy was believed to be forever abundant and cheap; efficiency ruled (meaning low prices, low inflation, and thus low interest rates) were here to stay; and that innovation and the creative use of leverage – in the burgeoning fields of securitized products, leveraged finance, and structured products – were the key strategies to earn higher returns to meet the demands from institutional investors worldwide.

The second trend was the unprecedented political power of these influential elites on national policy, due to the accumulation of wealth on Wall Street and the dominance of the financial sector in America's economy.

Building upon neo-institutional theory and the concept of "reverse legitimacy" Riaz, 2009, p 28), the case study proposes that regulatory institutions – instead of exercising prudence, fiduciary care and due diligence to ensure the safety and soundness of the financial system on the behalf of the collective – acquiesced and adopted the mind-set and prevailing practices on Wall Street and preemptively bestowed acceptance of these strategies and products, in the regulators' desire to be perceived as enabling or creating the institutional construct that made possible or contributed to industry success (Hudson and Maioli, 2010; Riaz, 2009). As a result of the reversal of the institutional-organizational legitimization process, wealth generating/maximizing opportunities from taking greater risks by the few trumped the safety, soundness and transparency for the many.

PROPOSITIONS

The study offers three propositions. The first proposition is that reverse legitimacy is positively associated with conformity of business practices, as the legitimacy is based on initial market success, not on institutional governance standards or other normative criteria. Proposition one suggests that when regulatory institutions permissively endorse industry practices in seeking the "halo" of their success, this success drives isomorphic conformity of behaviors, as per Table 1, which shows statistically significant Pearson product movement correlation of quarterly mortgage and loan volume, net of loss reserves, for six banks from Q1 1999 to Q4 2007.[3]

Correlations

		Citigroup	Wells Fargo	JPMorgan Chase	Goldman Sachs	Morgan Stanley	Bank of America
Citigroup	Pearson Correlation	1	.975**	.889**	.907**	.867**	.894**
	Sig. (2-tailed)		.000	.000	.000	.000	.000
	N	36	36	36	36	36	36
Wells Fargo	Pearson Correlation	.975**	1	.901**	.858**	.841**	.871**
	Sig. (2-tailed)	.000		.000	.000	.000	.000
	N	36	36	36	36	36	36
JPMorgan Chase	Pearson Correlation	.889**	.901**	1	.862**	.824**	.918**
	Sig. (2-tailed)	.000	.000		.000	.000	.000
	N	36	36	36	36	36	36
Goldman Sachs	Pearson Correlation	.907**	.858**	.862**	1	.896**	.970**
	Sig. (2-tailed)	.000	.000	.000		.000	.000
	N	36	36	36	36	36	36
Morgan Stanley	Pearson Correlation	.867**	.841**	.824**	.896**	1	.891**
	Sig. (2-tailed)	.000	.000	.000	.000		.000
	N	36	36	36	36	36	36
Bank of America	Pearson Correlation	.894**	.871**	.918**	.970**	.891**	1
	Sig. (2-tailed)	.000	.000	.000	.000	.000	
	N	36	36	36	36	36	36

**. Correlation is significant at the 0.01 level (2-tailed).

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[3] DISCLAIMER: Correlation supports proposition that, all things being equal, reverse legitimacy is associated with mimetic lending practices. Analysis, based on small sample (n=36), is NOT presented as statistically valid evidence that reverse legitimacy is the exclusive predictor of, or cause for, conformity of behavior

The second proposition is that increased concentration of national elite within a regulated industry is positively associated with reverse legitimacy. In support of the second proposition, business and social network maps of Wall Street executives with corporate, financial and social institutions were presented as emerging evidence that institutions responsible for serving the public interest have become increasingly beholden to, and aligned with, the private interests and ideology of the ruling class.

The study's third proposition is that there is a negative relationship of such mimetic behavior with organizational ability to recognize and adapt to changes in the environment. In support of the third proposition, five of the six banks continued to grow their mortgage and loan portfolios in 2007, despite overwhelming evidence of a downturn in market conditions. That is, despite clear indications that housing prices had inflated over the past few years, expansion of credit had gotten out of hand, and that financial models [which by definition are mathematical simplifications of real-world complexities and assume "normal" market conditions] do not factor for speculative bubbles or unexpected shocks to the system, key executives remained confident that a) credit risk models were accurately pricing risk, based on time-tested geographic diversification factors and time-proven inverse correlations among different asset types and investment vehicles; b) credit agencies were accurately rating the tranches of the securitized credit structures, based on the cash-flow-waterfall-based protection of senior layers and historical default rates; c) risk transfer mechanisms such as credit default swaps and traditional forms of bond insurance were effectively reducing counter-party exposure to firms; and that d) position capture and limits management systems had sufficient look-through capabilities and transparency to identify, aggregate, and manage concentration risk and identify any serious interdependencies to other financial institutions or third parties.

The study concludes that, in America's increasingly polarized economy, the "iron cage" of institutional isomorphism (DiMaggio & Powell, 1983) may indeed have been turned inside out, in which institutional actors, in their desire for upward mobility and acceptance by the ruling class, take their cues from powerful industry players who define the ground rules for economic life for all.

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CEO PERSONAL RISK-TAKING AND CORPORATE POLICIES

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This study analyzes the relation between CEO personal risk-taking, managerial risk-taking and total firm risk. We find evidence that CEOs who possess private pilot's licenses, our proxy for personal risk-taking, are associated with riskier firms. We trace the source of the elevated firm risk to specific corporate policies including leverage and acquisition activity. However, despite their willingness to bear increased levels of firm risk, we find no significant differences in the pilot CEOs' compensation structure. Our results suggest that observable personal risk preferences revealed outside the scope of the firm have implications for risk-related agency problems between CEOs and shareholders.

DOES EXPERIENCING A CRASH MAKE ALL THE DIFFERENCE? AN EXPERIMENT ON THE DEPRESSION BABIES HYPOTHESIS

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GRADUAL INFORMATION DIFFUSION IN THE STOCK MARKET: EVIDENCE FROM MULTINATIONAL FIRMS

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WHEN THE EU LEADERS MEET, THE MARKETS LISTEN. EXTRACTING SENTIMENT FROM POLITICAL STATEMENTS

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HUMAN CAPITAL, MANAGERIAL OVERCONFIDENCE, AND CORPORATE VALUATION

Richard Ebil Ottoo
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BEHAVIOURAL PORTFOLIO SELECTION: ASYMPTOTICS AND STABILITY ALONG A SEQUENCE OF MODELS

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A fundamental problem in behavioural finance is understanding how behavioural agents (with distorted beliefs and non-concave utility functions) behave in a stochastic environment such as the financial markets. For several complete models in continuous time, there are surprisingly explicit results for this problem. However, these explicit results, as well as the resulting economic implications, do not carry over to discrete-time models.

This significant impact of the underlying model raises a natural stability question: Do the behavioural predictions generated by the portfolio selection problem in a particular model change drastically if we slightly perturb the model? The purpose is to answer this question in detail. We consider a sequence of financial markets that converges weakly in a suitable sense, and we maximize a behavioural preference functional in each market. For concave utilities, it is well known that the maximal expected utilities and the corresponding final positions converge to the corresponding quantities in the limit model. We prove similar results for non-concave utilities and distorted expectations, and we illustrate by a counterexample that these results require a stronger notion of convergence of the underlying models compared to the concave utility maximization. We discuss these new effects in detail and give sufficient conditions to prevent such unpleasant phenomena. In order to illustrate the main results, we provide several applications: 1) we analyze how a (marginal) misspecification of the drift, volatility and investment horizon influences the optimal behaviour of the agent; 2) we provide numerical tractable methods to solve the behavioural portfolio selection in complete models in continuous time; and 3) we use the results to analyze more thoroughly possible behavioural explanations for the pricing kernel puzzle.

THEORIES OF ALLAIS TYPE OF BEHAVIOR: AN EXPERIMENT

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Allais paradox provides evidence against the plausibility of independence axiom. Allais argues against the cardinal measure of utilities for decisions under risk and claims that utility for risky prospects depends also on the distribution of the cardinal measure. Savage responds to Allais by arguing that common consequences are difficult to see in Allais type of tests and claims that people would not wish to violate the independence axiom if the common consequences are presented in a clear and understandable way.

In this paper, we first test whether the presentation of common consequences in a clear and understandable way makes a difference in terms of violating choices. In order to do this, we created six different lottery pairs that differ only in terms of the value of the common consequence. Specifically, each lottery pair consist of a safe lottery S=($c, 89%; $8, 11%) and a risky lottery R=($c, 89%; $10, 10%; $0, 1%) with the common consequences of c={0, 5, 8, 10, 16, 20}. For one group, we presented lotteries in standard Allais format, which is description of lotteries in words, and we call it the Allais presentation. For the other group, we presented the lotteries in a matrix format in which the common consequences are aligned on the first column and we call it the Savage presentation since this was the presentation Savage proposed to make non-paradoxical choices. We find that the presentation does not decrease the expected utility violating choices although it affects subjects' risk attitudes.

Second, we test whether real rewards make a difference in terms of paradoxical choices. We gave the six lottery pairs in Savage format with real rewards in one group and with hypothetical rewards in the other group. We find that the expected utility violating choices do not diminish with real rewards. Allais type of systematic violations, however, disappears with real rewards.

Although systematic violations disappear with real rewards, the amount of expected utility violations we observe is large enough (around 40%) to deserve special attention. In the literature, a number of alternative theories were proposed in order to explain the Allais paradox. Birnbaum et al. (1992) argues that zero-outcome creates special biases; that is, people sometimes overweight the probability of zero-outcome events but sometimes they ignore them completely. Borch (1968) claims that certain outcome creates biases and because of that people make paradoxical choices. Initially, we investigate how much of the data can be explained with zero-effect and certainty effect. Then, we test the predictions of alternative theories including fanning out, rank dependent utility, cumulative prospect theory, and finally disappointment aversion. We find that 45% of the violations can be explained by zero effect. Alternative theories cannot provide additional explanation for the rest of the violations.

In the literature regarding Allais type of choices, certainty effect was one of the areas researchers focused on largely and many of the alternative theories were created with this effect in mind. Our

study, however, points out that the zero-outcome effect might be much more important than certainty effect and it might be fruitful if theorists pay more attention to zero-outcome effect.

In summary, we test the predictions of Expected Utility Theory and proposed alternative frameworks in an Allais type of choice experiment. We present the lotteries in a transparent format by exposing the common consequences clearly. We find that none of the investigated theories can explain the data fully. Real rewards decrease Allais type of choices. The transparent presentation, however, does not decrease the paradoxical choices further. We also observe that, interestingly, subjects' choices reveal more risk-averse behavior when the lotteries are presented in a more transparent way.

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THE EFFECTS OF REFERENCE POINTS AND TIME ON ACQUISITION RISK AND PREMIUMS

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RELATING RISK PREFERENCE, WATER REWARDS, AND THIRST: WEALTH AND UTILITY IN MONKEYS

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Kenway Louie
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HYPERBOLIC DISCOUNTING: EVIDENCE OF RATIONAL BEHAVIOR

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A NEW MODEL OF REPRESENTATIVENESS AND CONSERVATISM

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DECONSTRUCTING FINANCIAL PSYCHOPATHS: CULTURE, EVOLUTION, OR OPPORTUNITY?

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An increasing number of papers and books examine the idea that psychopaths are prevalent in corporate America, and specifically, in the field of investment finance. Unlike "traditional" psychopaths, who kill others without remorse and perhaps even derive satisfaction from exacting physical brutality, these so-called financial psychopaths do not physically harm anyone. A "true" financial psychopath would ruin the lives of others through his or her activities involving financial transactions, and correspondingly derive pleasure from his or her actions, suffering no remorse.

In this paper, the case is made that many of the so-called financial psychopaths are not psychopaths as defined by the current *Diagnostic and Statistical Manual of Mental Disorder-IV*'s clinical definition of Antisocial Personality Disorder (*DSM-IV-TR*, 2004), under which grouping psychopaths fall; rather that the definition has been usurped. Several hypotheses are put forth to account for the rise in the number of individuals labeled as financial psychopaths. The first is that financial psychopaths have been prevalent throughout time and we are only now becoming more adept at distinguishing psychopaths in situations other than those in which violent physical evidence is present. A second hypothesis is that there has been a fundamental change within the investment sector itself; the type of person employed by financial firms has changed and/or the environment within which finance is conducted is different. The third hypothesis is that society's expectation of financiers has changed, causing more individuals working in the financial sector to be perceived as acting in a psychopathic manner.

Work by Robert D. Hare, considered the leading expert on psychopathology, is examined in order to ascertain whether psychopathology in the financial profession has become more prevalent. Drawing on research in anthropology, neuropsychology, and evolutionary biology, the role, if any, each component plays in behaviors that meet at least one of the criteria for psychopathic diagnosis is considered. From this analysis it is possible to compose a picture of how individuals employed in investment finance may be perceived as psychopaths, when other factors may instead be responsible for instigating behavioral patterns and attitudes that mimic those of traditional psychopaths.

This differentiation is important to ascertain, because people who are truly psychopathic are predatory by nature and do inflict severe damage on others. The ability to change their behavior and attitude through psychotherapy is almost impossible. Financial professionals who are incorrectly labeled may lose not only their careers, but also the opportunity to become more integrated humans who are able to play a greater functional role in society. A study of one financial professional who was labeled as a financial psychopath in the media is discussed to determine if the label was justified given the findings in this paper.

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TRAPPED BY WISDOM: HOW NON-OVERESTIMATING LEADS TO UNDERUSE (EXPERIMENTAL EVIDENCE FROM A HEALTH CLUB)

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This paper analyses time-consistency of decisions to visit the gym when individuals are asked to choose between their current fixed fee and a menu of three new variable fees, according to three different time commitments of permanency.

We conduct a natural experiment on 290 members of a health-club, located in Barcelona from December 2009 to May 2010. Subjects are offered to switch from their former flat fee to a multi-part tariff one in June 2009. For the study period we collect for each subject: former fee, new fee (if changing), number of attendances per month during the study period, gender and age.

We first look for consistency in their pre-decision behavior by comparing their flat fee with the one-day-entrance ticket option. Second, we measure consistency in their decision of changing or not to the new menu of fees according to their pre- decision number of attendances.

Finally we observe post decision attendances in order to detect behavioral biases derived from the change in the structure of the contract.

We find a relation between expected attendance estimation's accuracy and level of consistency. We observe statistically significant behavioral bias for switchers that show a tendency to underuse their "free" units of their multi-part tariff.

KEY WORDS:
Contract structure, Natural experiment, Gym attendance, Decision making and Time-Consistency,

JEL CLASSIFICATION:
D12, D21

DECISION, UNCERTAINTY AND COOPERATION:
A BEHAVIORAL INTERPRETATION BASED ON QUANTUM STRATEGY

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The paper presents a new attempt to explore people's cooperative behavior under the natural uncertainty in decision making process. The most recent development of quantum cognition creatively enriched the exploration to the endogenous uncertainty in human behavior by expanding the strategic space. In this paper we extend the quantum decision-making model to a two-player Prisoner's dilemma game by bringing in the evolutional decision operators with quantum phases. These quantum phases, following uniform random distribution when the decisions are confined to individual decision-making process, will change according to the different levels of implied cooperative inclination, and lead to possible new Nash Equilibriums that emerge from a "hyper" decision space. We also bring in the Dissimilarity Index from complex network literature, to capture and measure the cooperative inclination between the players. Conditions of Quantum Nash Equilibrium are derived out from dynamic quantum equations under the Heisenberg Picture.

Keywords: quantum strategy; cooperative inclination; dissimilarity index
JEL : C79 D81 D85

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THE DISPOSITION EFFECT AND GROUP DECISION MAKING

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Introduction

Group decisions taken under conditions of risk are better than those taken individually? This article examines how groups of people behave in face of decision making under risk, focusing on the behavioral bias, described by prospect theory (PT), called disposition effect. This motivation stems from the fact that, as stated by Cooper and Kagel (2005, p. 478), a large number of investment decisions in the financial market and strategic decisions of a company are made from a consensus between two or more people. This contrasts with much of the financial and economic theory and their respective empirical tests, which do not distinguish between decisions made by a group or by a single individual.

Therefore, the present paper attempts to answer some of the following questions: (a) Is there a disposition effect when groups of people are tested in a laboratory controlled environment? (b) Is this effect different (bigger, smaller, or equal) when the experiment is carried out individually? (c) Does the effect change as the group size increases?

Methodology
Design of the experiment and the software *ExpEcon*

Experiments were conducted with undergraduate students, in which participants made decisions on investment through a software that simulates a simplified stock market, called ExpEcon. (GOULART, SCHMAEDECH, & DA COSTA JR., 2008). This software simulates a simplified stock market, where participants make operations of purchase and selling of six assets for thirty periods and was developed based on Weber and Camerer (1998).

The experimental sessions were conducted to three different designs: (i) individuals, (ii) groups formed by two people, (iii) groups formed by three people. Participants in the experiments were 174 undergraduate students from courses in Administration, Accounting, Economics, and International Relations of the Federal University of Santa Catarina. The final sample consisted of thirty individuals, thirty groups of two members, and twenty-eight groups formed by three students, and data were collected in six experimental sessions. In order to increase the internal validity of the experimental sessions, it was also included a system to reward participants of this research.

Estimation of the disposition effect

Basically, the methodology used to measure the disposition effect was based on Odean (1998). The individual (or group) will present the disposition effect if the Proportion of Gains Realized (PGR) is higher than the Proportion of Losses Realized (PLR) in a given period. The result of the subtraction between PGR and PLR will be called the coefficient of disposition (CD). A positive CD indicates the presence of the disposition effect, because the investor held a higher percentage of gains than losses. Following are the variables defined above.

$$\frac{RG_i}{RG_i + PG_i} = PGR_i \qquad \frac{RL_i}{RL_i + PL_i} = PLR_i \qquad CD_i = PGR_i - PLR_i$$

where, RG is the Realized Gains, PG is the Paper Gains, PGR is the Proportion of Realized Gains, RL is the Realized Losses, PL is the Paper Losses, PLR is the Proportion of Realized Losses, CD is the Coefficient of Disposition, and i is the individual or group.

In order to find when gains or losses were realized (RG and RL) it was necessary to calculate a reference point, as in Kahneman and Tversky (1979). The reference point used in this research was the average purchase price (APP).

Results

Considering the three experimental configurations, table 1 shows that the t test (H1:CD>0) was statistically significant at 1% with the individual CD, the test with the CD of the pairs was significant only at 10%, and the test with the CD of the trios was not statistically significant. Table 1 also shows t tests performed with the PGR and the PLR for each treatment of the experiment. The alternative hypothesis adopted was that the PGR's mean was greater than the PLR's mean (H1: PGR>PLR). The results show that, at a significance level of 5%, the PGR was greater than the PLR in total results (0.219 against 0.164) and in the individuals (0.263 against 0.152). About the groups of two and three members it was not possible to say that the means of PGR and PLR were different.

The results are in accordance with the works that were the basis of this research (ODEAN, 1998; WEBER & CAMERER, 1998) and confirm the presence of the disposition effect in individuals. However, it was observed that groups did not present the disposition effect, and by analyzing the proportions of gains and losses and after the statistical tests performed, we perceive that individuals showed a higher PGR than groups (see the whole paper for more tests and results), but the PLR was not statistically different between groups and individuals. Thus, we can infer that the presence of the disposition effect in the individuals was due a higher propensity in realizing gains; and this behavior can indicate that individuals were more risk averse than groups in a positive scenario. In the other hand, groups behaved more homogenously in both scenarios of gains and losses (similar PGR and PLR), coming closer to what would be expected by the expected utility theory (EUT).

Table 1. Individual disposition coefficients
*** significant at 1%; ** significant at 5%; * significant at 10%

	Individuals			Pairs			Trios		
	CD	PGR	PLR	CD	PGR	PLR	CD	PGR	PLR
Mean	0.111	0.263	0.152	0.046	0.193	0.146	0.001	0.198	0.197
Std. Dev.	0.241	0.204	0.146	0.193	0.110	0.186	0.153	0.156	0.218
Jarque-Bera	1.9			5.0			1.7		
p-value	0.379			*0.083			0.418		
t test (H1:CD>0)	2.510			1.310			0.040		
p-value	***0.009			*0.100			0.485		
t test (H1:PGR>PLR)		2.460			1.190			0.010	
p-value		***0.009			0.120			0.497	

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LEADERSHIP AND OVERCONFIDENCE

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CEOs' CONNECTEDNESS, SOCIAL CAPITAL, AND CORPORATE INVESTMENT

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This paper aims to investigate the impact of CEOs' career experiences on corporate investment decisions. Specifically, we propose that a CEO's social capital facilitates the firm's access to external resources and also mitigates information asymmetry between managers and outsiders, enabling a firm to become less dependent on internal funds. Consistent with this argument, by constructing connectedness measures from CEOs' career experiences we find that the investment of CEOs who have more diversified career experiences (well-connected CEOs) is less sensitive to internal cash flow than less diversified ones. We also find evidence that social capital embodied in the diversity of CEOs' career experiences does alleviate a firm's financial constraints, confirming the well-connected CEOs' advantage in obtaining external financing.

DEALER COMPETITION AND MARKET RESILIENCY: AN EXPERIMENTAL ANALYSIS BETWEEN MONOPOLY AND DUOPOLY STRUCTURES

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RETURN CHASING AND INVESTMENTS: EVIDENCE FROM THE HOUSING MARKET

In Gu Khang
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A GOOD HORSE NEVER LACKS A SADDLE: MANAGEMENT QUALITY PRACTICES AND CORPORATE SOCIAL RESPONSIBILITY

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DIVIDEND CHANGES SIGNAL CHANGES IN FUTURE PROFITABILITY OF COMPANIES WITH BETTER CORPORATE GOVERNANCE PRACTICES

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THE SOCIAL RESPONSIBILITY DISCOUNT: MEASURING THE COST OF EQUITY CAPITAL FOR BENEFIT CORPORATIONS

Craig R. Everett
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A DECISION MODEL FOR SELECTING RECIPIENTS OF CORPORATE COMMUNITY INVOLVEMENT PROGRAMS

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SOCIAL MOOD, STOCK MARKET PERFORMANCE AND U.S. PRESIDENTIAL ELECTIONS: A SOCIONNOMIC PERSPECTIVE ON VOTING RESULTS

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We analyze all U.S. presidential election bids. We find a positive, significant relationship between the incumbent's vote margin and the prior net percentage change in the stock market. This relationship does not extend to the incumbent's party when the incumbent does not run for re-election. We find no significant relationships between the incumbent's vote margin and inflation or unemployment. GDP is a significant predictor of the incumbent's popular vote margin in simple regression but is rendered insignificant when combined with the stock market in multiple regression. Hypotheses of economic voting fail to account for the findings. The results are consistent with socionomic voting theory, which includes the hypotheses that (1) social mood as reflected by the stock market is a more powerful regulator of re-election outcomes than economic variables such as GDP, inflation and unemployment and (2) voters unconsciously credit or blame the leader for their mood.

PORTFOLIO DIVERSIFICATION DYNAMICS OF INDIVIDUAL INVESTORS: A NEW MEASURE OF INVESTOR SENTIMENT

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REALIZED IDIOSYNCRATIC VOLATILITY AND RETAIL INVESTORS

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Recent research demonstrates a negative relation between idiosyncratic risk and future return for some stocks. We explain this market irregularity with a behavioral finance argument. We argue that high idiosyncratic volatility stocks present a preferred trading habitat for individual investors because of the lottery-type qualities of these stocks. Consequently, individuals overvalue these stocks, reducing future return levels. Our findings that the negative idiosyncratic volatility premium is concentrated in the portion of the market that is characterized by relatively high retail investor trading support our argument. Moreover, we find that the phenomenon is particularly strong for daily returns and realized volatility, the result, we contend, of the activities of individual day traders.

Although traditionally finance theory argues that only systematic risk should be priced in the market, more recent theory suggests that idiosyncratic risk could be priced to compensate investors for an inability to hold the market portfolio. Exogenous factors, such as resource limitations, transaction costs, incomplete information or various institutional constraints, might restrict investors from holding the market portfolio. This restriction leads investors to demand return based on the total risk of their portfolio.   If we accept that idiosyncratic risk is a priced factor, we would expect risky asset returns to be positively and significantly related to idiosyncratic risk.

Surprisingly, in US equity market data, Ang, Hoderick et al. (2006), [AHXZ 06], find evidence of a negative premium for idiosyncratic risk. Subsequent studies show that the negative returns to stocks with high idiosyncratic volatility cannot be explained completely by an elevated exposure to aggregate volatility risk and that the relation is robust to value, size, liquidity, volume and momentum controls, and is persistent in both bull and bear markets, as well as recessions and expansions [Ang, Hodrick et al. (2009)].

We explain this 'idiosyncratic volatility puzzle' with the preferred trading habitats of retail investors. Stocks with high levels of idiosyncratic volatility offer low probability, high payoff prospects, and hence a greater opportunity for individuals to experience high levels of realization utility, that is, utility derived from realizing gains or losses [Barberis and Xiong (2012)]. Moreover, Kahneman and Tversky (1979) observe that the risk-averse nature of a decision maker changes for prospects with a small probability of an extremely high payoff. We argue that retail investors, perceiving high idiosyncratic volatility stocks as these lottery-type investments, will be willing to overpay for them, lowering subsequent returns.

We use Australian data to test our hypotheses because we are fortunate to have had access, through the Clearing House Electronic Sub register System (CHESS) database of the Australian Stock Exchange (ASX), to trading data that identifies investors by category. Most related studies have to rely on proxies to estimate individual investor activity. As stocks must be registered with the clearinghouse before they can be traded on the exchange, our data encompass virtually all of the trading on the Australian Stock Exchange.

There are, however, other motivations for considering these questions with Australian data. A study by the Australian Stock Exchange (ASX) reports that in 2002 37% of the adult population owned stocks directly, as opposed to through retirement or other managed funds, and this ownership was increasingly distributed over all income and education levels of the population.[4]

In contrast, a study entitled *Equity Ownership in America, 2005* reports that, in 2002, 19.7% of U.S. households held individual stocks directly outside of employer sponsored retirement plans, and only 23.9% held individual stocks at all. Moreover, the ASX is the eighth largest equity market in the world and it is well-diversified; the top 20 stocks represent 56 percent of the market capitalization, and concentration drops precipitously for larger samples. Among large, diversified, developed stock markets, Australia is a good candidate for exploring the significance of retail investor trading.

We employ a portfolio based approach, as in Han and Kumar (2008)[5], testing our hypotheses by considering monthly levels of idiosyncratic volatility and the proportion of retail trading. We find that the negative idiosyncratic volatility premium is concentrated in the fragment of the market that is characterized by a relatively high proportion of retail investors. Conversely, in stocks characterized by low levels of individual investor trading, idiosyncratic volatility and future returns display the expected positive risk-return relation.

Given this preferred habitat argument, we expect the negative idiosyncratic volatility return relation to be even stronger at a daily investment horizon. Day traders are, by definition, retail investors with particularly short investment horizons. They attempt to profit from the volatility of their investments, and would therefore be expected to prefer high realized idiosyncratic volatility stocks. Furthermore, Campbell, M. Lettau et al. (2001) demonstrate a relationship between idiosyncratic volatility and the activity of day traders. Our results support the proposition that day trader activity produces the negative idiosyncratic/return relation. Our conclusions are further bolstered by additional tests that consider other characteristics of lottery-type stocks and eliminate other possible explanatory factors.

CONCLUSION

We examine the presence of the negative relation between idiosyncratic volatility and future returns in the Australian market, arguing that the behavioral biases of retail investors cause the anomaly. Our analysis reveals that the negative idiosyncratic risk premium is concentrated in stocks with higher levels of retail trading. We use observed levels of retail trading, obtained from the CHESS database of the ASX, unlike preceding studies which rely on the use of a trade-size

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[4] This high incidence of direct share ownership was likely motivated by high fees for mutual funds. A study by ASSIRT Research (2005) found that as of January 2005, a typical Australian Shares Managed Fund charged entry fees of 4.00% and had a management expense ratio of 1.95%.

[5] This working paper has been refocused and accepted for publication in the JFQA as "Speculative Retail Trading and Asset Pricing." We cite both versions to acknowledge the methodology contributions of the earlier version, altered in the newer version, to our study.

proxy. Monthly return analysis provides evidence that retail investors have a preference for high idiosyncratic volatility stocks.

We argue that overpaying by retail investors for high idiosyncratic volatility stocks causes these stocks to, on average, earn lower subsequent returns. We show that once retail trading levels are controlled for, the negative relationship between idiosyncratic volatility and future returns disappears. We contend that individuals are attracted to the potentially sizeable payoff offered by high idiosyncratic volatility stocks, viewing them as speculative, lottery-type investments. We also consider idiosyncratic skewness, an additional speculative characteristic, and find that the negative idiosyncratic volatility-return relation is largest in stocks with high idiosyncratic skewness, and that retail investors prefer trading in these high idiosyncratic volatility and skewness stocks. Their preference leads retail investors to overpay for this type of stock, lowering their future returns.

If the negative relationship between idiosyncratic volatility and future returns can be explained by retail investor behavior, then we would expect this phenomenon to be especially prominent in daily data. Day traders are, by definition, short term, speculative retail investors who attempt to profit from the volatility of the stocks in which they invest. Daily realized idiosyncratic volatility analysis provides stronger evidence of a negative idiosyncratic volatility-return relation; both raw and portfolio-specific returns show that this negative relationship is observed over all levels of retail trading. Consistent with our hypothesis that high idiosyncratic volatility stocks represent a preferred trading habitat for day traders due to the stocks speculative characteristics, we find evidence that daily trading by retail investors is highest in stocks exhibiting both high idiosyncratic volatility and idiosyncratic skewness.

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HOW MUCH DO INVESTORS REALLY WANT TO PROTECT THEIR INVESTMENTS AGAINST LOSSES?

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A SURVEY ANALYSIS ON THE INVESTMENT ATTITUDES OF INDIVIDUAL INVESTORS

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MEDIA, ASSET PRICES, AND MARKET EFFICIENCY

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SELF-ESTEEM AND FINANCIAL RISK PREFERENCE: IMPACT ON RISK PERCEPTION AND RISK PROPENSITY

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Behaviour finance is an emerging field which relates behavioral elements of an individual with financial decision making. Risk preference of an individual can be attributed to the situation and psychology of an individual. This paper identifies the reasons for risk seeking behaviour of high self-esteem individuals by differentiating the influence of self-esteem on risk perception and risk propensity. Study suggests that risk perception of an individual is situation specific while risk propensity can be taken a personality trait. Further high self-esteem individuals choose more risky options because of their low risk perception and it is not fair to say that high self-esteem individuals have more risk taking ability. Financial objectives and socio-economic status being of the same low risk perception of high self-esteem individuals compared to others can be attributed to their favourable past experiences which lead to formation of heuristics and cognitive biases.

Rosenberg's Self Esteem Scale was used as questionnaire to be filled up by participants to generate data on Self Esteem. The same participants were requested to play a Disc Game prepared by us. This provided data on Illusion of Control (= Inverse of Risk Perception). This measured bias in financial decision making model.

Later, a Multi agent Model was developed within a Simon's Bounded Rationality framework. Risk propensity was allowed to vary and graphs revealed skew-ness in Risk Preferences via a Risk Preference Equation.

This paper did three things: Justified Prospect Theory of Kahneman and Tversky in both High Self Esteem and Low Self Esteem Individuals in a dis-aggregated, heterogeneous data set comprising of differential classification based on gender, student and non students based on differential age groups. A multiagent model was devised to show Risk propensity of individuals/groups showed skew-ness within a set of bounded rationality assumptive set.

Keywords: Risk perception; risk preference; risk propensity; self-esteem.

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THE RESOLUTION OF FINANCIAL DISTRESS UNDER HETEROGENEOUS BELIEFS

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GOING FOR BROKE!
OPPORTUNISTIC BEHAVIORS IN TRADING SIMULATIONS.

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1. Literature review

The use of simulations and computer applications in financial markets is by now recognized as effective teaching methodology in the field of financial education, and is in common use thanks to the active participation of the participants in the learning process (Alonzi et al., 2000). While their use is increasingly common, above all thanks to the continued reduction of implementation costs, the results of laboratory studies are still uncertain, and often conflicting. More consistent and homogeneous results can be obtained if one passes from a laboratory analysis to research analyzing financial markets, where investors appear to derive greater benefits from past experience (Gervais and Odean, 2001). Among the different errors that affect the choices made by traders, the phenomenon of overconfidence plays a crucial role in comparison with others. The concept of overconfidence refers to the risk that investors overestimate their skills and abilities when they have to make a decision (Barber et al., 2009).

This paper can be seen as part of this line of research, with the aim of understanding whether the initiative of financial education through the use of simulations effectively teaches participants to operate in the markets in a profitable manner, while avoiding some cognitive biases present in real markets. Towards this objective, this paper analyses the real-money transactions on financial markets of 44 teams of Italian university students enrolled on higher degree courses during the period from March to September 2010. The unique nature of the data is demonstrated by the availability of an initial capital of €5,000 in "real money" directly provided to the teams by the broker sponsor of the initiative, the chance for the participants to invest this sum in a discretionary manner, in domestic and international financial markets, and the publications on a weekly basis for the duration of the championship of partial rankings.

2. Methodology and results

I attempt to construct a model capable of verifying whether the performance of the various teams is influenced (or otherwise) by opportunistic behavior, and if so, what are the main explanatory factors that are able to explain such behavior. The model incorporates some of the hypotheses present in the work of Seru, Shumway and Stoffman (2010) that describe how some investors improve their trading strategies with experience, while others prefer to stop trading once they come to understand that their skills are limited.

As in the above-cited study, a model of learning is constructed, which can be expressed in the following form:

$$R_{i,t} = \alpha + \beta_1\, CP_{i,t-1} + \beta_2\, MT_i + \beta_3\, DS_{i,t} + \beta_4\, NM + \beta_5\, dist_{i,t-1} + \beta_6\, month + \beta_7\, rank \quad (1)$$

Where:

$R_{i,t}$: is the performance of team *i* in month *t*

$CP_{i,t-1}$: is the cumulative performance of team *i* in month *t-1*

MT_i : is the number of monthly transactions (/10) of team *i*

$DS_{i,t}$: is the number of different securities (/10) traded by team *i* in month *t*

NM : is the number of months after the start of the game

$dist_{i,t-1}$: is the distance (in percentage terms) between the performance of the team i and the team ranked first at the time t-1

month : dummy variable with a value of 0 or 1 according to the month of the gam

rank : dummy variable with a value of 0 or 1 according to the position of the team in the ranking (1 quartile, 2 e 3 quartile, 4 quartile)

α : constant

Excluding the variables that present situations of collinearity with others, the model takes into consideration 213 full monthly observations in their entirety in the period April-September 2010. Table 1 shows the summarized results of the model:

Table 1: Results of the model

	Coeff.	Std. Err.	T	P>|t|	Significance[+]
Cumulative perf. (t-1)	-0.5731304	0.0993327	-5.77	0.000	***
Monthly trans. (/10)	-0.0002760	0.0037636	-0.07	0.942	
Diff. securities (/10)	0.0297425	0.0315074	0.94	0.346	
Number of months	-0.0325162	0.0123775	-2.63	0.009	***
Distance top (t-1)	-0.1355819	0.0529550	-2.56	0.011	**
May	-0.0434568	0.0488930	-0.89	0.375	
June	-0.0821290	0.0475711	-1.73	0.086	*
July	0.1349982	0.0551994	2.45	0.015	**
Rank (I) quartile	0.6521084	0.0589081	11.07	0.000	***
Rank (II+III) quartile	0.4651161	0.0454506	10.23	0.000	***
_cons	-0.3925839	0.0725915	-5.41	0.000	

[+] : ***, ** and * denote significance at 1%, 5% and 10%, respectively

The model provides interesting points for discussion. First and foremost the most significant variables are the cumulative performance with the previous month and the months of the game since the beginning of the championship. This confirms the assumptions and strategies

described in qualitative terms by Martelli (forthcoming): with increasing cumulative performance, each team tends to reduce trade, both in terms of volume and in terms of risks taken, thus generating lower performance for the month in progress. The contrary is true in cases where cumulative performance is down on the previous month, as the participants tend to increase the number of transactions and the degree of risk in the hope of an increase in performance for the month under review.

Other significant variables that amplify this way of working are the distance of a team from the team ranked first, both in percentage terms and on the leader board (Distance top t-1), considering the position in the standings of the follower in the various quartiles (rank), where such speculative behavior is accentuated with the growth of such a gap.

It is also surprising that the variables considered as a proxy for experience gained by traders in the model of Seru, Shumway and Stoffman (such as monthly transactions and the diverse securities traded) are not significant in the situation under analysis, which is most likely to indicate that in the use of simulations participants adopt more speculative than rational types of behavior.

3. Conclusions

This paper aims to determine whether the use of simulations can help traders to overcome / reduce cognitive errors (overconfidence in particular) from which they may have suffered in the past, thanks to the experience they have gained during the course of the game. The research is based on the analysis of data obtained from a trading game played with real money, with the participation of 44 teams from various Italian faculties, in the period from March to September 2010.

The analysis of the behavior of the participants and the results of an explicative model demonstrate that the simulation does not allow for significant improvement in the performance of the teams (reducing the phenomena of overconfidence) during the months of the game; indeed, most teams appeared to show increasingly speculative, or better, opportunistic behavior, as the end of the simulation approached (the teams at the top of the league table reduced the number of transactions to avoid risking a negative impact on their previously positive cumulative performance, while the teams following them increased trading, in terms of both numbers and risk, in the hope of climbing the rankings).

It can be seen that principle causes of this opportunistic behavior are hence:
- ✓ the presence of an asymmetry in the repartition of the final performance;
- ✓ the publications of partial weekly rankings;
- ✓ the end of the competition known to all students.

The presence of these characteristics mainly affected the performance of underperforming teams, as seen by the increase in speculative / opportunistic behavior by various team. These conclusions can also be extended to most simulations carried out in the financial markets, that as in the game under analysis show the same characteristics.

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SIN STOCK RETURNS AND INVESTOR SENTIMENT

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HOME AND HOST COUNTRY INVESTOR SENTIMENTS AND ADR INDEX RETURNS: A BRAZILIAN CASE

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American Depository Receipts (ADRs) provide international portfolio diversification opportunities to the investors in their host country as the underlying securities come from foreign (home country) stock markets. ADRs are appealing because of the fact they are no different from any share of stock that is listed on US stock exchanges and are denominated in US dollars. Such appealing properties of ADRs triggered significant research on ADR return behaviors; however, research on bidirectional relationships between home/host country sentiments and the ADR returns remain rather limited. In an attempt to close this gap, our study investigates the dynamic relationships among the home/host country investor sentiments and the ADR Index returns using US stock exchange traded-Brazilian ADR index as a case study.

We choose a Brazilian ADR index since Brazil is one of the leading emerging economies, and her securities are widely used globally for portfolio diversification purposes. We use the monthly time series data from the period of December 2005 to July 2009. As proxies for individual and institutional investor sentiments, consumer and business confidence index scores for Brazil and US are used. Monthly closing prices of Dow Jones Brazil Titans 20 ADR Index are utilized to calculate the Brazilian ADR index returns. Vector Auto Regression (VAR) is chosen as the model due to its superior ability to investigate postulated relationships.

Our results indicate that the impulse responses of the Brazilian ADR Index returns to one-time standard deviation increases (shocks) in individual and institutional investor sentiments of both Brazil (home country) and US (host country) are positive and significant. However, the durations of the significant impacts vary depending on the type and the origin of the sentiment variables. The impulse response of the Brazilian ADR index returns to one-time standard deviation increase in the Brazilian institutional investor sentiment is positive and significant for the first three months whereas the same impulse response to one-time SD innovation in the US institutional sentiment lasts for the first two months only. The impulse responses of the Brazilian ADR index returns to one-time innovations in individual sentiment variables are positive and significant for only one month following the innovations for both US and Brazil individual investor sentiments. Thus, the results concluded that institutional investor sentiments in general, Brazilian institutional investor sentiments in particular, have more pronounced and persistent impacts on the Brazilian ADR index returns. Moreover, the impulse responses of the all sentiment variables in both countries to a one-time standard deviation increase in the Brazilian ADR index returns are positive and significant for the first month. It should also be noted that the

impulse response of the Brazilian institutional investor sentiment remains persistent for a longer time.

In summary, we see a significant and strong feedback effect between the Brazilian institutional investor sentiment and the Brazilian ADR index returns. Although, the effects of home and host country sentiments on Brazilian ADR index returns show similarities, the bidirectional relationship between home country (Brazil) institutional investor sentiment and the ADR index returns are stronger and more persistent. Thus, the institutional investor sentiment of the origin country of underlying stocks for ADRs is the most important and matters the most. The implications of the study can be interpreted as even the host country sentiments and ADR returns are positively and significantly affect each other, the home country sentiments, especially the home country institutional investor sentiment, reveal stronger ties with the ADR returns. These findings are in line with the previous studies that find that the institutional investor sentiments have more pronounced and persistent effects on stock returns than individual investor sentiments. The most plausible outcome of our study is although the ADRs mimic stocks in many aspects, they do reflect their home country's institutional investor sentiments more than their host country's institutional investor sentiments.

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INFERRING INVESTOR BEHAVIOR FROM FUND FLOW PATTERNS OF CZECH OPEN-END MUTUAL FUNDS

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Introduction

Modern form of collective investment in the Czech Republic was developed in 1991 as a product of specific method of privatization - the voucher privatization. But some of privatization funds exploited a weak legislation, and embezzled assets. The number of Czechs on the basis of this disillusionment mistrust in the collective investment schemes up to now.

There are a number of studies that looked into the fund flow dynamics in the U.S. All these studies show evidence that past performance has a significant effect on the flow of funds. High performing funds tend to attract new money, while the poor performing funds had higher outflows. This paper looks at two behavioral patterns of investors based on the law of small numbers.

The law of small numbers is the behavioral opposite of well-known law of large numbers. The law of small numbers describes a situation in which an individual identifies the characteristics of a relatively or absolutely small sample of the total population with the characteristics of the total population. The tendency of investors to generalize from a small sample can lead to the following two behavioral patterns.

Gambler's fallacy: According to this psychological effect an individual is trying to compare the presence of variables in a small sample and their distribution in the general population. A typical example is guessing the side of the coin in case of a higher incidence of one of the sides in the last few flips of the coin. For example, after three flips of heads, the individual usually guesses that next will be tails. In fact, the probability of calling tails is still 50/50. If investors believe that on the average all mutual fund returns should trend towards a common mean, then a fund that is outperforming others should soon produce low returns so as to get back to the average.

Hot-hand bias: This is a psychological effect based on extrapolating current sample to the future. The most common example is the reaction of investors on the performance of mutual funds. In the event that the fund has succeeded, then investors insert more additional resources than collect from it, and vice versa.

Data
    Based on the type of assets in which the fund invests, the total sample is divided into the following categories:

Table 1: Funds data sample

Type of asset	Number of Funds	Number of weekly observations
Bonds	23	522
Equity	25	522
Fund of Funds	31	473
Mixed	82	522
Money Market	15	522

Source: Czech Capital Market Association (AKAT ČR)

The weekly data covers the period from January 1, 1999 to December 31, 2008 and the monthly data covers the period from January 1, 1999 to December 31, 2011. The individual fund data is arranged in a panel data format for each of the categories. The panel data is unbalanced.

Methodology
The effect of past inflows, outflows, investment returns, size, and overall inflows and outflows into the sector are analyzed using the following fixed effects regression:

$$NCF_{i,t} = \sum_{n=1}^{5} \alpha_{1,n} CFI_{i,t-n} + \sum_{n=1}^{5} \alpha_{2,n} CFO_{i,t-n} + \alpha_{3,1} RET_{i,1} + \alpha_{3,2} RET_{i,2} + \alpha_{3,3} RET_{i,3} + \alpha_{3,4} RET_{i,4} + \alpha_{3,5} RET_{i,5} + \alpha_4 SIZE_{i,t} + \alpha_5 EIN_{i,t} + \alpha_6 EOUT_{i,t} + \sum_{i=1}^{m} \beta_i D_i + \varepsilon_{i,t} \qquad (1)$$

$CFI_{i,t}$ and $CFO_{i,t}$ are the cash inflows and outflows of ith fund at time t, $RET_{i,1-5}$ are the cumulative weekly returns for the previous 1 to 5 weeks, and $SIZE_{i,t}$ is the natural logarithm of the assets under management for the fund at time t. The fund flows into and out of a particular fund is determined by the market conditions prevailing during the week. If there is an overall increase or decrease in the fund flows into the market, it will affect all funds to some extent. To control for this market effect, two control variables are created. These variables are the excess inflows and outflows into a fund compared to the market. The last set of variables in the regression equation is for controlling the fixed effects.

Results
The past inflows had a significant positive impact on all different sectors of the Czech open-end fund market. This momentum of inflows persisted up to three lags in most of the sectors and in the case of money market funds, it persisted up to 4 lags. Similarly the past outflows had a significant negative impact on the monthly net flows in all sectors up to a lag length of 3 weeks, except for money market funds. Interestingly the fifth lag of outflows was significant for bond, equity and money market sectors. As evidenced in previous studies, the size of the fund had a significant negative impact on the net fund flows in all sectors, except for mixed funds. The control variable for overall market inflows is significantly positive and the control variable for market outflows is significantly negative in all sectors.

Controlling for all other variables, there is very little evidence that the past returns had significant effect on the net fund flows. In the case of mixed funds there is weak evidence (significant at 10%) that past one period return had a negative impact on the fund flow, which is an indication of gambler's fallacy. Cumulative returns for three periods had a negative impact on fund flows of bond sector and positive effect on net flows into the fund of funds sector. Cumulative 4 month return has a significant negative effect on the net fund flow of mixed funds sector.

The results of panel regression of weekly data indicates that past cash inflows had a positive and statistically significant impact on the net flows of bond and fund of funds sectors for up to 2 lags, and up to 3 lags for the equity sector. Inflows had no significant effect on the net flows of mixed and money market sectors. This variable is significant for the 5 lags for all sectors, except for the bond sector, which can possibly be explained by the monthly nature of investment inflows. Outflows had negative impact on the fund flows bonds and fund of funds sectors for 5 and 4 lags respectively and for 1 lag in the case of money market funds. Compared to the monthly flows, the weekly inflows and outflows have relatively less influence on the net fund flows. The effects of size and market control variables are similar to that of monthly regressions.

The effect of past returns is positive and significant for 1 lag for all sectors and significant for 5 lags for bond and fund of funds sectors, indicating a possible presence of hot-hand fallacy among the investors of these two sectors. Assuming that these two sectors are relatively less risky, investors may be basing their investment decisions mostly on the past performance of the funds. In the case of equity sector, the cumulative returns for 4 and 5 weeks are significant and positive, which indicates that the investors are possibly having the hot-hand fallacy, but with a delay of two weeks. Money market and funds and mixed funds did not show the same level of persistent effect of past returns on net flows.

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THE BEHAVIORAL BASIS OF SELL-SIDE ANALYSTS' HERDING

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EXAMINING THE IRRATIONALITY OF CONCENTRATED STOCK PORTFOLIOS: THE IKEA EFFECT, SMALL DIVESTITURES AND BENCHMARK INCLUSION

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THE PERFORMANCE OF MUTUAL FUNDS ON FRENCH STOCK MARKET: DO STAR FUNDS' MANAGERS EXIST OR DO FUNDS HAVE TO HIRE CHIMPANZEES?

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We test here the kahneman (kahneman 2011) results about fund managers: that is, do managers are really skilled or could any chimpanzee do the job? Recall the Lusha's effect: a chimpanzee in Russia named Lusha outperformed 94% of the country's investment funds. Her portfolio increased in value by 300% (Stewart (2010)). Few recent studies focus on the French Stock market. Otten and Blatt 2002, for example, found that English, French, Italian mutual funds over perform the market. But their study covers the period from 1991 to 1998, before the stormy decade from internet bubble crisis, September 11, to the subprime crisis. So, in this paper, we investigate the performance, persistence and behavior of mutual funds only investing in the Paris stock exchange market from 2000 to 2012.

1. Performances

We use the Lipper Global Fund Screener database and select 334 funds investing only in the French market. Funds are investing in Large, Mid and Small caps. 157 funds were active during all the 2000-2012 period. Since mutual funds are long term investments we compare the performances of markets relative to mutual funds with a 60 months moving average, an investment horizon generally proned by funds managers.[6] Clearly (see table 1), the funds over perform the market (Fama-French index) on average. The over performance is +4.2% on average over the period. Performances are net of management fees but gross of purchase fees.

Table 1: Moving average performances over 60 months: market vs. funds

Investment Period	Market performance	Funds performance	Relative performance
dec1999-june 2007	-3.5%	0.7%	4.2%
Dec1999-june2001	-8.1%	-3.2%	4.9%
june2001-dec2003	5.7%	8.3%	2.6%
jan2004-june2007	-7%	-2.1%	4.9%

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[6] The date is the investment date.

Figure 1 : average funds performances (red) vs. market (blue) (60 months moving average)
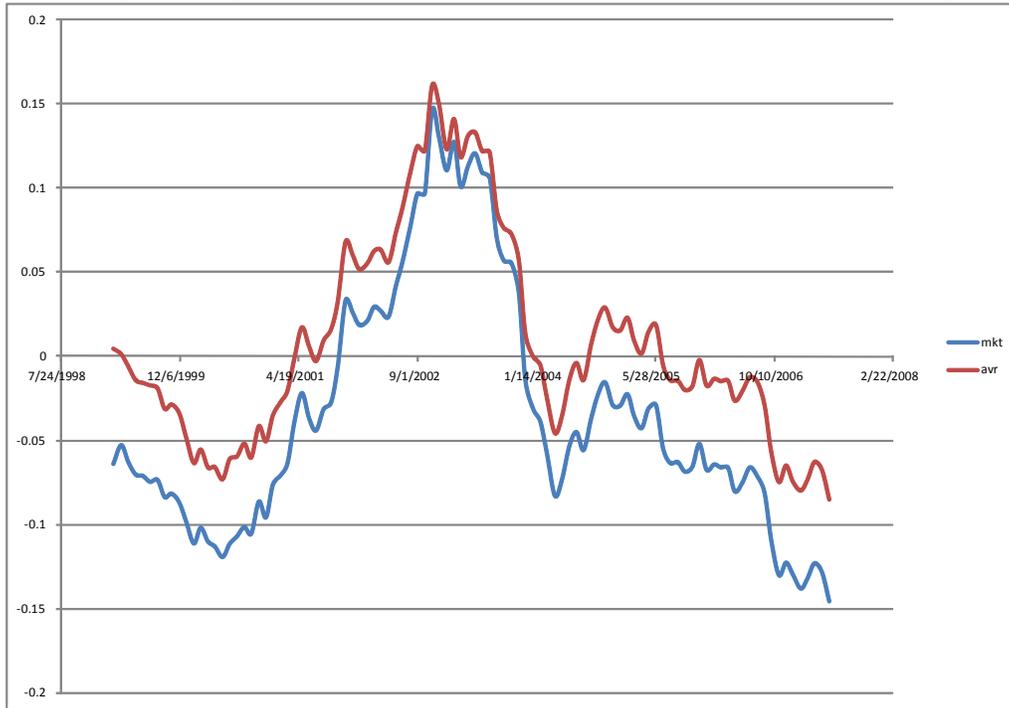
2. Is there persistence in results?

One classic question regarding funds performance is their ability to persistently enjoy excess returns. Intuition suggests that lucky fund managers will not report persistently good results, while good managers will do so: luck is only short-run. There should therefore be a relation between performance and autocorrelation. Using three different methods, nothing seems so clear; we prefer to conclude that there is no clear persistence effect for mutual funds.

3. Fama-French three-factor model extended to Carhart 4 factors model

The performances are well described by the 4-model factor of Carhart (1997). It extends the Fama-French 3 factors model by introducing the momentum effect of Jegadeesh and Titman (1993).

Table 2: Carhart 4-factors estimation, period 2000-2012

estimation	Alpha	mkt	smb	hml	wml	R2	se
Average	-0.21%	0.65	0.10	-0.03	-0.20	72.4%	0.09%
min	-1.04%	0.43	-0.44	-1.06	-0.56	46.8%	0.04%
Max	0.63%	0.85	1.24	0.77	0.16	84.6%	0.30%

The R2 are good, the model has a high power of explanation of the risk premium. Alphas are slightly negative; hence performance can't be attributed to portfolio active management by funds. The Alpha factor is not significant for the great majority of funds (97.7%) and alpha expositions is close to zero (only 6 funds have a significant alpha…). Following figures and tables focus on the factorial expositions and contributions to performances over periods.

Figure 2: Average factorial exposition
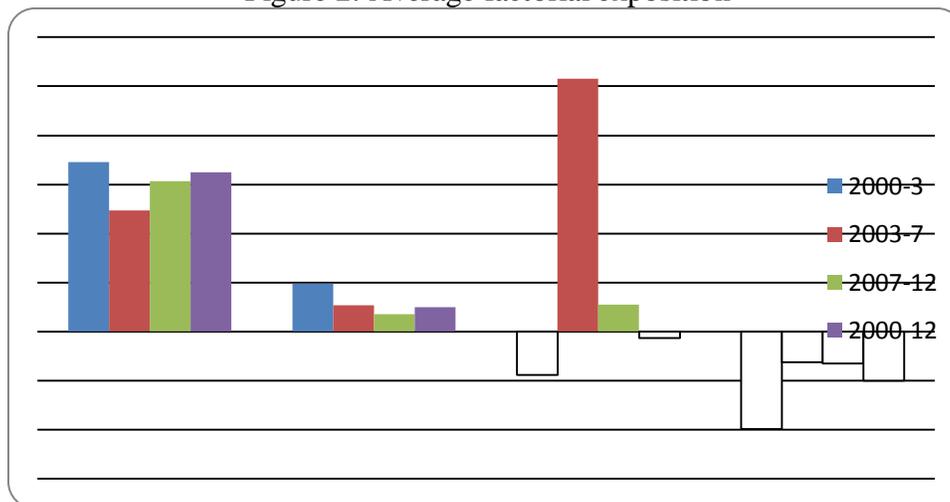
Figure 3 : factorial contribution to performance
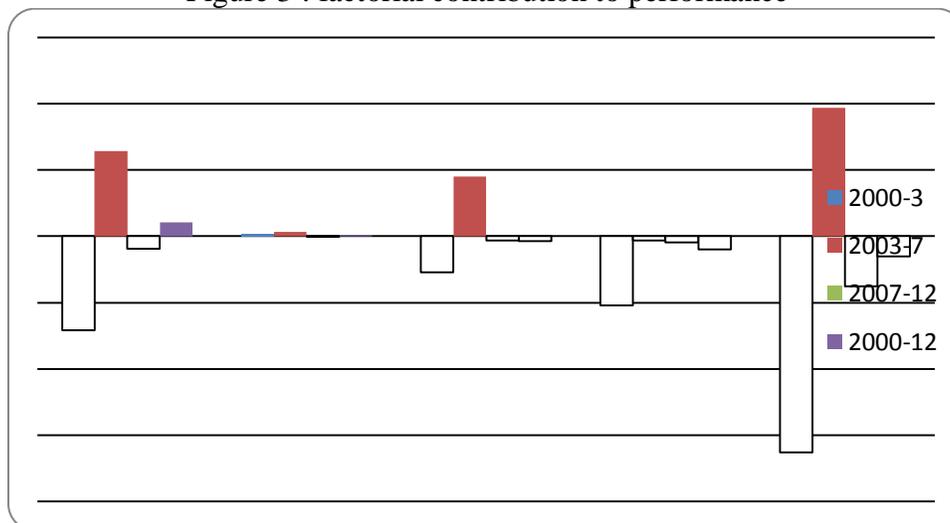
The alpha factor is clearly not significantly different from zero. Hence Funds manager's skill can be rejected. The performances of the funds are clearly driven by their four elementary strategies choices. But these strategies reflect risk allocation of portfolios.

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THE "SMART MONEY" EFFECT: RETAIL VERSUS INSTITUTIONAL MUTUAL FUNDS

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INFORMATION ACQUISITION, INTERNATIONAL UNDER-DIVERSIFICATION AND PORTFOLIO PERFORMANCE OF INSTITUTIONAL INVESTORS

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Mark Fedenia
University of Wisconsin-Madison

Hilla Skiba
University of Wyoming

Tatyana Sokolyk
Brock University

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MARKET FRICTIONS, INVESTOR SOPHISTICATION AND PERSISTENCE IN MUTUAL FUND PERFORMANCE

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INDIVIDUAL INVESTORS AND THE FINANCIAL CRISIS

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Na Wang
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FINANCIAL LITERACY AND ASSET ALLOCATION OF NON-EXPERT AGENTS: AN EXPERIMENTAL STUDY

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Elisa Cavezzali
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Ugo Rigoni
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TACTICAL IGNORANCE? THE OSTRICH EFFECT, INDIVIDUALS' DIFFERENCES & TRADING BEHAVIOUR OF INDIVIDUAL INVESTORS

Svetlana Gherzi
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THE INFLUENCE OF FEMALE DIRECTORS ON COMPANY ACQUISITIVENESS

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Zakaria Ali Aribi
University of Central Lancashire, UK

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"I DO": DOES MARITAL STATUS AFFECT HOW MUCH CEOS "DO"?

Gina Nicolosi
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MARKET PERCEPTION OF A CEO'S GENDER

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NOISE TRADERS AND THE RATIONAL INVESTORS: A COMPARISON OF 1990S AND 2000S

Shady Kholdy
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Ahmad Sohrabian
California State Polytechnic University

This paper intends to compare the reaction of rational investors to irrational sentiments of noise traders during of 1990s when there was persistence upward trend in stock prices compared to the decade of 2000 when the market was more volatile. Our study focuses on the stocks prone to sentiments and speculation i. e., stocks of small firms, unprofitable firms, non-dividend paying firms, extreme growth and distressed firms. We assume individual investors represent noise traders and institutional investors represent rational investors.

Following the literature, we use survey data to measure the sentiment of individual and institutional investors in the U.S. market. Our sample includes monthly data from Jan 1990 to Dec 2010. Our empirical findings, using the VAR model, underscore the following points:

During the period of Jan 1990 – Dec 2000, the exuberance of noise traders (individual investors) had significant effect on the return of stocks prone to speculation i.e., small firms, unprofitable firms, and the extreme growth firms. The sentiment of the institutional investors, however, did not have any significant effect on return of the stocks these firms.

On the contrary, during the more volatile period of Jan 2000 – Dec 2010, the sentiments of institutional investors had significant effect on the stock price of firms whose stocks are prone to speculation, while the exuberance of noise traders only affected the stock price of small and extreme growth firms. Our findings further indicate that there was bi-directional causality between the sentiment of individual and institutional investors in both decades; the effect of stock returns on sentiment was much stronger than vice versa; and finally the effect of sentiment on stock return was short –term and continued 2 to 6 months.

Overall, our findings provide further evidence for the view that overly optimistic sentiment of noise traders can lead to significant mispricing during periods of persistent upward trend in stock prices. The possibility of higher stock prices in the future makes the arbitrage risky and prevents the rational investors to correct the prices through short sales. During the more volatile periods, however, our results suggest the rational sentiments of institutional investors have much stronger effect on stock prices than the irrational sentiments of noise traders.

A NON-RANDOM WALK DOWN HOLLYWOOD BOULEVARD: CELEBRITY DEATHS AND INVESTOR SENTIMENT

Gabriele M. Lepori
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A MODEL OF MOMENTUM, MOMENTUM CRASHES, AND LONG-RUN REVERSALS: THEORY AND EVDENCE

Liang Ma
University of Wisconsin-Madison

This paper unifies three prominent patterns in cross-sectional return predictability: momentum, momentum crashes, and long-run reversals. A theoretical model is developed to analyze the asset pricing implications when investors possess the well-known self-attribution bias. The model parallels Daniel, Hirshleifer, and Subrahmanyam's (1998) but with an alternative focus on how public signals about a macroeconomic factor affect investors' confidence dynamically. In addition to unifying momentum, momentum crashes, and long-run reversals, the model endogenizes their relationship with market conditions and generates a set of testable implications. These implications find strong empirical support when raw and CAPM-adjusted momentum and reversal profits are examined. To account for a potential alternative explanation based on time-varying risk, I adjust profits with an instrumental-variables-based conditional CAPM, and these results are also consistent with the model's implications.

THE EFFECT OF REFERENCE PRICES, PAST DECISIONS, PREVIOUS PERFORMANCE, AND SOCIAL INTERACTIONS ON MARKETING DECISIONS UNDER UNCERTAINTY

Fabio Mattos
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Studies on grain marketing (i.e. the process of pricing and selling grain to food processors or consumers) have traditionally relied on standard economic theory in which producers make decisions that are logical and out of self-interest. However, there is evidence that individual producers do not necessarily follow the standard rationality assumption. Research suggests that they exhibit characteristics such as loss aversion and probability weighting, tend to sometimes overestimate price and underestimate risk, and are influenced by their decisions in previous years.

The objective of this research is to explore factors that influence the decision-making process in grain marketing and investigate a broader range of deviations from the standard definition of rationality in marketing decisions under uncertainty. In particular, this study will examine whether producers make decisions based on reference prices (i.e. whether they only decide to sell above a certain price level), how their own previous decisions and past performance affect their current decisions, and whether decisions and performance of their peers affect their own decisions.

This study uses a unique data set of all wheat producers in Western Canada to perform a comprehensive analysis of marketing decisions in grain markets. Exploring this topic is relevant as it sheds more light on the decision-making process in grain marketing. Despite the importance of marketing in the agricultural industry it is alarming to realize that prevalent ideas about marketing decisions and performance still do not rely on a large body of evidence. This study aims to fill in these gaps and move us towards a more complete understanding of grain marketing. Overall, producers and the grain merchandisers can benefit from this research as its results may help improve the design and communication of marketing alternatives developed for producers. Results may also be relevant for government agencies, extension programs, and marketing advisory services, which might be able to gather more insight about producers' decision-making process.

MENU PRICING WITH REFERENCE DEPENDENT CONSUMER PREFERENCES

Najmeh Rezaei-khavas
Utrecht School of Economics, Netherlands

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NO MAN IS AN ISLAND: SOCIAL DISTANCE, NETWORK FLOW, AND OTHER-REGARDING BEHAVIORS IN A NATURAL FIELD EXPERIMENT

Xiaoye Li
National University of Singapore

Liangjie Li
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A natural field experiment is designed to explore the impacts of social distance and network flow on other-regarding behaviors. A greater degree of communication between the voluntary organization and volunteers was found to reduce their social distance and thereby improve volunteering commitment. The improvement was even more notable if the party initiating communication was the voluntary organization. Two other practical means of lessening social distance were for volunteers to learn more about other volunteers, and for information to be dispersed throughout the organization more rapidly. Additionally, this study shows a reversed "U-shaped" relationship between network flow and volunteering commitment.

Key words: *Volunteering, Social distance, Network flow, Natural field experiment, Other-regarding behaviors*
JEL Classification: C93 D03 D64[7]

HOT HAND AND MUTUAL FUND MANAGERS TRADING BEHAVIOR

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Jason Berkowitz
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DO MUTUAL FUND INVESTORS CHASE FALSE RETURNS? [*]

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Changes in holding period returns (HPR) reported by mutual funds are jointly and equally influenced by the most recent return observation added and the oldest end-return observation which drops from the sample. Thus, via the simple passage of time, negative end-returns drop from the sample, giving the false perception of improved current fund performance via reported HPRs. We find that mutual fund investors chase these "false returns" with equal or greater aggression as they chase current returns. This behavior is particularly irrational or naïve as these stale signals provide no new information regarding manager ability or future fund performance. Fund managers take advantage of the predictable nature of end-return effects on HPRs, preferentially timing advertising campaigns to promote positive false returns. False return-chasing is most pronounced amongst funds which advertise HPR trends and amongst funds which benefit from indirect promotion via Morningstar ratings based on HPRs. Managers further benefit from investor sensitivity to false returns by increasing fees during periods of heightened investor demand which coincide with positive false returns. Our results are consistent with mutual funds using performance advertising to exploit less savvy investors who are unable to differentiate between the stale and current information in advertised HPRs.

DISPOSITION BEHAVIOUR IN MUTUAL FUND TRADES

Dries Heyman
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Michèle Vanmaele
Antwerp University

Sofieke Van Osselaer
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IMPLIED VOLATILITY AND STOCK MARKET SPECULATION

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CULTURE AND R2: THE EFFECTS OF TIGHTNESS AND INDIVIDUALISM

Cheol S. Eun
Georgia Institute of Technology

Lingling Wang
Tulane University

Cong Xiao
Georgia Institute of Technology

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HAPPY NEW YEAR(S) AROUND THE WORLD: CULTURAL NEW YEAR HOLIDAYS, MOOD, AND STOCK RETURNS

Kelley Bergsma
Florida State University

While prior literature documents a January effect around the world, this study uncovers a novel non-January New Year effect in major international markets that celebrate cultural New Year holidays not on January 1st. I find that average monthly returns are 4.11% higher during cultural New Year months relative to other non-January months. A trading strategy that exploits both the New Year effect and January effect yields an annual return of 7.29% over a benchmark strategy. My results suggest that investors' positive mood from cultural New Year holidays increases their propensity to buy stocks, particularly stocks with attributes favored by retail investors.

JEL: G02; G15

IS THERE A PREMIUM TO GO GREEN?

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University of Rhode Island

Zhenzhen Sun
Siena College

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ENTREPRENEURIAL FINANCING, INFORMATION, AND OVERCONFIDENCE

Ralf Keller
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Empirical studies show that entrepreneurs often overestimate their chances of being successful. We analyzed how this overconfidence among a fraction of the pool of entrepreneurs influences the behavior of a monopolistic bank. In our model we assume that loan applicants produce information that a bank uses in order to improve their creditworthiness tests. The information produced is determined by the entrepreneurs' beliefs about the profitability of the initial investment. Hence, overconfidence influences the information produced by the entrepreneurs. The consequence of overconfidence depends on how the entrepreneurs' information influences the creditworthiness tests. In the cases where loan applicants are able to reduce the screening costs of the bank or increase the probability that the bank can correctly identify a creditworthy entrepreneur, the information produced by the loan applicants is increased through overconfidence. However, in the cases where the entrepreneurs' information reduces the probability that a non-creditworthy loan applicant receives a loan, the results are ambiguous. Thus, overconfidence can increase or decrease the information produced by the entrepreneurs. We show that a monopolistic bank benefits when overconfidence increases the information produced by the loan applicants. The reason is that when more information is available, a bank is able to improve the risk-return profile of its own pool of borrowers.

WHICH FACTORS SHOULD BE USED BY BUSINESS ANGELS IN THEIR SCREENING PROCESS? AN ORDERED LOGIT ANALYSIS OF THE GAP BETWEEN APPLICANTS' FORECASTS AND THEIR REAL ECONOMIC PERFORMANCE

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OLD CAPTAINS AT THE HELM: CHAIRMAN AGE AND FIRM PERFORMANCE

Urs Walchli
University of Bern, Switzerland

Jonas Zeller
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PERCEIVED HUMANITY IN LENDING RELATIONSHIPS: WHY EBENEZER SCROOGE CHANGED HIS MIND

Andrea Moro
University of Leicester, UK

Matthias Fink
University of Leicester, UK

Antti Fredriksson
University of Leicester, UK

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EXCHANGES AND THEIR INVESTORS: A NEW LOOK AT REPORTING ISSUES, FRAUD, AND OTHER PROBLEMS BY EXCHANGE

Sofia Johan
York University

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SHORT INTEREST AS A SIGNAL TO ISSUE EQUITY

Dominique Gehy
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Don Autore
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THE IMPACT OF REFERENCE POINT PRICE ON SEASONED EQUITY OFFERINGS

Huajing Hu
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TESTING THE ADEQUACY OF AGENCY THEORY IN EXPLAINING THE VENTURE CAPITALIST – ENTREPRENEUR RELATIONSHIP: THE FIRM LIFE CYCLE PERSPECTIVE

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OPTIMAL ALLOCATION OF CONTROL RIGHTS IN VENTURE CAPITAL CONTRACTS

Guillaume Andrieu
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A RESOURCE-BASED VIEW OF NEW FIRM SURVIVAL: NEW PERSPECTIVES ON THE ROLE OF INDUSTRY AND EXIT ROUTE

Susan Coleman
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PRIVATE EQUITY EXITS: DOES SIZE OF SYNDICATE AND FOREIGN CERTIFICATION MATTER?

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LIFTOFF: WHEN STRONG GROWTH IS PREDICTED BY ANGELS AND FUELLED BY PROFESSIONAL VENTURE FUNDS

Peter Wirtz
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Christophe Bonnet
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NEITHER WITH NOR WITHOUT YOU (AIM) DO MY TROUBLES (SMES FINANCIAL PROBLEMS DURING THE FINANCIAL CRISIS) HAVE REMEDIES

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University Pablo de Olavide (Seville)

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DEBT INVESTMENTS IN PRIVATE FIRMS: LEGAL INSTITUTIONS AND INVESTMENT PERFORMANCE IN 25 COUNTRIES

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HOW DO START-UP FIRMS FINANCE THEIR ASSETS? EVIDENCE FROM THE KAUFFMAN FIRM SURVEYS

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ASSET-BACKED VS. COMPETENCE-DRIVEN LEVERAGE: THE NEXT ENTREPRENEURAL FINANCE CHALLENGE.
EVIDENCES FROM THE ITALIAN EXPERIENCE IN SMALL BUSINESS FINANCE

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Funding small business is getting more and more difficult. The lack of assets to refer leverage along with the lack of information flows to refer growth monitoring is suggesting to divert corporate funding from debt to equity capital. According to this trend, the introduction of new regulation frameworks based on the so-called "Basel-II agreement" has dramatically changed the funding procedures for credit allowances used by financial intermediaries. Thus Small and Medium Business have been mostly involved in a dramatic credit crunch as a consequence of the higher credit risk highlighted by standard financial analysis procedures. The short-termism of the financial system contributes dramatically to such a credit crunch. When time horizons of business valuation straighten, the relative importance of the value of growing options reduces in credit allowance decisions. When future is fully irrelevant the liquidation value are the only driver for capital allowances. This being the case, high market-to-book value corporations might be affected by a lack of credit flows that are more driven by invested asset (i.e. book values) than growing opportunities (i.e. market values).

The actual dimension of the market-to-book ratio is strongly related to four items: (a) the replacement (i.e. liquidation) value of assets; (b) the gap between corporate return and cost of capital; (c) the time extension of such a gap; (d) the entrepreneurial ability to have a time persistency of previous conditions. While the market efficiency usually affects the perception of items (a) and (b), the market completeness impacts the perception of item (c) and (d). Rules for regulating bank procedures in credit allowances are concentrating more and more on items (a) and (b) in order to reduce inefficiencies: a very comfortable approach when (c) and (d) detection is guaranteed. But what about crowding effects in debt allowance procedures between items (a) and (b) detection and (c) and (d) one? Is it possible to observe a lack of debt capital to sustain corporations having few asset in place but high values?

Entrepreneurships are hit even more by the previous crowding-out effect, due to their higher concentration of investments in intangible assets and human capital. Their credit rating is often reduced because of the inability to reap debt capital from the banking system since the un-intangibility of their investments reduce the market completeness. The lack of asset in place reduces the required debt capital to cultivate competences inside the corporation, while the equity capital is fully concentrated in intangible and competence efforts. But both debt and equity capitals divert from Entrepreneurial Finance transactions for their low return-to-risk mainly due to excess perceived risk and high investor's risk aversion.

In a previous paper we suggested a common root to both sides of the puzzle: the lack of competence value measurement. Neither the professionals nor the academics came to an unequivocal answer to the puzzle. The practice of application of financial analysis tools demonstrates a kind of schizophrenia: it recognizes the importance of following a policy based on market values, but gives the criteria based on book values relative weight increased. Still a

problem of gap between market and book value as before even if in this case the loop is clear: "no measurement" means "no assessment", that means "no business decision", that means "no investment", that means "no market values", that means "no measurement" opportunities.

In that paper, we suggested the T-Ratio as a possible measurement tool for competence value at industry. Now we seek for possible relationships between competence value level and debt funding in small business. We must confess that at the very beginning of the research, we were expecting that the complexity generated by anomalies and asymmetries of the Italian case could be an exceptional gymnasium to develop alternative approaches for more efficient banking support to Entrepreneurship. We were even expecting the debt capital sourced by banks to be inadequate for the Italian SMEs to permit the emergence of their competence value. But how could corporations have big competence value even in the case the banking system have serious deficiencies in its detection? The empirical results were terrific in confirming our bias: the banking capital flows simply support the asset-in-place-funding while the huge amount of commercial debts support the competence-value-funding. Commercial debts reflects in huge amounts of working capital being the mean of competence spreading inside the value chain.

Competence value estimation through the Intato's T-Ratio

At time zero, the market value of a competitive corporation can be computed as the present value of expected cash returns. Since the corporation is competitive, its book returns are expected above the cost of capital level. The market value will be higher than book value if the corporate rate of return "r" is higher than the cost of capital "k". The absolute value of goodwill can be exposed as $G = Price - BookValue = BV[(r/k)-1]$. In an entrepreneurial venture having the same competitive adventure plus grafted skills lower expected cash flows are generated until competence is fully transferred to the organization so that lower value can be estimated:

[1] $$W_1 = BV \ (r-x)/k$$

Being: W, the estimated value of the entrepreneurial business; "x" is the relative weight of competence investments

"x" being positive, W_1/BV will be lower than P/BV…apparently! The competence spreading into the corporation could generate, in case of success, higher return-to-risk "t" years, thus completing the corporate value. The missing value can be described as follows

[2] $$W_2 = [p/(1+k)t] \ [E(X) + E(C)]/k$$

Being: "p" the probability of entrepreneurial success; E(X) the investment required for competence pullulating; E© the extra-cash flow generated by competences at work; "t" the required time-spreading of competences

The missing price-to-book value will be

[3] $$W_2/BV = [p/(1+k)t] \ [x + c]/k$$

The gap between P and W_1+W_2 will depend from the relationship between "c", "x", "p", "k" and "t", i.e. the determinants of W_2/BV. If the entrepreneurial project is successful W_2 is transformed in market value, thus regenerating the missing value (including goodwill): we call W_2 as "competence value". In a state-preference approach value discovery of competence value can be done by thinking about entrepreneurial success as a real call option having expected maturity at time "t". Being an European-style option such an option highlights these economics: (i) $P-W_1$ is the premium to call W_2; (ii) $[W_1+W_2]-P$ is the economic value of the option when it enters in-the-money; (iii) $[P_{-t} - P]$ is the actual payoff of the option. A huge help in valuing the option may

derive from the Lintner's approach to asset pricing. Such a model is based over a bottom-up approach, i.e. do not require to collect from complete financial markets to fix investment values. The use of confidence estimation of the shortfall level is consistent with the value-at-risk typically adopted inside Basel-related risk measurement systems.

The Empirical evidence in the Treviso's District
In order to better understand the connection between competence value and financial debts levels we estimated the total amount of debts in any specific industry. According to the methodology for competence value estimation, detailed figures must refer to the same period of analysis (2004-2009): 663 corporations compose the analyzed set. For any specific corporation the Q-Ratio and the T-Ratio was computed referring to the five years figures; this limited the subset to only 582 companies about which the analysis could be fully carried on. In order to conduct the analysis we estimate the total amount of financial debts (i.e. excluding the commercial ones) net of liquid financial assets so that the net financial position (PFN) will be considered.

Empirical analysis on the 582-companies dataset gave us a dramatic information: a <u>negative</u> relationship is proven between the Q-ratio and the dynamics of the PFN (i.e. $\square$PFN), while no immediate evidence is available for the connection to T-ratio. A possible explanation of the evidence can be given by the pecking-order-theory: the over performance generated by companies is used to reduce debts. But another explanation could be related to the low-efficiency in capital allocation by the banking system, aiming to give more capital to those presenting sided granting (i.e. assets) instead of competitive returns. Such results can be confirmed by further empirical evidence showing that: (a) no corporate risk indicators seems to be relevant for credit allowances while debt funding seems to be asset-backed by operating working capital; (b) debt funding is asset-backed by operating working capital even in case of its negative correlation with corporate returns; (c) no long term performance (i.e. T-Ratio) is relevant in credit allowances

The extreme focus on book-value-based methodologies in financial analysis seems to be the actual source of this situation. Adopting an effective methodology of possible competence value estimation like the Intato's Methods makes possible the detection of companies with strong prospective competence value emersion. The adopted measure (T-Ratio) demonstrate to be a good regressive indicator, but the next-to-zero coefficient of regression signals its irrelevance in banking procedures: only equity owners seems to be interested in it at empirical level. This contributes to maintain incomplete financial markets, while standard approaches in banking as imposed by financial regulators seems to reduce opportunities for credit allowances to Entrepreneurship. The Intato method clearly contributes to show strong differences between goodwill generation and competence widespread. That is why the latter is considered less affordable in standard financial analysis procedures.

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WHY DOES VENTURE CAPITAL PERFORMANCE PERSIST OVER TIME? EVIDENCE FROM A DYNAMIC SIMULATION

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VENTURE CAPITAL ROUNDS, DELISTING, AND SOX

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"DON'T DO IT?" REVERSE MERGERS REVISITED

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LISTED PRIVATE EQUITY, ANNOUNCEMENT RETURNS AND LIQUIDITY

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We examine the market reaction and liquidity impact of investment and exit announcements made by listed private equity (PE) firms. We find that both types of announcements result in wealth gains to shareholders and that liquidity, as measured by trading volume, bid-ask spread and the Amihud illiquidity ratio, increases significantly on days surrounding these announcements. We also analyze the impact of a listed PE entity's stage focus, financing style and organizational form. We observe that the market reacts more positively to acquisitions made by venture investors and less positively to exits executed by listed PE firms that provide equity financing or manage multiple products. Exit announcements made by venture investors generate increased trading volume but widen bid-ask spreads and increase the Amihud illiquidity ratio.

CORPORATE SOCIAL RESPONSIBILITY AND VALUE CREATION

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CORPORATE SOCIAL PERFORMANCE AND IDIOSYNCRATIC RISK: A VARIANCE DECOMPOSITION ANALYSIS

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A FRESH LOOK AT U.S. MICROFINANCE: THE EVOLUTION OF A REVOLUTION

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GREEN HOUSE GAS EMISSIONS MITIGATION AND FIRM VALUE: A STUDY OF AMERICAN AND EUROPEAN FIRMS

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