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Finance Research Letters
Volume 19, Pages 1-314 (November 2016)

Articles **1 - 43**

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☐ Editorial Board
Page IFC
   PDF (50 K)

☐ Directors' duties of care and the value of auditing Original Research Article
Pages 1-14
Suman Banerjee, Mark Humphery-Jenner
   Abstract

☐ Almost stochastic dominance for risk averters and risk seeker Original
Research Article
Pages 15-21
Xu Guo, Wing-Keung Wong, Lixing Zhu
   Abstract   Close research highlights

   Highlights

   • Introduce the concept of almost stochastic dominance (ASD) for risk seekers.

   • Develop properties of the ASD for both risk averters and risk seekers.

   • Discuss the advantages and disadvantages of using ASD and generalized ASD.

☐ Directors' and officers' liability insurance and analyst forecast
properties Original Research Article
Pages 22-32
Narjess Boubakri, Lobna Bouslimi
   Abstract   Close research highlights

   Highlights

   • We examine if D&O Insurance purchases around equity issues is priced
   information.

   • The purchase of insurance is a signal of increased litigation risk and agency
   costs.

   • Financial analysts' optimism is lower for insured firms that increase their
   coverage.

☐ Estimation of bid-ask prices for options on LIBOR based
instruments Original Research Article
Pages 33-41
Masimba Energy Sonono, Hopolang Phillip Mashele
   Abstract   Close research highlights

   Highlights

   • An approach to estimate bid-and-ask premiums for caps and floors is proposed.

   • The proposed approach factors in the risk sentiments prevailing in the market.

   • The unhedgeable risk is reduced through the proposed approach.

The proposed approach can make market participants reach consensus on the premiums.

Abstract | Close research highlights

Highlights

- The time-varying dependence between European and US CDS spreads markets is studied.

- Time-varying Gaussian and Student-t copulas are used.

- Nonlinear dependence structure of CDS spreads between the US and Europe is found.

- Substantial variation in the dependence structure of sovereign CDS spreads is found.

Abstract | Close research highlights

Highlights

- We use the squared wavelet coherence to investigate the co-movement between sentiment and the Islamic and conventional equity returns in the US.

- We uncover the time-varying nature of co-movement for both the Islamic and conventional indexes.

- The Sharia rules have no influence on the connectedness between sentiment and Islamic equity returns.

- Only middle cap firms are susceptible from negative innovations in investors' sentiment.

Abstract | Close research highlights

Highlights

- We provide a market microstructural model decomposing noise trading.

- We estimate the probabilities of informed (PIN) and heuristic-driven trading (PH).

- PIN varies significantly both in time-series and cross-sectional analysis.

- PH is universal and constant both in time and across different asset types.

- Heuristic-driven and informed traders form independent microstructural classes.

Abstract | Close research highlights

Highlights

- An analytical integral-form pricing formula for the European discrete double-barrier options is obtained.

- We extend the numerical algorithm initially proposed by Milev and Tagliani (2010) to price European discrete double-barrier options on underlying assets whose prices follow exponential Lévy processes.

- We introduce a numerical integration method of adaptive Gauss–Lobatto quadrature with five points into the algorithm to address the integration of Lévy-type density functions.

- The corresponding error estimate for the proposed algorithm is derived.

- Numerical experiments with NIG process as an example and Monte Carlo simulation as a benchmark show that our numerical algorithm is both effective and efficient.

Highlights

- A model shows that a Tobin tax affects the risk of investment by different traders and thus their demand.

- Imposing a Tobin tax reduces market volatility.

- Imposing a Tobin tax solely on the seller further reduces market volatility.

Highlights

- We consider power exchange options, by introducing a common jump process to allow for correlated jump risk.

- We obtain an explicit pricing formula for power exchange options, and illustrate the effects of systematic jump risk.

- We also investigate the difference between the impacts of idiosyncratic jump risk and systematic jump risk.

Highlights

- We evaluate the Comprehensive Assessment (CA), the most complete analysis of euro area banking sector before the Single Supervisory Mechanism took place.

- We find that the capital deficit of a bank is positively related to the most common market-based risk measure of the bank: its historical volatility.

- Results show that the leverage ratio is a better indicator than the risk-weighted capital ratio.

- Our analysis supports the view that CA has been effective in establishing a level playing field among euro area banks.

Highlights

- We find strong in-sample evidence that the CBOE Gold ETF Volatility Index (GVZ) and jumps are significant in forecasting next day volatility of the Shanghai gold futures.

- Our results are robust when the recent financial crisis is considered.

- Out-of-sample analysis confirms that the GVZ and jumps are important factors in forecasting future volatility.

- We show that the GVZ outperforms jumps in terms of forecasting performance.

Highlights

- I examine how incomplete information of the investment opportunity set affects the investor's optimal consumption and portfolio decisions.
- I develop a model in which the investor cannot exactly observe the expected returns of a risky asset.
- I contribute to belief-behavior solutions to the explicit log-utility case, and to the approximate unit-risk-aversion case.
- Her belief behavior depends on the parameters of investment opportunities and investor preferences.
- The size of the elasticity of intertemporal substitution of consumption (EIS) determines whether her belief behavior is increasing or decreasing in prior belief.

Quantile behaviour of cointegration between silver and gold prices Original Research Article
Pages 119-125
Huiming Zhu, Cheng Peng, Wanhai You

Abstract | Close research highlights

Highlights

- This paper investigates the quantile cointegration relationship between silver and gold prices.
- The cointegration relationship exists mainly due to the tail quantiles outside the interquartile range.
- We reject the null of constant cointegrating coefficients across quantiles.
- The contemporaneous gold price change dominates the silver price change in short-run dynamics.
- The tail-quantile cointegrations also depend on the market states of gold.

Idiosyncratic volatility and excess Return: Evidence from the Greater China region Original Research Article
Pages 126-129
Li-Hsun Wang, Chu-Hsiung Lin, Jui-Heng Kang, Hung-Gay Fung

Abstract | Close research highlights

Highlights

- This study uses data from Greater China region to investigate the IV-ER relation.
- The IV-ER relations are insignificant in Hong Kong and Taiwan, and so is in Shanghai after 2005.
- Our results provide support to Merton's (1978) theory.

Developing the exchange traded market for government bonds: Effect of recent quote rule changes in South Korea Original Research Article
Pages 130-138
Woon Wook Jang, Hak Kyum Kim, Yong Joo Kang

Abstract | Close research highlights

Highlights

- This paper examines the effect of the 2010 quote rules on the exchange KTB market.
- Overall, the new quote rules have been successful in the exchange KTB market.
- For the 5- and 10-year maturity KTBs, there was a knock-on effect to the OTC market.
- However, for the 3-year maturity KTBs, the OTC market liquidity was reduced.

Do managers learn from the market? Firm level evidence in merger investment Original Research Article
Pages 139-145
Wenjing Ouyang, Samuel H. Szewczyk

Abstract | Close research highlights

Highlights

- Stock price firm-specific information increases the sensitivity of merger investments to Tobin's Q.
- This relation holds with diverse measures of stock price informativeness.
- This relation holds when including other information and firm related variables.
- Firms with more informative stock prices achieve better post-merger operating performance.

- New evidence on manager learning from the market in making merger investments.

☐ Does the earnings quality matter? Evidence from a quasi-experimental setting Original Research Article
Pages 146-157
Giulia Baschieri, Andrea Carosi, Stefano Mengoli

Abstract | Close research highlights

Highlights

- This paper investigates whether the market rewards firm compliance with accounting principles.

- The investor preference for local stocks is exploited as quasi-experimental setting.

- Isolated low earnings quality firms trade at premium compared to similar but high earnings quality firms.

- The low-high earnings quality premium increases when the local investor trading is stronger.

- While non-local investors are sensitive to accounting information, local and better-informed investors are not.

☐ China credit constraints and rural households' consumption expenditure Original Research Article
Pages 158-164
Changsheng Li, Liqiong Lin, Christopher E.C. Gan

Abstract | Close research highlights

Highlights

- The study uses a sample of rural household from Jiangxi province in South China to investigate the impact of credit constraints on rural households' consumption expenditure.

- The study uses two instrumental variables to resolve the endogeneity problem between the credit constraint and consumption expenditures.

- The study result shows 54.9% of the respondents were credit constrained. The consumption expenditure of the rural households who were credit constrained is 7.34% less than those who were not credit constrained.

- The results of the study revealed that relaxing of the rural households' credit constraints is helpful to improve their consumption expenditure in less developed countries.

☐ The role of arbitrage risk on the elasticity of demand: New evidence from 100% secondary equity offerings Original Research Article
Pages 165-172
William B. Elliott, Hilmi Songur

Abstract | Close research highlights

Highlights

- Demand curve elasticity varies across firms with the level of arbitrage risk.

- Demand curves are inelastic for firms with high levels of arbitrage risk.

- In the post-decimalization period, demand curves are elastic for all stocks.

☐ Testing the adaptive market hypothesis and its determinants for the Indian stock markets Original Research Article
Pages 173-180
Gourishankar S. Hiremath, Seema Narayan

Abstract | Close research highlights

Highlights

- Hurst exponents are developed using rolling and fixed windows for Indian stock markets.

- Time-varying Hurst exponents indicate long memory persistence.

- The efficiency gap between the estimated and theoretical Hurst level is developed.

- The efficiency gap is unaffected by liquidity and market capitalization.

- Net flow of foreign institutional investments increases the efficiency gap.

☐ Dynamic spillovers between Shanghai and London nonferrous metal futures markets Original Research Article
Pages 181-188
Sang Hoon Kang, Seong-Min Yoon

Abstract | Close research highlights

Highlights

- We examine dynamic spillovers between the Shanghai Futures Exchanges (SFE) and the London Metal Exchanges (LME).

- Diebold and Yilmaz (2012) approach is adopted to nonferrous metal futures returns and volatilities (aluminum, copper, and zinc).

- The LME market has a greater impact on the SFE market.

- The recent financial crises intensify the strength of dynamic spillovers across nonferrous metal futures markets.

A note on the Wang transform for stochastic volatility pricing models Original Research Article
Pages 189-196
Alexandru Badescu, Zhenyu Cui, Juan-Pablo Ortega

Abstract | Close research highlights

Highlights

- We determine the diffusion limit of a risk-neutralized non-Gaussian GARCH model.

- Risk-neutralization is carried out using the conditional Wang transform.

- The Wang transform coincides with the Generalized Local Risk-Neutral Valuation Relationship.

- The risk-neutral diffusion exhibits a non-zero market price of volatility risk.

- This price depends on the Wang distortion and the skewness and kurtosis of the GARCH innovations.

Patents and R&D expenditure in explaining stock price movements Original Research Article
Pages 197-203
Gun Jea Yu, KiHoon Hong

Abstract | Close research highlights

Highlights

- We investigate whether the patents can complement R&D expenditure in explaining stock returns.

- We find that the number of patents have more significant explanatory power than R&D expenditure.

- Hence incorporating the number of patents in explaining stock returns could add value.

Integral representation of vega for American put options Original Research Article
Pages 204-208
Yanchu Liu, Zhenyu Cui, Ning Zhang

Abstract | Close research highlights

Highlights

- An incorrect formula on vega in an influential published paper is found.

- The substantial missing term is pointed out and the correct formula is presented.

- Implementation procedure for the correct formula is discussed.

A note on optimal portfolios under regime–switching Original Research Article
Pages 209-216
Markus Haas

Abstract | Close research highlights

Highlights

- We generalize the stochastic dominance criteria for normal mixture distributions.

- Returns may be subject to different regime-switching processes.

- Stochastic dominance rules of orders higher than two are also considered.

- These can be interpreted in terms of the within-regime and overall Sharpe ratios.

Political constraints and trading strategy in times of market stress: Evidence from the chinese national social security fund Original Research Article
Pages 217-221
Yong Li, Karen Benson, Robert Faff

Abstract | Close research highlights

Highlights

- We examine the state sponsored investors' trading strategies during the financial crisis.

- CNSSF maintains portfolio liquidity for future social liquidity provision.

- CNSSF sell their low risk stocks first, signaling an informed investor.

☐ Foreign funding shocks and the lending channel: Do foreign banks adjust differently? Original Research Article
Pages 222-227
Felix Noth, Matias Ossandon Busch
　　　Abstract　│　Close research highlights　│　Supplementary content

Highlights

- A lending channel of bank-specific foreign funding shocks is identified.

- The analysis is based on a novel bank-level dataset on four emerging countries.

- Shocks negatively affect lending after Lehman's collapse in September 2008.

- The negative effect of shocks concentrates in foreign-owned banks.

- Considering this result for regulatory purposes may enhance financial stability.

☐ Credit risk findings for commercial real estate loans using the reduced form Original Research Article
Pages 228-234
Andreas D. Christopoulos, Joshua G. Barratt
　　　Abstract　│　Close research highlights

Highlights

- Reduced form Pr[Default] and E[Loss] for all mortgages underlying CMBX 1–7.

- Reconciliation of influences of age, interval compression, and updated information.

- Highly accurate comparisons with historical record by vintage.

- Robust commercial real estate loan database and 73 factor simulated economy.

- Provides analysis which supports the use of reduced form in risk evaluation of CMBS.

☐ Deferred compensation withdrawal decisions and their implications on inside debt Original Research Article
Pages 235-240
Gemma Lee
　　　Abstract　│　Close research highlights

Highlights

- Unlike pension plans, deferred compensation can be vested before retirement.

- The withdrawal decision is negatively associated with default risk and CEO power.

- Deferred compensation serves as an important alignment role with debt holders.

☐ On the weight sign of the global minimum variance portfolio Original Research Article
Pages 241-246
Wan-Yi Chiu, Ching-Hai Jiang
　　　Abstract　│　Close research highlights

Highlights

- The regression hedge can accurately identify the GMVP weight sign.

- The regression hedge effect determines the GMVP weight sign.

- The higher modified information ratio yields a larger weight in the GMVP.

☐ How do China's oil markets affect other commodity markets both domestically and internationally? Original Research Article
Pages 247-254
Qiang Ji, Ying Fan
　　　Abstract　│　Close research highlights

Highlights

- The contemporaneous causality among Chinese and international commodity markets is studied.

- An error correction model combined with a directed acyclic graph method is employed.

- China's oil markets are cointegrated with other commodity markets.
- China's crude oil market is always a price taker affected by other markets.
- The whole influence of China's commodity markets is strengthened.

☐ Pure higher-order effects in the portfolio choice model Original Research Article
Pages 255-260
Trino-Manuel Ñíguez, Ivan Paya, David Peel

Abstract | Close research highlights

Highlights

- This paper studies the optimal solution of the standard portfolio choice model.
- A higher-order solution for the optimal share of wealth invested in risky assets is derived.
- The optimal solution depends on higher-order risk attitudes and distributional moments.
- Empirical evidence for the US shows that the higher-order effects are relevant but moderate.

☐ The risk in capital controls Original Research Article
Pages 261-266
Konstantinos Gkillas (Gillas), Athanasios Tsagkanos, Costas Siriopoulos

Abstract | Close research highlights

Highlights

- We investigate the impact of capital controls on market risk, in Greek market.
- Extreme value theory is used.
- Parametric bootstrap risk measures are applied for more accurate results.
- Standard risk measures underestimated the market risk after the capital controls.

☐ Modelling order arrivals at price limits using Hawkes processes Original Research Article
Pages 267-272
Afshin Haghighi, Saeid Fallahpour, Reza Eyvazlu

Abstract | Close research highlights

Highlights

- We proposed a model using Hawkes processes for order flow dynamics at price limits.
- Three events incorporated: same and opposite direction orders and cancellations.
- The goodness of fit tests show that the model appropriately fits empirical data.
- The decay kernels represent dominant self-exciting behaviour of order arrivals.

☐ Debt-threshold effect in sovereign credit ratings: New evidence from nonlinear panel smooth transition models Original Research Article
Pages 273-278
Oussama Ben Hmiden, Nidhaleddine Ben Cheikh

Abstract | Close research highlights

Highlights

- We test for the presence of threshold effect in sovereign credit ratings
- We implement a nonlinear panel smooth transition model
- The appropriate threshold value is estimated endogenously from the data
- We point out a strong regime-dependence in rating decisions
- The determinants of sovereign risk vary across different vulnerability levels.

☐ Valuing resettable convertible bonds: Based on path decomposing Original Research Article
Pages 279-290
Yun Feng, Bing-hua Huang, Yu Huang

Abstract | Close research highlights

Highlights

- Use complete path decomposition method for valuing resettable convertible bonds whose embedded options contain conversion, call and put provisions and reset clause.
-

The formulae show comprehensive insight of the value of each provision feature in the resettable convertible bonds intuitively.

- Our model provides a theoretical underground for portfolio allocation, arbitrage, hedging and risk management involving resettable convertible bonds for practitioners.

☐ Brexit: (Not) another Lehman moment for banks? Original Research Article
Pages 291-297
Dirk Schiereck, Florian Kiesel, Sascha Kolaric

Abstract | Close research highlights | PDF (391 K) | Supplementary content

Highlights

- We analyze the reaction of banks' stocks and CDS spreads to the Brexit announcement.

- Our results show that the Brexit announcement lead to an increase in CDS spreads.

- Compared to the Lehman Brothers bankruptcy filing, CDS spread increases are small.

- Especially EU banks' share prices declined following the Brexit announcement.

- This drop in share prices was more severe than following Lehman's bankruptcy.

☐ Dating the financial cycle with uncertainty estimates: a wavelet proposition Original Research Article
Pages 298-304
Diego Ardila, Didier Sornette

Abstract | Close research highlights

Highlights

- We describe a connection between the time-frequency decomposition of the MODWT and classical business cycle analysis.

- A proposal to date the financial cycle is presented, introducing the idea of uncertainty and interval estimation in the dating procedure.

- The proposal and other stylized facts of the financial cycle are illustrated using data from 19 OECD countries.

☐ Pricing vulnerable options with stochastic default barriers Original Research Article
Pages 305-313
Xingchun Wang

Abstract | Close research highlights

Highlights

- We study vulnerable options when the default barrier is stochastically affected by common factors.

- We obtain an explicit pricing formula for vulnerable options, and illustrate the impacts of stochastic barriers on option prices.

- The U-shape appears when we investigate option prices against the volatility of default barriers.

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