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## DIPLOMARBEITEN / MASTER THESES IM HWS 2011

**THEMA R1: Asset Pricing with Downside Risk: International Evidence**

Advisor: Florian Weigert

**THEMA R2: Lottery Stocks and the Cross-Section of Expected Stock Returns: International Evidence**

Advisor: Florian Weigert

**THEMA R3: Comovement**

Advisor: Florian Weigert

**THEMA R4: Active Share and Performance History**

Advisor: Lena Jaroszek

**THEMA R5: Share Repurchase Announcements – Evidence from actual data**

Advisor: Alexander Hillert

**THEMA R6: Seasoned Equity Offerings and Repurchase Patterns of firms in the U.S.**

Advisor: Alexander Hillert

**THEMA R7: Performance of Balanced Mutual Funds**

Advisor: Jieyan Fang

**THEMA R8: Which News is Really „New“? Investor Reaction to Stale News**

Advisor: Paraskevas Tsotsonos



## THEMA R1: Asset Pricing with Downside Risk: International Evidence

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Academic research in decision analysis and finance documents that agents care differently about downside losses than they care about upside gains. Investors who place greater weight on downside risk demand additional compensation for holding stocks with high sensitivities to market downside risk. Hence, assets with high sensitivities to downside market movements should have high average returns. Controlling for traditional risk factors, Ang / Chen / Xing (2006) find that the premium for downside risk in the cross-section of stock returns in the US from 1963 to 2001 is approximately 6% p.a.

This thesis investigates whether the downside risk premium is a global phenomenon and exists on stock markets around the world. In particular, we want to examine whether the premium can be related to country-specific cultural dimensions (as in Chui / Titman / Wei (2011)).

### Requirements:

We expect the candidate to have a sound knowledge in the theory of asset pricing and statistics. The empirical work requires the use of CRSP and/or the Thomson Datastream database (access will be provided). We recommend that the candidate should feel comfortable in the use of a statistical software program (such as Stata).

### Literature:

- Ang, A.; Chen, J.; Xing, Y. (2006). Downside Risk. *Review of Financial Studies*, 19, pp. 1191-1239
- Chui, A.; Titman, S.; Wei, K.C. (2011). Individualism and Momentum around the World. *Journal of Finance*, forthcoming
- Harvey, C.R.; Siddique, A. (2000). Conditional Skewness in Asset Pricing Tests. *Journal of Finance*, 55, pp. 1263-1295
- Hofstede, G. (2001). *Culture's Consequences: Comparing Values, Behaviors, Institutions, and Organizations across Nations*, Second Edition, Sage Publication, Beverly Hills, CA
- Kraus, A.; Litzenberger, R.H. (1976). Skewness Preference and the Valuation of Risk Assets. *Journal of Finance*, 31, pp. 1085-1100
- Ruenzi, S.; Weigert, F. (2011). Extreme Dependence Structures and the Cross-Section of Expected Stock Returns, Working Paper, University of Mannheim

Advisor:      Florian Weigert

## **THEMA R2: Lottery Stocks and the Cross-Section of Expected Stock Returns: International Evidence**

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There is evidence that investors have a preference for lottery-like assets, i.e. assets that have a relatively small probability of a large payoff. While any specific stock is unlikely to possess the extreme characteristics of lotteries, some stocks might share these features qualitatively. Motivated by these findings, Bali / Cakici / Whitelaw (2011) examine the role of extreme positive returns in the cross-sectional pricing of stocks. They find, that stocks with extreme maximum daily returns during the previous month (lottery stocks), underperform in the following month. This evidence suggests that investors may be willing to pay more for stocks that exhibit extreme positive returns, and thus these stocks exhibit lower returns in the future.

This thesis investigates the pricing of lottery stocks on stock markets around the world. In particular, we want to examine whether the low returns of lottery stocks can be related to country-specific cultural dimensions (as in Chui / Titman / Wei (2011)).

### **Requirements:**

We expect the candidate to show a sound knowledge in the theory of asset pricing and statistics. The empirical work requires the use of CRSP and/or the Thomson Datastream database (access will be provided). We recommend that the candidate should feel comfortable in the use of a statistical software program (such as Stata).

### **Literature:**

Bali, T.; Cakici, N.; Whitelaw, R. (2011). Maxing Out: Stocks as Lotteries and the Cross-Section of Expected Returns. *Journal of Financial Economics*, 99, pp. 427-446

Barberis, N.; Huang, M. (2008). Stocks as lotteries: The implications of probability weighting for security prices. *American Economic Review*, 98, pp. 2066-2100

Chui, A.; Titman, S.; Wei, K.C. (2011). Individualism and Momentum around the World. *Journal of Finance*, forthcoming

Hofstede, G. (2001). *Culture's Consequences: Comparing Values, Behaviors, Institutions, and Organizations across Nations*, Second Edition, Sage Publication, Beverly Hills, CA

Kumar, A. (2009). Who Gambles in the Stock Market?. *Journal of Finance*, 64, pp. 1889-1933

**Advisor: Florian Weigert**

## THEMA R3: Comovement

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A substantial body of work examines whether the sensitivity of asset returns to common factors can help explain average rates of return. Much less work, however, has been done to understand why common factors arise in the first place. Why do certain groups of assets comove while others do not? The traditional view of comovement holds that stock prices move together in response to market-wide information. However, a number of authors contend that observed stock return comovement appears excessive relative to fundamentals (see Barberis / Shleifer / Wurgler (2005) or Green / Hwang (2009) among others).

This thesis investigates the comovement of stocks in different international stock markets around the world. In particular, we want to examine whether comovement can be completely linked to fundamentals or is also driven by investor sentiment.

### Requirements:

We expect the candidate to show a sound knowledge in the theory of asset pricing and statistics. The empirical work requires the use of CRSP and/or the Thomson Datastream database (access will be provided). We recommend that the candidate should feel comfortable in the use of a statistical software program (such as Stata).

### Literature:

Barberis, N.; Shleifer, A.; Wurgler, J. (2005). Comovement. *Journal of Financial Economics*, 75, pp. 283-317

Green, T.; Hwang, B.-H. (2009). Price-based Return Comovement. *Journal of Financial Economics*, 93, pp. 27-50

Kasch, M.; Sarkar, A. (2011). Comovement Revisited, Working Paper, Federal Reserve Bank of New York

Kumar, A.; Lee, C.M.C. (2006). Retail Investor Sentiment and Return Comovements. *Journal of Finance*, 61, pp. 2451-2486

Pirinsky, A.; Wang, Q. (2006). Does Corporate Headquarters Location Matter for Stock Returns. *Journal of Finance*, 61, pp. 1991-2015

**Advisor:**        **Florian Weigert**

## THEMA R4: Active Share and Performance History

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Facing investment decisions investors would like to identify fund managers who are able to beat the fund's benchmark in future years. Such over-performance can only stem from the fund portfolio's deviation from its benchmark. However, tracking error turned out to be a rather useless indicator trying to link the activeness of a fund manager's investment decisions to performance. To the contrary, Cremers and Petajisto (2009) developed a measure dubbed "Active Share" to determine the deviations of a fund's portfolio for which they were able to find a positive correlation to benchmark adjusted returns. Furthermore, concerning manager's skills, prior-year winners among most active fund managers show a year on year performance persistence.

The thesis should answer the question how managers decide upon the active share they take depending on their previous period performance. Furthermore it should be investigated whether there are differences in the adjustment behavior between teams managing funds and single managed funds.

### Requirements:

We expect the candidate to show a sound knowledge in the theory of asset pricing and statistics. The empirical work requires the use of CRSP and/or Morningstar database (access will be provided). We recommend that the candidate should feel comfortable in the use of a statistical software program (such as Stata).

### Literature:

Cremers, K. J. M.; Petajisto, A. (2009). How Active Is Your Fund Manager? A New Measure That Predicts Performance. *Review of Financial Studies*, 22, pp. 1-37

Pütz, A.; Ruenzi S. (2011). Overconfidence Among Professional Investors: Evidence from Mutual Fund Managers. *Journal of Business Finance & Accounting*, forthcoming.

Bär, M.; Kempf, A.; Ruenzi, S. (2010). Is a Team Different from the Sum of its Parts? Evidence from Mutual Fund Managers. *Review of Finance*, 14, pp. 1-38

**Advisor:**      **Lena Jaroszek**

## THEMA R5: Share Repurchase Announcements – Evidence from actual data

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Like dividends share repurchases are part of a firm's payout policy. Ikenberry, Lakonishok, and Vermaelen (1995) find significant abnormal returns after repurchase announcements for the period from 1980 to 1990. Peyer and Vermaelen (2009) find evidence that positive abnormal returns after announcements still exist for the period from 1991 to 2001. However, these papers use data from the SDC database and not from the SEC filings (10-Ks and 10-Qs) directly. The SDC database is known to have problems with respect to data quality and data coverage. This issue raises the question whether this buy back anomaly can still be found using the SEC data.

Moreover, during the last decades there have been significant changes regarding the regulatory environment of repurchases (e.g. the introduction of the "safe harbor rule" 10b-18), which leads to the question whether and how this has affected the patterns around repurchase announcements. Furthermore, given the fact that there is a huge variation in the completion rate of repurchase programs between firms, it seems worthwhile to investigate whether the market learns from past repurchase programs. One question would be whether future repurchase announcements are evaluated differently depending on the firm's repurchase history, e.g. its past repurchase program completion rates.

The first task in this thesis is to give a detailed literature overview about share repurchase announcements. This literature overview should discuss conflicting results (e.g. Peyer and Vermaelen (2009) vs. Schwert (2003)), explain the different motives for undertaking repurchases, and finally highlight open questions in this research field. In the empirical part the actual repurchase data should be compared to the data from SDC and Capital IQ (coverage, systematic biases, etc.) and the results of Peyer and Vermaelen (2009) should be replicated with both data sources. Finally, the question about the evolvement of the repurchase anomaly over time as well as the question whether the market learns from past repurchases should be addressed.

A proprietary raw dataset of repurchase announcements and monthly repurchases is available at the University of Mannheim. A cross-checking and editing of the data will however be required. All further databases (CRSP, Compustat, Capital IQ, SDC M&A) are as well accessible at the University of Mannheim.

**Preliminaries:** Basic knowledge (or ability/willingness to acquire basic knowledge) in econometrics and STATA.

### Literature:

Grullon, G., and R. Michaely, 2004, The Information Content of Share Repurchase Programs, *Journal of Finance*, Vol. 59, 651-681.

Ikenberry, D. L., J. Lakonishok, and T. Vermaelen, 1995, Market Underreaction to Open Market Share Repurchases, *Journal of Financial Economics*, Vol. 39, 181-208.

Peyer, U., and T. Vermaelen, 2009, The Nature and Persistence of Buyback Anomalies, *Review of Financial Studies*, Vol. 22, 1693-1745.

Stephens, C., and M. Weisbach, 1998, Actual Share Reacquisitions in Open Market Repurchase Programs, *Journal of Finance*, Vol. 53, 313-333.

**Advisor:** Alexander Hillert



## **THEMA R6: Seasoned Equity Offerings and Repurchases Patterns of firms in the U.S.**

Both Seasoned Equity Offerings (SEOs) and stock repurchases are concerned with the financing of corporations. While SEOs usually augment the available capital (if not used as a vehicle of changing ownership), repurchases effect the opposite. It is reasonable to assume that growth companies with many investment opportunities and low cash-flows raise capital via SEOs while mature companies with few growth options and high cash-flows use repurchases to reduce agency costs (as implied by the Free-Cash Flow hypothesis of Jensen 1986). However, a substantial number of companies engages in SEO and repurchase activity simultaneously.

Numerous studies have shown that firms are more likely to issue equity when their market values are high and to repurchase equity when their market values are low (misvaluation hypothesis). Recent literature tries to link different corporate events such as SEOs and repurchases to each other. Dittmar and Dittmar (2008) demonstrate that both equity issuance and repurchases are driven by the same economic stimulus – growth in gross domestic product (gdp). Meanwhile, Rau and Stouraitis (2011) document that SEO waves take place earlier in the life cycle of a company than repurchases. Their results appear to be consistent with both the misvaluation hypothesis and the neoclassical efficiency hypothesis which suggests that firms undertake corporate transactions in order to adapt to the course of the business cycle or exogenous shocks. Furthermore, Baker and Wurgler (2002) show that market timing of SEOs and repurchases has a persistent effect on the firms' capital structure.

The thesis should wrap up the theoretical and empirical literature on stock repurchases and SEOs with respect to market timing, capital structure, and business cycle theories of the firm. Consequently, an empirical analysis should be conducted primarily focusing on the relationship between SEOs and stock repurchases. One key question that should be addressed in this analysis is why firms conduct SEOs and repurchases simultaneously. All relevant databases (Capital IQ, SDC M&A, Compustat, CRSP) are available at the University of Mannheim. Furthermore, there is a proprietary raw dataset of repurchase announcements and monthly repurchases available at the University of Mannheim which can be used for the empirical analysis. A cross-checking and editing of the data will however be required.

**Preliminaries:** Basic knowledge (or ability/willingness to acquire basic knowledge) in econometrics and STATA.

### **Literature:**

Baker M., and J. Wurgler, 2002, Market Timing and Capital Structure, *Journal of Finance*, Vol. 57, 1-32.

Dittmar, A., and R. F. Dittmar, 2008, The timing of financing decisions: An examination of the correlation in financing waves, *Journal of Financial Economics*, Vol. 90, 59-83.

Rau, P. R., and A. Stouraitis, 2011, Patterns in the timing of corporate event waves, *Journal of Financial and Quantitative Analysis*, Vol. 46, 209-246.

Skinner, D. J., 2008, The evolving relation between earnings, dividends, and stock repurchases, *Journal of Financial Economics*, Vol. 87, 582-609.

**Advisor:** Alexander Hillert





## THEMA R7: Performance of Balanced Mutual Funds

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Balanced Mutual funds are funds which can invest both in stocks and bonds. They are different from equity funds or bond funds which mainly invest in stocks and bonds respectively. For balanced funds it is important to have timing ability which leads to profitable switching between stocks and bonds. In other words, good balanced funds invest more in stocks when the equity market has a better performance and invest more in bonds if the bond market has a better performance.

In this thesis you are going to empirically analyze the performance of balanced funds with a particular focus on the timing skills of balanced funds.

### Requirements:

We expect the candidate to show a sound knowledge in the theory of asset pricing and statistics. The empirical work requires the use of CRSP and/or Morningstar database (access will be provided). We recommend that the candidate should feel comfortable in the use of a statistical software program (such as Stata).

### Literature:

George Commer, Hybrid Mutual Funds and Market Timing Performance, *Journal of Business*, 2006, Vol 79. No. 2. 771 – 797

Treynor, I. und K. Mazuy (1966): Can mutual funds outguess the market?, *Harvard Business Review*, 44:131, 136

**Advisor:** Jieyan Fang



## THEMA R8: Which News is Really "New"? Investor Reaction to Stale News

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In recent years, the role of the media for price formation in financial markets has been an upcoming topic in the academic literature. From a classical point of view, namely assuming efficient, frictionless markets and rational investors, media coverage on news events should have no effect, because the market incorporates new, value-related information almost instantly into security prices.

However, there are possible explanations for why media coverage can affect prices. Firstly, if we assume that investors are only incompletely informed about the market, then media coverage on news events increases the speed of information dissemination. A formal theory for this was developed by Merton (JF, 1987) and has been verified by empirical studies such as Fang, Peress (JF, 2009).

Another hypothesis is that investors exhibit biases in processing news, i.e. that investors react irrationally to media coverage. These biases are assumed to be more severe for retail investors. In a recent study, Tetlock (RFS, 2011) shows that investors have trouble distinguishing whether a news story really contains "new" information or is simply stale. By using textual analysis of news articles, he shows that investors overreact to financial news, leading to temporary movements in stock prices. This effect increases with the staleness or redundancy of information.

The goal of this thesis is to give an overview of the existing relevant literature on the effect of news coverage on financial markets, with a focus on investor reaction. In addition, an own empirical study should be conducted where the results of Tetlock (RFS, 2011) are (in parts) replicated.

### Requirements:

The candidate should have a sound knowledge of the theory of asset pricing and statistics. Additionally, the candidate should feel comfortable in learning a new programming language or already have good knowledge in using programs such as R.

### Introductory Literature:

Barber, B.M.; Odean, T. (2008): All That Glitters: The Effect of Attention and News on the Buying Behavior of Individual and Institutional Investors, *Review of Financial Studies* 21, pp. 785-818.

Fang, L.; Peress, J. (2009): Media Coverage and the Cross-section of Expected Returns, *Journal of Finance* 64, pp. 2023-2055.

Merton, R.C. (1987): A Simple Model of Capital Market Equilibrium with Incomplete Information, *Journal of Finance* 42, pp. 483-510.

Tetlock, P.C. (2007): Giving Content to Investor Sentiment: The Role of the Media in the Stock Market, *Journal of Finance* 62, pp.1139-1168.

Tetlock, P.C. (2011): All the News That's Fit to Reprint: Do Investors React to Stale Information?, *Review of Financial Studies* 24, pp. 1481-1512.

**Advisor:** Paraskevas Tsotsonos