

Report Type

End of Award Report

Full Name

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CERF

Project Title

Research Associate

Project Start Date

Jan 01, 2018

Project End Date

Aug 31, 2018

Project Abstract

A long-standing debate in the literature argues whether risk or mispricing is responsible for asset pricing anomalies. This paper suggests a new paradigm: that both risk and mispricing may contribute to an anomaly, and, moreover, that they may contribute in the same or opposite directions. I estimate the contributions by risk and mispricing, which are complementary percentages, to 151 anomaly variables. I find that the contribution by mispricing, while low on average at 15.53%, ranges widely, from 95.89% for firm-momentum to -44.40% for value-versus-growth. Overall, the anomalies have become weaker over time, an effect that is driven by mispricing. As the contribution by mispricing to an anomaly increases, this anomaly is increasingly likely to disappear over time. This new paradigm of "risk-and-mispricing" has the potential to explain some current puzzles and enhance our understanding of the behaviours of stock prices.

Activities and Achievement

Anomalies are the empirical regularities that firm characteristics are related to future stock returns in the cross-section. Previous literature has sought to differentiate between risk and mispricing as explanations for anomalies. This paper instead puts forward a "risk-and-mispricing" paradigm in which both risk and mispricing are allowed to contribute to an anomaly. This paper also quantifies the contribution of each explanation. It finds that the average contribution by mispricing (risk) to anomalies is 15.53% (84.47%). The contribution by mispricing is highest in momentum and lowest in value strategies. Hence, investors should concentrate their investments on momentum and avoid value strategies.

Dissemination

This paper has been submitted to a finance journal. I am waiting for the editor's decision.

Outputs

Major Difficulties and Any Other Issues

N/A

Web Links

<https://sites.google.com/site/ylemcam/research>

Additional Information

Declaration

This award has not yet produced any relevant outputs, but details of any future publications will be submitted to the CERF database as soon as they become available.