FAKULTÄT FÜR BETRIEBSWIRTSCHAFTSLEHRE
Lehrstuhl für Internationale Finanzierung
Prof. Dr. Stefan Ruenzi

UNIVERSITÄT MANNHEIM

Universität Mannheim · Lehrstuhl für Internationale Finanzierung · 68131 Mannheim

Besucheradresse:
L9, 1-2
68161 Mannheim
Telefon 0621/181-1646
Telefax 0621/181-1664

Alexander Hillert
hillert@bwl.uni-mannheim.de
http://intfin.bwl.uni-mannheim.de

Seminar FSS 2011: „Investor Sentiment and its Effect on Asset Prices"

TOPIC R1: **Investor Sentiment and Stock Returns**
Advisor: Paris Tsotsonos

TOPIC R2: **Momentum, Cultural Differences and Investor Sentiment**
Advisor: Paris Tsotsonos

TOPIC R3: **Initial Public Offerings and Investor Sentiment**
Advisor: Paris Tsotsonos

TOPIC R4: **Sports Sentiment**
Advisor: Paris Tsotsonos

TOPIC R5: **The time-series relation of Investor Sentiment and Momentum**
Advisor: Alexander Hillert

TOPIC R6: **Analysts' forecasts and Investor Sentiment**
Advisor: Alexander Hillert

TOPIC R7: **Valuation and Investor Sentiment**
Advisor: Alexander Hillert

TOPIC R1: Investor Sentiment and Stock Returns

Advisor: Paris Tsotsonos

In contrast to classical finance theory, which considers only competition among rational investors and/or argues that the demand of irrational investors is irrelevant for stock prices since it is offset by arbitrageurs, empirical studies have shown that sentiment (or uninformed, irrational) demand can have a significant impact on stock prices and returns. The effect becomes stronger for stocks whose valuations are highly subjective and that are difficult to arbitrage, for example high volatility stocks. Baker/Wurgler (2006) construct several sentiment proxies and show that when sentiment is high (low), subsequent average returns of sentiment stocks are low (high).

The objective of this thesis is to describe the relevant literature of the impact of investor sentiment on stock prices and returns. In addition, selected results from the benchmark paper (Baker/Wurgler (2006)) should be replicated in a small empirical study.

Introductory literature:

Baker, M.; Wurgler, J. (2006): Investor Sentiment and the Cross-Section of Stock Returns, Journal of Finance 61, pp. 1645-1680.

Baker, M.; Wurgler, J. (2007): Investor Sentiment in the Stock Market, Journal of Economic Perspectives 21, pp. 129-157.

Shleifer, A.; Vishny, R.W. (1997): The Limits of Arbitrage, Journal of Finance 52, pp. 35-55.

TOPIC R2: Momentum, Cultural Differences and Investor Sentiment

Advisor: Paris Tsotsonos

Momentum describes the anomaly that securities that experienced high (low) past returns will also tend to exhibit high (low) returns in the future. A vast body of empirical studies has shown the existence of momentum on several financial markets, especially for the stock market. Besides some papers which consider momentum profits as a compensation for risk as in classical asset pricing frameworks, others have focused on behavioral explanations of the momentum effect including the existence of sentiment investors. In line with the latter studies, Chui et al. (2010) show that cultural differences in the level of individualism can have an impact on momentum profits.

The objective of this thesis is to describe the relevant literature of behavioral explanations of momentum with a focus on the role of culture. In addition, the link between cultural differences and momentum profits can be examined in an own empirical study.

Introductory literature:

Chui, A.C.W.; Titman, S.; Wei, K.C.J. (2010): Individualism and Momentum around the World, Journal of Finance 65, pp. 361-392.

Daniel, K.; Hirshleifer, D.; Subrahmanyam, A. (1998): Investor Psychology and Security Market Under- and Overreactions, Journal of Finance 53, pp. 1839-1886.

Jegadeesh, N.; Titman, S. (1993): Returns to Buying Winners and Selling Losers: Implications for Stock Market Efficiency, Journal of Finance 48, pp. 65-91.

TOPIC R3: Initial Public Offerings and Investor Sentiment

Advisor: Paris Tsotsonos

Two of the most puzzling phenomena in empirical corporate finance are that stocks of companies that go public tend to be underpriced (measured as the difference between the offer price and the first day closing price) and that IPOs are clustered in so-called "hot markets". Besides a vast body of literature that tries to rationalize these findings, recent work has highlighted the importance of sentiment investors for the IPO pricing process, in the sense that there are overoptimistic investors who bid up the stock price beyond true value, resulting in high initial returns and incentivizing companies to time their IPO.
The objective of this thesis is to describe the relevant literature of behavioral explanations of IPO underpricing and hot markets. In addition, in an own empirical study the impact of investor sentiment on IPO activity and/or underpricing should be examined.

Introductory literature:

Derrien, F. (2005): IPO Pricing in "Hot" Market Conditions: Who Leaves Money on the Table?, Journal of Finance 60, pp. 487-521.

Ljungqvist, A.; Nanda, V.; Singh, R. (2006): Hot Markets, Investor Sentiment, and IPO Pricing, Journal of Business 79, pp. 1667-1702.

Ljungqvist, A. (2007): IPO Underpricing, Handbook of Corporate Finance: Empirical Corporate Finance edited by Eckbo, B. E., pp. 375-442.

TOPIC R4: Sports Sentiment

Advisor: Paris Tsotsonos

Empirical studies have shown that a change in investor mood can have a direct impact on stock prices. The announcement and/or the result of important sport events, such as the Olympics or the FIFA world cup, can affect the mood of investors drastically and therefore result in abnormal stock price movements. For instance, Edmans et al. (2007) show that after elimination of a team from the FIFA world cup, the respective stock market exhibits an average abnormal return of -38 basis points.
The objective of this thesis is to describe the literature and the results of the studies that examine the impact of sport events on stock prices. The impact of sports sentiment should be examined in an own empirical study.

Introductory literature:

Dick, C.; Wang, Q. (2010): The Economic Impact of the Olympic Games: Evidence from Stock Markets, Applied Economics Letters 17, pp. 861 – 864.

Edmans, A.; Garcia, D.; Norli, O. (2007): Sports Sentiment and Stock Returns. Journal of Finance 62, pp. 1967–1998.

Kaplanski, G.; Levy, H. (2010): Exploitable Predictable Irrationality: The FIFA World Cup Effect on the U.S. Stock Market, Journal of Financial and Quantitative Analysis 45, pp. 535-553.

TOPIC R5: The time-series relation of Investor Sentiment and Momentum

Advisor: Alexander Hillert

Momentum describes the empirical finding that stocks with high returns over the last three to twelve months on average outperform stocks with low returns over the next three to twelve months. Loosely speaking, winners stay winners and losers stay losers. But there are also periods in which the loser stocks strongly outperform the winner stocks, e.g. March to May 2009. The aim of this paper is to analyze the relation between momentum and investor sentiment over time. One hypothesis would be that periods of high investor sentiment predict high momentum profits and periods of low sentiment (e.g. March to May 2009) predict low momentum profits.
The objective of this seminar thesis is first to explain the momentum effect and to describe theoretical models that relate investor sentiment to momentum. In an own empirical analysis one should implement a momentum strategy and analyze the time-series relation of momentum profits and investor sentiment.

Introductory literature:

Baker, M. P.; Wurgler, J. (2006): Investor Sentiment and the Cross-Section of Stock Returns, Journal of Finance, 61, pp. 1645-1680.

Barberis, N.; Shleifer,A.; Vishny,R. (1998): A model of investor sentiment, Journal of Financial Economics, 49, pp. 307−345.

De Long, J.B.; Shleifer A.; Summers, L.; Waldmann, R. (1990): Positive feedback investment strategies and destabilizing rational speculation, Journal of Finance, 45, pp. 375−395.

Jegadeesh, N.; Titman, S. (1993): Returns to Buying Winners and Selling Losers: Implications for Stock Market Efficiency, Journal of Finance, 48, pp. 65-91.

Jegadeesh, N.; Titman, S. (2001): Profitability of Momentum Strategies: An Evaluation of Alternative Explanations, Journal of Finance, 56, pp. 669-720.

TOPIC R6: Analysts' forecasts and Investor Sentiment

Advisor: Alexander Hillert

Empirical studies have shown that retail investors are prone to investor sentiment. The research question of this paper is whether analysts as professionals are also affected by investor sentiment. There is empirical evidence that analysts forecast are in general too optimistic and too extreme. Since high investor sentiment can be seen as (over-)optimism it seems worthwhile to investigate the relation of analysts' forecasts optimism and investor sentiment, i.e. does higher (lower) investor sentiment lead to more (less) optimistic earnings forecasts? A further question is whether and how investor sentiment is related to the dispersion of earnings forecast.
The objective of this seminar thesis is first to give a short introduction about analyst forecast in general. Second, one should give an overview about the existing literature dealing with biases in analysts' forecast (e.g. optimism and overreaction). Finally the relation between analysts' forecasts and investor sentiment should be analyzed in an own empirical study.

Introductory literature:

Abarbanell, J. S.; Bernard V. L. (1992): Tests of analysts' overreaction/underreaction to earnings information as an explanation for anomalous stock price behavior, Journal of Finance 47, 1181-1207.

Baker, M. P.; Wurgler, J. (2006): Investor Sentiment and the Cross-Section of Stock Returns, Journal of Finance, 61, pp. 1645-1680.

Barberis, N.; Shleifer,A.; Vishny,R. (1998): A model of investor sentiment, Journal of Financial Economics, 49, pp. 307−345.

Lim, T. (2001): Rationality and Analysts' Forecast Bias, Journal of Finance, 56, pp. 369-385.

TOPIC R7: Corporate Valuation and Investor Sentiment

Advisor: Alexander Hillert

Practitioners often use multiples (e.g. price-to-earnings ratio) to value firms. If a company has relatively low (high) multiples it is seen as relatively cheap (expensive). One question that arises in this context is whether and how investor sentiment influences multiples and whether changes in multiples reflect rational changes in expectations or irrational changes, i.e. changes in investor sentiment. For example, does a high multiple reflect positive prospects (large future cash flows) or rather high investor sentiment. In the first case the valuation would be rationally justified while in the second case the company would be overvalued. The aim of this seminar paper is to disentangle rational and irrational, i.e. sentiment driven, changes in corporate valuation.

The objective of this seminar thesis is first to give a short introduction to corporate valuation using multiples and to review the relevant literature (e.g. accuracy and biases of the valuation methods, identification of factors that influence multiples). The main focus should be on an own empirical analysis dealing with the relation between valuation and investor sentiment. One main question would be which fraction of changes in multiples is driven by sentiment.

Introductory literature:

Baker, M. P.; Wurgler, J. (2006): Investor Sentiment and the Cross-Section of Stock Returns, Journal of Finance, 61, pp. 1645-1680.

Cliff, M.T.; Brown, G.W (2001): Investor Sentiment and Asset Valuation, Working Paper, 2001.

Lie, E.; Lie, H. J. (2002): Multiples Used to Estimate Corporate Value, Financial Analysts Journal, Vol. 58, pp. 44-54.

Liu, J.; Nissim D.; Thomas J. (2002): Equity Valuation Using Multiples, Journal of Accounting Research, 40, pp. 135-172.