THE ABFER ASIAN BUREAU OF FINANCE AND ECONOMIC RESEARCH DIGEST

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INSIDE THIS ISSUE:

Cost of Bereavement: How Does Parental Loss Affect Mutual Fund Managers

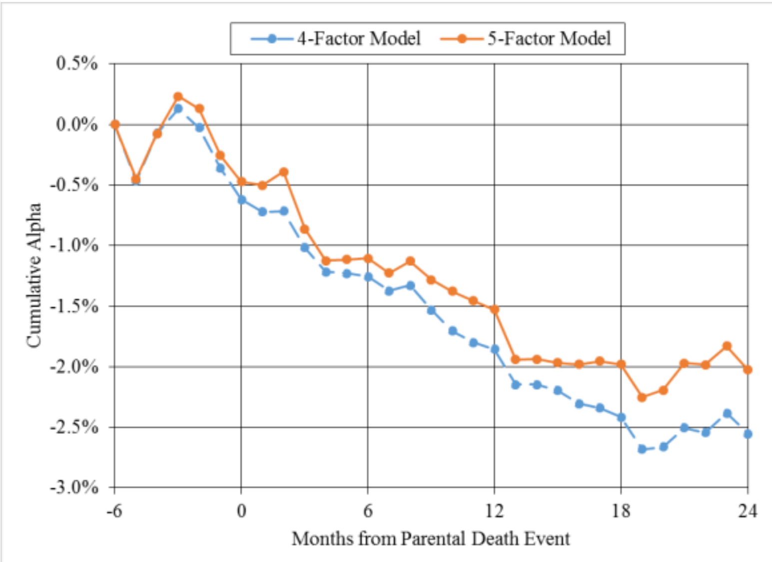
Tao Shu (UGA), Johan Sulaeman (NUS), P. Eric Yeung (Cornell)

The loss of a loved one is an unfortunate and sad experience for most people and can affect them in various ways. However, when a mutual fund manager loses a parent, it can have an unexpected downward impact on returns on the funds managed by him or her, according to a new study.

An interesting study on the **Cost of Bereavement: How Does Parental Loss Affect Mutual Fund Managers** has been done by *Tao Shu, Johan Sulaeman and P. Eric Yeung*.

On examining the impact of parental death on the performance and behaviour of mutual fund managers, the authors find that the returns on mutual funds managed by them decline by about 3 percentage points around the time of the parent's death. They say that this under performance persists for about a year, suggesting long term negative impact of the death on fund managers' cognitive ability. This effect is robust to using various measures of fund performance and is stronger when the parental death was less expected.

The authors say that the underperformance cannot be explained by alternative explanations like physical distractions around parental death as these distractions are mostly temporary. They also look at real estate sales following parental deaths which the potential of causing long-term distractions and find that these sales are relatively infrequent and the corresponding transaction amounts seem too small to generate a prolonged significant impact on the bereaved fund managers.



Source: Authors

The bereaved managers' investing behaviour also changes around the time of the parental death as they become less likely to take risk as they reduce tracking errors, shift holdings to larger stocks and trade less actively. They also become more impatient as they incur higher transaction costs and close their positions more quickly to realise gains. At the same time, the fund managers become more sensitive to losses as they are more likely to eliminate stocks following large negative returns.

In addition to finding that life experience can impact an economic agent's performance and behaviours, the study also contributes to the literature on behavioural finance by showing that sadness, a common emotional state, can have a large influence on professional investors. Examining mutual fund managers who are widely considered to be relatively sophisticated investors, the study's findings suggest that individual investors may suffer a similar or even stronger impact when they experience sadness due to personal life events. These experiences are likely to generate substantial effects on their risk preferences as well as their investing performance.

The study also contributes to the mutual fund literature by highlighting the importance of fund managers' personal life events that can have a large negative effect on their performance. Thus, the study gives both good and bad news about fund managers. While the deterioration in performance due to personal life events shows the critical role that the mutual fund managers play in creating value for their investors, the results also show that even these professional money managers are not immune to the impact of emotions caused by events of a personal nature.

Harnessing the Wisdom of Crowds

Zhi Da (ND) and Xing Huang (MSU)

In their study **Harnessing the Wisdom of Crowds**, *Zhi Da and Xing Huang* show that extensive herding is harmful on a crowd-based earnings forecast platform – Estimize.com, which is a popular United States website. By tracking user viewing activities, they monitor the amount of information a user viewed before making an earnings forecast.

Estimize.com is an open web-based platform that facilitates the aggregation of financial estimates from a diverse community of individuals. Since the firm's founding in 2011, increasingly more contributors have joined the platform and the coverage of firms has also significantly expanded. As on May 2015, more than 7,000 analysts contribute on the platform, resulting in coverage of over 1,500 stocks every quarter. The consensus forecasts are available on both the company's website and Bloomberg terminals.

A diverse group of users make forecasts. Of the 1,773 users studied in the sample for the paper, one third were financial analysts, and the remaining were working professionals from different industries and students. The authors find that the more public information is viewed, the more an individual forecaster will underweight his or her private information. While this improves the accuracy of each individual forecast, it reduces the accuracy of the consensus forecast since useful private information is prevented from entering the consensus, which is consistent with herding.

The authors say that the evidence using the unique release view information suggests that the influence we exert on each other can make the crowd collectively dumber, consistent with the prediction of herding. But not all users are created equal. Some users potentially can exert stronger influence on the others. The authors' say that they would expect the herding behaviour to be more severe when more "influential" users are present in the crowd.

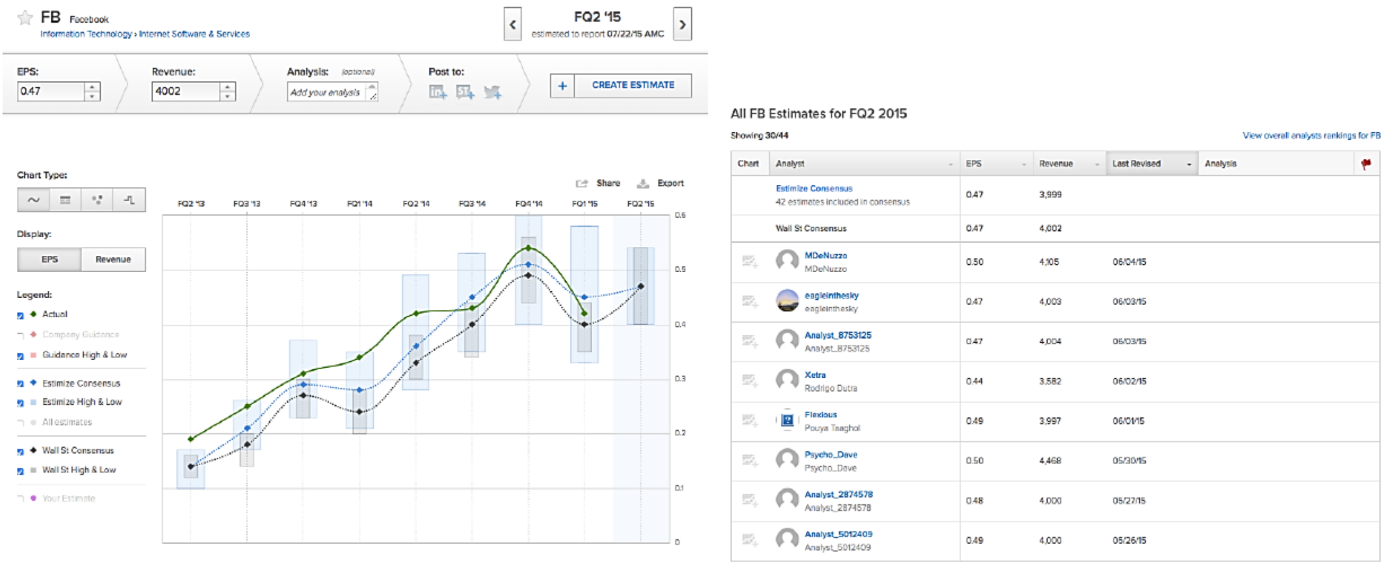
To address the endogeneity concerning the information acquisition choice, the authors collaborated with Estimize.com to run experiments where they restricted the information set on randomly selected stocks and users. The experiments confirm that "independent" forecasts lead to more accurate consensus and convinced Estimize.com to switch to a "blind" platform from November 2015.

The authors say that the wisdom of crowd hinges on having independent estimates. In many real life applications, however, estimates and opinions from a crowd are elicited in a sequential basis. Since participants learn from observing each other, they also exert influence on each other, herding behaviour arises, resulting in the loss of useful private information.

Finally, a randomized experiment offers clean evidence that wisdom of crowd can be better harnessed by encouraging independent voice from the participants. Ironically, by limiting the crowd's information access, the accuracy of their average forecast can actually by improved. The authors' say that based on their study they are confident that by adopting such a "blind" platform, Estimize.com will generate more accurate corporate earnings forecast that are crucial for the efficiency and well-functioning of the financial market. Overall, the findings from the paper suggest that the wisdom of the crowd can be better harnessed by encouraging independent voice from the participants.

Figure 3: Example of a Release Page

The figure presents a screenshot of the release page of Facebook, Inc. (FB) for the second fiscal quarter of 2015. The left chart plots the historical data of actual EPS, the range and consensus of Wall Street forecasts, the range and consensus of Estimize forecasts. The right chart lists all Estimize estimates of FB's EPS.



Source: Authors

To Stay or to Migrate? The One-Child Policy, Land Tenure Arrangements, and Work-based Migration in China

Pei-Ju Liao (Academia Sinica), Ping Wang (WUSTL), Yin-Chi Wang (CUHK) and Chong Kee Yip (CUHK)

While China has experienced rapid economic growth since 1980, it has also implemented two unique policies: the one-child policy and the household registration (hukou) system, which serves to control internal population movement. The one-child policy is closely linked to the hukou system in that the rural-urban migrants have to follow a stricter fertility policy.

The paper, **To Stay or to Migrate? Rural-urban Migration and the One-Child Policy in China**, by *Pei-Ju Liao, Ping Wang, Yin-Chi Wang and Chong Kee Yip* looks at how the one-child policy and the hukou system interact with each other to affect the fertility choice, the migration decision and the subsequent differentials in economic development across urban and rural China.

Under China's hukou system, there are three major migration channels: moving from rural to urban areas for attending higher education, working, or making investments in cities. Previously the authors of this paper have shown in another study the importance of education-based migration to the development of China. But data on migration by reason shows that work-based migration is no less important than education-based migration. Continuing this line of research, the authors ask: how did the land tenure arrangement system and the one-child policy affect rural-urban migration reasons? And to what extent did they affect the migration pattern and the development of China?

In this study, the authors construct a dynamic general equilibrium model with endogenous fertility, land reallocation and migration decisions to study the issue of rural-urban work-based migration in China. They say that to the best of their knowledge, this paper is the first to examine rural-urban migration with land tenure arrangements, the one-child policy, and the hukou system in a dynamic general equilibrium model. The model is calibrated to fit the data from China, and quantitative analysis to investigate the impacts of fertility control and land policies on China's rural-urban migration is provided.

The authors say that different from the existing literature, their model is more close to the reality in the way that the reallocation of land is incorporated in the model. With this new channel, they find interesting interactions between fertility choices and migration decisions in the counterfactual experiments. Due to the higher child-rearing costs in urban areas, a higher fertility quota in urban areas only leads to very small increases in urban fertility rates.

However, less strict fertility control policies in urban areas attract more rural workers, resulting in a higher migration rate and a lower birth rate in rural areas when workers who love children more emigrate to cities. When the fertility quota in rural areas is loosened, more rural workers will migrate to cities due to the land dilution effect. As the dilution of land drives rural workers who prefer to have more children away from their hometown, the rural fertility rates drop as a result, say in conclusion.

“Just Do Your Job”: Obedience, Routine Tasks, and the Pattern of Specialization

Filipe R. Campante (Harvard) and Davin Chor (NUS)

Do cultural attitudes towards obedience have broader socio-economic consequences? This is the question that motivates a recent study by *Filipe R. Campante* and *Davin Chor*, entitled **“Just Do Your Job”: Obedience, Routine Tasks, and the Pattern of Specialization**. The hypothesis that cultural norms and attitudes can leave their imprint on comparative development outcomes has a long vintage. For example, this idea gained much attention during the debate on the importance of “Asian values” in explaining the success of the East Asian tiger economies.

In this project, the authors focus on attitudes towards obedience, specifically obedience in the context of workplace instructions. The research draws on data from the World Values Survey (WVS), a study of socio-cultural attitudes around the world. The WVS contains a particular question that asks respondents how inclined they would be to follow instructions from their work supervisor, as opposed to questioning them, even when one might disagree with the instructions. As phrased, the question therefore elicits responses on attitudes towards “workplace obedience”.

The authors establish two key facts that speak to how cultural attitudes on “workplace obedience” interact with the structure of the economy. The first finding is the “Specialization Fact”. This rests on the idea that workplace obedience would not be uniformly helpful across all forms of production activities and tasks. The authors posit that workplace obedience would be particularly beneficial in tasks that require the routine execution of a set of instructions or standards, such as in production line assembly. (See the accompanying picture for an example of workplace instructions in an automobile assembly plant visited by one of the co-authors in Mexico.) On the other hand, an attitude of “just follow the instructions” would instead be detrimental in tasks that require more active, non-routine thought processes, such as in computer coding or R&D.

The Specialization Fact is precisely about how attitudes towards workplace obedience can influence the pattern of industry specialization observed at the country level. Using the WVS responses, together with information on the age cohort structure of the workforce over time, the authors construct measures of the “average obedience” of the workforce of different countries. Combining this with country export data, they show that as prevailing attitudes in a country become (for instance) more pro-obedience, this is associated with an increase in specialization and exporting in industries where the task content is more routine in nature.

Where following instructions is important: Workplace instructions in an automobile factory in Mexico. (Photo Credit: Filipe R. Campante)

The second finding – the Obedience Fact – takes seriously the view that there can be a further feedback effect from patterns of specialization on cultural attitudes towards obedience. This builds on a recent influential line of work in the cultural economics literature arguing that culture is not entirely immutable. Instead, prevailing economic conditions can affect the choice of cultural values that one generation chooses to transmit to the next.

Toward this end, the authors uncover evidence that attitudes towards workplace obedience do indeed appear to be shaped by the past structure of the economy. The regression analysis shows that individuals with higher levels of education tend to express less agreement with obedience per se in the workplace. However, this effect of education is muted if the individuals were exposed during their formative years (age 20 and under) to an economic environment that featured more production and exporting in routine industries. In other words, growing up in an “export-routine” environment can lead individuals – even those with high levels of education – to be more inclined to simply follow workplace instructions. This evidence strongly suggests that attitudes towards obedience are transmitted either through the family or the schooling system: On the basis of economic conditions that they are exposed to, parents or teachers pass on cultural values towards workplace obedience to the next generation, and these attitudes in turn persist with this next generation into their adulthood.

To make sense of these findings, the project develops an overlapping generations model that features a cultural transmission decision. The model generates predictions akin to the Specialization and Obedience Facts: The obedience attitudes held by the current generation of adult workers affects the contemporaneous pattern of industry specialization in the economy, which in turn affects the obedience attitudes that are then passed on to the next generation. One of the takeaways from the modeling exercise is that it reveals the possibility of an "Obedience Trap", a situation where the economy remains specialized in routine industries such as basic manufacturing, enforced by a prevailing culture of obedience, which comes at the expense of the development of more non-routine sectors. The authors are keen to expand the project to examine how cultural attitudes toward obedience and human capital in different countries affect patterns of civic engagement and political participation.

It's Showtime! Conference Call Participation and Analysts' Career Outcomes

Ling Cen (U TORONTO), Jing Chen (PKU), Sudipto Dasgupta (HKUST & CEPR) and Vanitha Ragunathan (UQ)

Early participation in earnings conference calls shows some connection with management. This later on influences broker's labour market mobility. It has been seen that managers pick brokers who are favourable to them. Also new employers value connectivity and network. Numerous results show that early participation if good for analysts.

In their study: **It's Showtime! Conference Call Participation and Analysts' Career Outcomes**, *Ling Cen, Jing Chen, Sudipto Dasgupta and Vanitha Ragunathan,* rely on three datasets – a list of brokerage closures, analyst participation in earnings conference calls around brokerage closures, and their job outcomes after broker closures. They got information on analyst attendance from earnings conference calls transcripts from StreetEvents.

The authors say that while there is a large literature in finance and accounting on the role of sell-side analysts in financial markets, it is not easy to evaluate this role for three reasons. First, sell-side analysts have to keep a delicate balance between the twin objectives of having good relationships with the management of companies they cover and their buy-side clients. Second, it is not possible to observe analysts' compensation data, which is typically proprietary information. Therefore, large sample studies on how analysts are rewarded and what matters to them and their employers are not possible. Third, it is very difficult to separate analyst-firm connectivity and brokerage-firm connectivity and determine whether analyst-firm connectivity has any value to their prospective employers.

In this paper, the authors use analyst participation in earnings conference calls, and especially, the order in which analysts are allowed by management to ask questions, as a proxy for both analyst connectivity and skills. They examine how the analysts' job outcomes are affected following the brokerage closures by their prior conference call participation.

The study finds that analysts who participate in earnings conference calls and get to ask the first questions are likely to enjoy special access to management. The authors argue that such access could either signal connectivity to management, or analyst stature or reputation recognized by management. Their measure of connectivity is different from other measures of connectivity used in the literature since it is analyst-specific and endures even after the closure of the brokerages. The authors examine sell-side analysts' labour market performance in brokerage closure events, and find that analysts' prior early call participation predicts more successful and speedy job searches.

The study finds evidence that early participation reflects both connectivity to management and industry-specific skills: sell-side employers value both, but buy-side employers do not seem to value connectivity to management of a particular stock. Consistent with the connectivity interpretation, the study finds that early call participants engage in greater strategic distortion between earnings forecasts and recommendations, and this is exacerbated when there is less institutional ownership.

Creative Destruction, Investor Beliefs and the Evolution of Stock Returns

Sheridan Titman (U Texas) and Aydogan Alti (U Texas)

Financial economists have been aware of what has been referred to as asset pricing anomalies since the late 1970s. The literature has documented that various past return measures, price scaled variables, and profitability measures have historically predicted future returns. The focus of this study: **Creative Destruction, Investor Beliefs and the Evolution of Stock Returns by** *Sheridan Titman (U Texas) and Aydogan Alti (U Texas)* is on anomalies that are based on firm fundamentals.

Figure 1, which plots rolling three year cumulative returns of a strategy that buys stocks that exhibit high profitability, high book to market ratios, and low asset growth rates, illustrates the importance of these anomalies over the past 50 years. As the figure shows, this portfolio strategy earned positive returns over almost all three year periods; the exception being the internet boom years in the late 1990s.

The authors argue that these return patterns represent an unexpected sample path, reflecting systematic mistakes that investors may have made. To explore the types of mistakes that investors can make they develop a model where investors learn about a latent state variable that influences a source of systematic risk in the economy. The systematic source of risk they examine is what they call the climate of disruptive innovation, which influences the flow of investment projects.

For understanding the authors' model and how it connects with empirical evidence, they say that it is useful to think about firms as combinations of assets in place and growth opportunities. Firms in this economy differ in two ways. The first dimension describes their access to new growth opportunities; growth firms get new projects steadily while value firms just harvest the profits from their existing opportunities. The second dimension is the firm's history. New growth firms like Twitter have very little assets in place and thus low profits, while more mature firms like Apple have very profitable assets in place as well as growth opportunities.

Figure 1
Trailing Three-Year Cumulative Return of Equal-Weighted Characteristic Portfolio

Source: Authors

The authors say that the innovation shocks can have temporary as well as persistent components and investors imperfectly distinguish between these components from the observed arrival rate of new projects and from soft information technological advances and the political climate. And since the innovations prospects in the economy are unobservable and change from time to time even fully rational investors are sometimes too optimistic and sometimes too pessimistic about the benefits of an innovation shock.

The model is flexible enough to consider full rationality, biased pre-conceptions, and slow learning that takes place for instance from over-confidence. The authors show that even under complete rationality, one can generate value and profitability effects in small samples. A contribution of the authors' quantitative model is that it allows them to more precisely define and explore what they mean by long versus short samples and slow versus national learning. The study considers behavioural biases that come from two sources. The first is the tendency of investors to be overly optimistic about the impact of new technology. This bias, which can influence the initial beliefs of investors, can generate the value and profitability anomaly in the early part of the sample. However, as investors do learn in the model, this effect should diminish over time.

The second source is a tendency of investors to be overconfident about their abilities to evaluate soft information. The authors say that this tendency does not necessarily bias investors towards any particular type of shock. However, because it does slow down the learning process, it increases the probability of observing pricing anomalies in small samples.

The analysis in this paper complements the growing literature that examines asset pricing in settings where rational investors learn about uncertain parameters. The analysis is also related to the behavioural finance literature. The authors' model also contributes to a series of papers that explore how investor perceptions can endogenously generate co-variation between stocks.

Inside Brokers

Frank Weikai Li (HKUST), Abhiroop Mukherjee (HKUST) and Rik Sen (HKUST)

Insider trading laws in various countries focus closely on anyone involved professionally with any firm, and hence in a position to glean private information – like lawyers, accountants etc. Surprisingly, however, they completely ignore people professionally involved with firm insiders, whose job makes them just as likely to glean private information in the process of their interaction with the insider. One prime example is the stock broker through whom an insider trades. The broker is likely to glean information beyond that contained in the disclosure of the trade itself, for example, the nature of the trading instruction – was the order placed as a limit order 6 months in advance to be executed on a certain day, or was it a quick market order placed right after a contentious board meeting?

In their study **Inside Brokers,** authors *Frank Weikai Li, Abhiroop Mukherjee and Rik Sen* identify the stock broking house that firm insiders trade through, and show that analysts employed at such "inside brokers" have a clear and substantial information advantage over the rest of the market. These "inside analysts" forecast earnings of the insider's firm more accurately, compared to other analysts as well as compared to their *own* forecasts in periods when the insider does not trade.

The inside broker's information advantage is stronger for firms that are smaller, more opaque, and with greater disagreement about their future. The authors find that unlike many other sources of analyst comparative advantage, the inside broker effect is stronger after Regulation Fair Disclosure. Their results imply that information beyond that contained in public disclosure of the trade itself passes to the broker of the insider, which the equity analyst employed by the broking house can take advantage of.

This study has important implications on the role played by financial intermediaries in the process of information assimilation into prices. Broking houses, for example, may have an information advantage that they can get from their private information on the nature of the trading instructions from their clients – and clients may include not just firm insiders, but also hedge funds, activists and anyone else endowed with asymmetric information.

About ABFER

The Asian Bureau of Finance and Economic Research is an institute founded by academics from Asia, North America, and Europe. The Bureau intends to create a virtual and independent network of high-quality academics akin to the NBER/CEPR, as well as conferences and workshops.

The purposes of the Bureau include:

- to promote Asia-Pacific oriented financial and economic research at local, regional and international levels;
- to connect globally prominent academic researchers, practitioners and public policy decision-makers on Asia-Pacific related financial and economic issues;
- to enhance the research capabilities and development of strong clusters of finance and economic research groups in academic institutions and other institutions in Singapore and Asia-Pacific.

This Digest summarizes selected papers presented in the ABFER's 4th Annual Conference which was held in May 2016 at the Shangri La Hotel, Singapore. More information on the conference can be found here.

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