

The Exchange

NEWS FROM THE FINANCIAL ECONOMICS INSTITUTE AT CLAREMONT MCKENNA COLLEGE

VOLUME 5, FALL 2007

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Director's Report

THIS FALL, THE FEI EMBARKED ON ITS fourth year and is now firmly established as part of "CMC culture." Since its inception, over 40 students have been associated with the FEI as Research Analysts, completing projects in conjunction with faculty members from CMC, Pomona, and CGU. The support has been made possible by the generous contributions of our Board of Advisors and Associates, and the BGI Fellowship Program, which provides support for faculty-student research on investment management topics. The research efforts have resulted in over 30 articles being published in outlets such as the *Journal of Finance*, *Journal of Corporate Finance*, *Journal of Financial Economics*, *Journal of Law and Economics*, *Journal of Banking and Finance*, *Journal of Financial and Quantitative Analysis*, *Applied Financial Economics*, and *Financial Management*. Articles from the FEI-sponsored conference on SEC Regulation were recently published in a special issue of the *Journal of Corporate Finance*, co-edited by Professor Janet Smith and Professor Harold Mulherin (now at the University of Georgia).

This semester, we welcomed Professor Eric Hughson to CMC and the FEI as a professor of financial economics. Professor Hughson is rapidly getting to know CMC students by teaching two sections of Investments and by



CMC students, alumni, faculty, and staff enjoying an FEI-sponsored cocktail reception at The California Club in Los Angeles

supervising several FEI students on research projects. He is a nationally renowned financial economist, known best for his work on market microstructure and financial econometrics. His research has been published in high-impact outlets, including the *American Economic Review*, *Review of Financial Studies*, and the *Financial Analyst Journal*. A recent publication is featured

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The Financial Economics Institute fosters education and research in financial economics by offering a unique undergraduate curricular program, the Financial Economics Sequence, supporting state-of-the-art databases, and encouraging student-faculty interaction on research.

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in an article on page 5. We are very pleased to have him on board at CMC.

We are also pleased to welcome Robert Morris, III and Kevin Tan '86 to the FEI Board. Mr. Morris, who lives in San Francisco, is a Retired Partner at Goldman Sachs and his son, Bremner, is a junior at CMC. Kevin Tan '86 is the Chief Representative and Senior Vice President for The Northern Trust Company. Mr. Tan is based in Beijing, China.

Earlier in the semester, CMC announced an unprecedented gift of \$200 million from alumnus and Trustee Robert Day '65. The gift will create the Robert Day Scholars Program, a unique academic program combining CMC's liberal arts education with state-of-the-art curricula in financial economics, accounting, and organizational leadership. The gift also creates a Master's Program in Finance, which will be housed at CMC. With the introduction of the graduate program, CMC joins the ranks

of other selective liberal arts colleges that have recognized the benefits of offering graduate level programs, including Swarthmore, Williams, Bryn Mawr, Middlebury, Oberlin, and Wesleyan. In recognition of this extraordinary gift, the department of economics will be re-organized as a school and named the Robert Day School of Economics and Finance at Claremont McKenna College.

The gift provides for additional faculty, which will augment the current selection of classes and provide students with opportunities to explore additional areas of interest. The funding also will be used to provide student scholarships and to enhance CMC's existing career services and internship programs.

The FEI will continue to play a prominent role in the undergraduate program as well as in the new graduate program. The FEI provides critical support for databases, conferences, speaker series, faculty research stipends, student

fellowships, student networking trips, and mentoring opportunities. Additionally, the FEI coordinates the student thesis project component of the Financial Economics Sequence and handles the recruiting, hiring, and management of students involved with the Student Research Analyst Program. We expect that the addition of new faculty members will enable the FEI to involve more students in research and will add to the richness of the Sequence course offerings. The Sequence, already well-entrenched at CMC, is expected to be an even more attractive option going forward, as the Day gift provides for more faculty hiring in critical areas such as mathematics and finance. In sum, we fully expect the Day gift to have a significant and positive impact on past, present, and future CMC students.

Janet Kibohm Smith, Director, FEI ▲

2007 – 2008 BGI/Larson Asset Management Fellows

The BGI/Larson Asset Management Fellowship Program offers financial support and research experience for juniors and seniors at Claremont McKenna College who are interested in careers involving asset management and investment management. The recipients of this year's scholarships are:



Scott Arnold, a junior at Claremont McKenna College, is majoring in Economics and plans to complete the Financial Economics Sequence. Originally from San Juan Capistrano, CA, Scott grew up in Lafayette, CA. Scott has returned to his native Southern California roots for college. In addition to working as a BGI/Larson Asset Management Fellow at the Financial Economics Institute, Scott serves as the Co-President of the

Student Investment Fund and INVE\$T, as well as the Chief Financial Officer of the Associated Students of Claremont McKenna College. This past summer, Scott was an intern at UBS Investment Bank in Los Angeles where he worked on transactions in Mergers & Acquisitions and Corporate Finance. He will intern with Morgan Stanley in Los Angeles during the summer of '08. After graduation, Scott hopes to pursue a career in investment banking and private equity.



Catherine Powers is a senior at Claremont McKenna College. She is pursuing an Economics-Mathematics dual major with the Financial Economics Sequence. Originally from Bainbridge Island, Washington, Catherine played for the CMS Women's Soccer Team her freshman year and has been a Research Analyst at the FEI since the beginning of her sophomore year. This past summer, Catherine interned at Cascade Investment in Kirkland, Washington, and recently she

served as a CMC Representative on the 5-C Wall Street Weekend Planning Committee. She has accepted an investment banking position with Citigroup in San Francisco which will begin after graduation.



Kurt Sheline is a senior majoring in Economics at CMC with a focus in the health sciences. While he grew up in Claremont, he now lives in Carlsbad, CA. In addition to working at the FEI, he is a member of the CMS Men's Golf Team and the Student Investment Fund. This past summer, Kurt interned as an investment banking summer analyst at Merrill Lynch in San Francisco. Following graduation, Kurt will return

to Merrill Lynch in San Francisco where he has accepted a full-time investment analyst position.



Aseem Vyas is a senior at Claremont McKenna College. He is majoring in Economics and will complete the Financial Economics Sequence. His work experience includes interning at Trust Company of the West in Los Angeles and Barclays Capital in NYC, where he will be working full-time after graduation. During his senior year, Aseem intends on taking classes that will broaden his horizons and improve his

understanding of finance. He plans on enjoying his last year of college to the fullest. ▲

Financial Economics Institute 2007 Summer Research Analyst Internship Projects

NICK BURNETT '09

Faculty Advisors: Joshua Rosett and Janet Smith

PROJECT 1: Examined stock price reactions when quarterly earnings were announced over the past 20 years

- Reviewed quarterly earnings statements for approximately 530 firms

PROJECT 2: Assessed the number of analysts associated with firms during the course of insider lawsuits

PROJECT 3: Created a database for future research projects by combining information from CRSP and Compustat databases

TEJAS GALA '09

Faculty Advisor: Janet Smith

PROJECT 1: Examination of fraud-on-the-market and weak form market efficiency

- Classified lawsuits under class period dates, SIC Codes, industry types, dismissal, certification of class, judgment, and settlement
- Used CRSP to collect data on returns, volumes, and prices
- Analyzed data to obtain averages, medians, and standard deviations for each company's returns, volumes, and shares outstanding for pre-class period, class period, and post-class period
- Calculated regressions on returns, weighted returns and beta estimates to conduct Durbin-h, runs, and trading rules tests to test market efficiency

KEVIN HESLA '09

Faculty Advisors: Michelle Sovinsky Goeree and Darren Filson

PROJECT 1: Analyzed the relationship between pre-IPO Pharmaceutical companies

- Examined S-1 forms on Edgar database to create a spreadsheet identifying each firm's assets, research and development costs, total operating expenses, revenue, and net losses

PROJECT 2: Created a database linking Nielson Viewer rankings of primetime television programs with brand level advertising information based on ad cost and length. Also, evaluated total ad cost and total ad length per unique program timeslot

MARIA LÖHNER '10

Faculty Advisors: Janet Smith, Eric Helland, Greg Hess, Michele Bligh

PROJECT 1: The Merits of Security Class Action Lawsuits

- Examined the impact of shareholder litigation on directors' willingness to serve on boards

PROJECT 2: Federal Reserve Chairman Leadership and Speeches

- Completed a literature review on the topic and updated a database



Front row, from left: Nick Burnett '09, Maria Löhner '10, and Tinsley Lowe '08. Back row, from left: Thomas Spiller '09, Kevin Hesla '09, and Tejas Gala '09.

by collecting all the speeches, testimonies and statements given by Federal Reserve Chairmen

TINSLEY LOWE '08

Faculty Advisor: Janet Smith

PROJECT 1: Examination of fraud-on-the-market and weak form market efficiency

- Gathered data from security class action lawsuit documents
- Statistically summarized the data, beginning with running regressions in EViews and then calculating the Durbin-h statistic, the runs test, and the trading rule test

PROJECT 2: Road to Ruin

- Examined the governance of chronically underperforming firms

THOMAS SPILLER '09

Faculty Advisors: Janet Smith and Paul Zak

PROJECT 1: Built a double auction experiment in Z-Tree (Zurich Tools for Ready-Made Economic Experiments)

PROJECT 2: Road to Ruin

- Gathered governance and accounting information for various firms deemed "Chronically underperforming" (based on the return on assets for five consecutive years). This involved reading through Def 14A forms on the SEC Edgar Database, and formatting information collected from Compustat, IRRC, and Thompson Financial ▲

Reputational Penalties and the Merits of Class Action Securities Litigation

The Journal of Law and Economics, 49, 2006: 365-395

Eric Helland (Claremont McKenna College)

Summarized by Maria Löhner '10, FEI Student Research Analyst

INSIDER TRADING IS THE ILLEGAL buying or selling of securities with information that is only available to people inside the administration of a company. Although insider trading is a felony for which the SEC can levy large civil penalties for violations, allegations frequently are settled out of court. In very few instances, however, the allegations result in a trial. In order to examine the effect of recent litigation, Professor Helland created a comprehensive list of fraud allegations between 1994 and 2002.

The primary objective of the paper is to determine if private attorney generals enforce antifraud provision laws for private gain. Prof. Helland employs a novel approach of assessing the merits of private securities class actions by examining the reputation penalty paid by officers and directors who serve on a board accused of fraud. The findings indicate that for the average case, there is no evidence of a negative effect on reputation associated with allegations of fraud.

These results cause one to question the merits of the average private securities class action lawsuit which is typically enforced by the SEC or private attorneys. Previous studies have found that lawsuits are more likely against firms that are characterized as large, in certain industries, and that have experienced a large decline in stock value. One challenge with this study is that there is no benchmark for what constitutes a meritorious case. Higher turnover following a fraud allegation could result from a reputational penalty or the additional cost to the director or chief executive officer of defending against the allegation. Fraud could also be an indication that the internal controls of a firm are weak.

Prof. Helland's study measures the reputational effects over an eight-year period between 1994 and 2002. This time span was deemed appropriate because a director's reputation typically does not exceed four years. The study excludes all directors who are banned from holding future outside



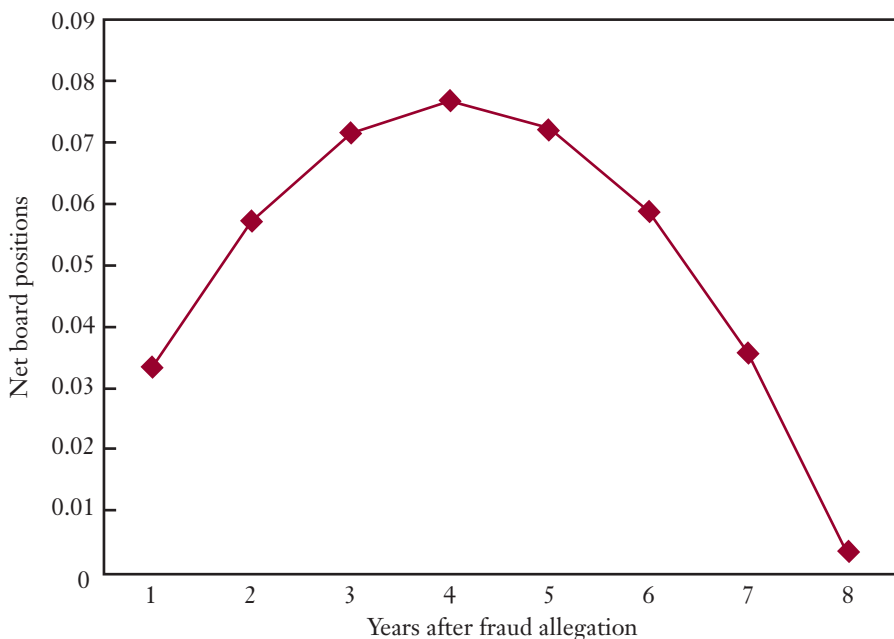
▲ **ERIC HELLAND** is a Professor of Economics at Claremont McKenna College, who specializes in law and economics and industrial organization.

directorships or are imprisoned. Additionally, the study controls for retirement age. In order to assess the directors' initial reputation, Prof. Helland calculated the total number of board positions in previous years.

The results indicate that a fraud accusation in a private securities case has a statistically significant and positive effect on the reputation of the outside directors. A fraud allegation increases the net number of outside directorships by .184. This represents a gain of nearly 17.5 percent in total board positions per year. One explanation for a positive effect of a fraud allegation is that the average private securities case is assumed to be a strike suit designed to elicit settlement but is without legal merit. Strike suits are lawsuits that do not identify actual fraud. Companies with a board made up of directors who are highly attractive candidates for additional outside board positions are also strong candidates for a suit. As the results show in Figure 1, the positive effect of a fraud allegation increases for the first four years, after which the effect is mitigated, returning to almost zero after eight years.

The effect of serving on a board of a company charged with fraud in a private securities class action also increases the net number of outside directorships for members of

Figure 1: Increases in Board Membership for Directors of Firms who have faced Fraud Allegations



The Misuse of Expected Returns

Financial Analysts Journal, 62, 2006, 88-96

Eric Hughson (Claremont McKenna College), Michael Stutzer (University of Colorado, Boulder), and Chris Yung (University of Colorado, Boulder)

Summarized by Tinsley Lowe '08, FEI Student Research Analyst

THE DIFFERENCE BETWEEN

estimating expected returns based on the mean or median has been a topic studied by many economists. In the article written by Professors Hughson, Stutzer, and Yung, the authors argue that the median is a better estimate when forecasting cumulative returns. This argument is based on the tendency for the mean to be larger than the median, especially over a long period of time.

One of the authors' main findings is that future expected returns are skewed since the mean is affected by larger outliers, causing it to exceed the median value. This additional value is then compounded when forecasting cumulative returns, increasing the expected value. Since calculations based on the mean will have a higher value, it is less likely for actual

cumulative returns to meet or exceed expectations. Therefore, calculations using mean gross returns to calculate expected cumulative returns are overoptimistic. In contrast, median returns are not affected by the outliers, and therefore are smaller, producing lower expectations. These lower expectations are more likely to be met or exceeded.

The authors conducted a thirty-year simulation to illustrate these concepts in which they created returns that followed the random walk hypothesis. The authors calculated gross returns, log gross returns, cumulative return forecasts, and historical cumulative returns in order to produce averages, expected returns, compounded averages, median returns, and compounded average log return. The one million simulated returns confirm that the mean cumulative return is always higher than the median, and the gap grows with the time horizon as the distribution gets more highly skewed.

For example, the mathematical expectation $([1+E(r)]^t)$ forecasted for year 30 (1.054^{30}) lies at the 80th percentile, meaning expectations would be met or exceeded only 20 percent of the time. The compounded average log returns $([e^{0.037}]^{30})$, where 0.037 =average log gross returns) produced a much closer estimation to historical cumulative returns, lying at the 50th percentile, which is consistent with the concept that forecasting median return is a better estimate of typical cumulative return for long time horizons. The authors also analyzed monthly returns data produced by CRSP from 1926-2004 to identify the difference between using mean or median to calculate cumulative returns. These findings also confirmed that forecasting median cumulative return is a more accurate prediction of long-term investments.

Although the authors believe calculating expected returns using the median is more accurate for long time horizons, they also indicate that using historical returns to forecast future cumulative returns may lead to inaccuracies. For the values to be good approximations of the future, they have to be



▲ **ERIC HUGHSON** is a Professor of Economics at Claremont McKenna College, who specializes in financial economics.

calculated using data from a long calendar history which is unbiased and independently and identically distributed (IID). In order to create a 95 percent confidence interval, one would need to gather historical returns for 54 years with an interval of ± 400 basis points per year, a wide uncertainty band for financial planners to use. Furthermore, it is unlikely that a long calendar of historical returns would be generated from the same distribution. If the distribution changes with time, compounding historical averages would be misleading. For these reasons, one must exercise caution when relying on estimated future cumulative returns to make investment decisions.

When making predictions about future cumulative returns, selecting the ideal estimator depends on the nature of the investment. For longer investments, using compounded log gross returns to predict expected median future cumulative returns is more accurate. The probability of meeting or exceeding the forecasted median cumulative returns is much higher than when using the mean. However, one should not rely on these calculations when making investment decisions. It is important to understand that these are just estimations and that the data are not collected from the "ideal" distribution. In fact, investors will significantly benefit from analyzing other factors of the potential investment when making an investment decision. ▲

Because cumulative returns are positively skewed, the mathematical expected cumulative return substantially overstates the future cumulative return that investors are likely to realize, and the problem grows worse as the time horizon increases.



DR. RICHARD L. PETERSON

October 16, 2007

Inside the Investor's Brain: The Power of Mind Over Money

DR. RICHARD L. PETERSON SPOKE at the Marian Miner Cook Athenaeum as the fall lecturer for the Financial Economics Institute's Speaker Series. He is Managing Partner of Market Psychology Consulting, a psychiatrist, and collaborating researcher at the Claremont Graduate University Center for Neuroeconomic Studies. Dr. Peterson has developed market forecasting software based on linguistic analysis of financial news, and he will be launching his own hedge fund in early 2008.

During his visit to the Athenaeum, Dr. Peterson discussed his recently published book, *Inside the Investor's Brain: The Power of Mind Over Money*, in which he examines the roots of financial decision-making behavior. Neuroscientists have found that common investment mistakes originate in the brain and Dr. Peterson reviewed the latest findings in the fields of behavioral finance while highlighting techniques and tools for improving individual financial choices.

Dr. Peterson received his medical and

bachelor's degrees from the University of Texas. He has conducted behavioral finance and neuroeconomics research at Stanford University, and has published articles in psychology, neuroscience, finance, and economic journals. He is an Associate Editor of the *Journal of Behavioral Finance*. Dr. Peterson's Athenaeum lecture was co-sponsored by the Center for Neuroeconomic Studies at Claremont Graduate University and the FEI. ▲

Eric Helland from page 4

that board. This result varies based on the type of outside directorships and the inclusion of an allegation of fraud in a class action suit. Because the average private securities class action is a strike suit, it does not convey negative information about a director.

Further evidence suggests that directors in a position of having inside information about corporate fraud do not actually suffer a reputational penalty. For example, directors who are the CEO and CFO of a company accused of fraud actually increase their net outside directorships beyond the increase experienced by all directors on boards accused of fraud. This suggests that even directors in a position to observe fraud, or who at least had been charged with preventing it, are rewarded

in the director labor market. The evidence is consistent with a number of suits not being meritorious and also suggests that those suits with large settlements are indicative of officer and director malfeasance. The policy implications of the results are ambiguous and the results suggest that cases of limited social value are ending up in the courts. At the same time, meritorious cases clearly exist.

There are two potential explanations for why the effect on director reputation is positive. One explanation is that a strike suit is more likely to result in a settlement for a director who is more effective as an outside director because he or she has a higher opportunity cost of time. The positive coefficient is also consistent with the hypothesis that the director

labor market actually encourages minimal oversight to avoid being the target of a suit.

Nevertheless, the other results of the paper argue against such an interpretation. The number of net board positions in the top quartile of board size decreases with an SEC fraud allegation. Moreover, when the SEC files a case the effect is negative and significant. Directors who serve on more than one board accused of fraud also seem to improve their reputation, at least for reputation measures based on company size or outside directorships of Fortune 500 companies. Following the passage of PSLRA, a 1995 law designated to reduce the ability of plaintiffs' attorneys to file strike suits, the effect on the reputation of directors is reduced, although it is still positive. ▲

Eric Hughson, Professor of Financial Economics

By Maria Löhner '10, FEI Student Research Analyst

Q WHAT CLASSES ARE YOU TEACHING THIS YEAR?

A This semester I am teaching Investments. It has been a long time since I last taught Investments and never to CMC students, so we will see. I am using a standard MBA book but the math is too weak for CMC students. I am hoping to make the class challenging without killing the students.

Q DO YOU HAVE ANY PARTICULAR INTERESTS IN THE WORLD OF FINANCE?

A I am particularly interested in market microstructure, especially how to minimize the impact of insider trading or transaction costs. I think that markets in general are working a lot better now and academics have helped it along a great deal. The New York Stock Exchange really seems to listen to academics, which is exciting.

Q TOWARD WHICH FINANCIAL FIELD WOULD YOU STEER STUDENTS?

A It really depends on their interests. Investment banking is fun, and so is management or corporate finance. These are all rewarding because you really see the effects of what you do. I think that with a background from CMC, students can go anywhere.

Q WITH SOURCES OF CREDIT ARISING ALL OVER THE WORLD, DO YOU THINK THERE WILL BE MORE JOBS CREATED IN FINANCE DOMESTICALLY OR ABROAD IN THE NEXT TWENTY YEARS?

A Abroad, no question about it, because the jobs are simply not as developed abroad. On the other hand, I'm not worried about job security here.

Q WHAT ADVICE WOULD YOU GIVE TO CMC STUDENTS?

A This is the time when you have the most flexibility in your life. Things other than academics matter like making friends and learning things that aren't in your area. There is a lot to get out of school other than grades; the Athenaeum, instruments, or sports teams. These are things that you will never be able to do again as easily and extracurriculars matter because they enrich you and make you more competitive.

Q WHAT IS YOUR BACKGROUND IN TEACHING FINANCE?

A I received my Bachelor in Mechanical Engineering and Applied Math from MIT and my PhD in Finance from Carnegie Mellon. I have taught at Caltech, the University of Utah, and most recently at the University of Colorado. One of the

great things about teaching at Colorado was that we did an Investment Practicum which consisted of a team-taught class where the students invested their own money. Students were forced to diversify their investments and learn about different sectors. As far as teaching, my mother was a great inspiration; she was the first female full-time faculty member at Columbia.

Q I HEAR THAT YOUR HOBBIES INCLUDE RUNNING AND BIKING?

A Yes, they actually took me running when they recruited me to work here. There are great trails in the mountains really close by.

Q IN CLOSING, HOW HAVE YOUR FIRST DAYS BEEN AT CMC AND IN CLAREMONT?

A I was surprised to see how similar it looked to when I used to work in Pasadena at Caltech. We already bought a new house, which my son picked out, with a huge backyard and found schools for our kids. My wife is actually teaching in the Psychology Department, so it's nice for both of us to be in the same college. Also, I enjoy that everything is so close here. I am used to living in the city and commuting a lot. All in all, I'm pretty excited to be here. ▲



From left: Catherine Powers (CMC '08), Nick Shannahan (CMC '07), Patrick Flemming (POM '07), and Professor Joshua Rosett.

Los Angeles Cocktail Reception at The California Club

ON FRIDAY, OCTOBER 19TH, THE FEI AND CMC'S ALUMNI Relations Office hosted a cocktail reception in downtown Los Angeles at The California Club. Over 70 guests attended the event including alumni, faculty, staff, and 11 of the FEI Student Research Analysts. The event provided a tremendous networking opportunity for the students and featured comments from FEI Director Janet Smith. Maria Löhner '10 reflected, "The cocktail reception was an excellent opportunity to reach out to the Los Angeles area alumni working in the field of finance. It was also great to see the recent alums that are now working in L.A., learning about the responsibilities in their new positions, and receiving advice from them." ▲

FEI Affiliated Faculty Research

Selected 2006–2007 publications by faculty members affiliated with the FEI:

- ▶ “The Role of Underwriter-Investor Relationships in the IPO Process,” (*Murat Binay*, Vladimir Gatchev and Christo Pirinsky), forthcoming, *Journal of Financial and Quantitative Analysis*
- ▶ “What Has Driven Chinese Monetary Policy Since 1990? Investigating the People’s Bank’s Policy Rule,” (*Richard C.K. Burdekin* and Pierre L. Siklos), *Journal of International Money and Finance*, 36, (2007), pp. 87-124
- ▶ “Can Interest-Bearing Money Circulate? A Small-Denomination Arkansas Experiment, 1861-1863,” (*Richard C.K. Burdekin* and *Marc D. Weidenmier*), forthcoming, *Journal of Money, Credit and Banking*
- ▶ “Nontraditional Monetary Policy Options and Commodity-Based Stabilization Policy,” (*Richard C.K. Burdekin*), *International Economics and Finance Journal*, 2 (2), (2007), in press
- ▶ “China’s Monetary Challenges: Past Experiences and Future Prospects,” (*Richard C.K. Burdekin*), New York: Cambridge University Press
- ▶ “The Development of ‘Non-Traditional’ Open Market Operations: Lessons from FDR’s Silver Purchase Program,” (*Richard C.K. Burdekin* and *Marc D. Weidenmier*), in Jeremy Atack (ed.), forthcoming, *The Evolution of Financial Institutions from the Seventeenth to the Twenty-First Century*, New York: Cambridge University Press
- ▶ “The Effects of Profit-Reducing Policies on Firm Survival, Financial Performance, and New Drug Introductions in the Research-Based Pharmaceutical Industry,” (*Darren Filson* and Neal Masia), forthcoming, *Managerial and Decision Economics*
- ▶ “Corporate Philanthropy,” (*Eric Helland*, William Brown and *Janet Kibolm Smith*), *Journal of Corporate Finance*, 12, (2006), pp. 855-877
- ▶ “Reputational Penalties and the Merits of Class Action Securities Litigation,” (*Eric Helland*), *Journal of Law and Economics*, 49 (2), (October 2006), pp. 365-395
- ▶ “Macroeconomic Variables and the E/P Ratio: Is Inflation Really Positively Associated with the E/P Ratio?” (Prem Jain and *Joshua G. Rosett*), *Review of Quantitative Finance and Accounting*, 27 (1), (2006)
- ▶ “Would a Stock By Any Other Ticker Smell as Sweet?,” (Alex Head, *Gary Smith* and Julia Wilson), forthcoming, *Quarterly Review of Economics and Finance*
- ▶ “The Valuation of Houses in an Uncertain World with Substantial Transaction Costs,” (*Gary Smith* and *Margaret H. Smith*), forthcoming, *Journal of Regional Science*
- ▶ “Shrunken Interest Rate Forecasts are Better Forecasts,” (Reid Dorsey-Palmateer and *Gary Smith*), *Applied Financial Economics*, 17, (2007), pp. 425-430
- ▶ “Measuring and Controlling Shortfall Risk in Retirement,” (Donald P. Gould and *Gary Smith*), *Journal of Investing*, 16 (1), (2007), pp. 82-95
- ▶ “Bubble, Bubble, Where’s the Housing Bubble?,” (*Gary Smith* and *Margaret H. Smith*), *Brookings Papers on Economic Activity*, 1, (2006), pp. 1-50
- ▶ “A Great Company Can be a Great Investment,” (Jeff Anderson and *Gary Smith*), *Financial Analysts Journal*, 62 (4), (2006), pp. 86-93
- ▶ “The Next Best Thing to Knowing Someone Who is Usually Right,” (*Gary Smith*, Joseph Steinberg and Robert Wertheimer), *Journal of Wealth Management*, 9 (3), (2006), pp. 51-60
- ▶ “What’s in Your 403(b)? Academic Retirement Plans and the Costs of Underdiversification,” (*John Angus*, William Brown, *Janet Kibolm Smith* and *Richard Smith*), *Financial Management*, 36, (2007), pp. 87-124
- ▶ “Evaluating the Boundaries of SEC Regulation,” (*Janet Kibolm Smith*), *Journal of Corporate Finance*, 13 (2-3), (2007), pp. 189-194
- ▶ “Banking Relationships and Access to Equity Capital Markets: Evidence from Japan’s Main Bank System,” (Kenji Kutsuna, *Janet Kibolm Smith* and *Richard Smith*), *Journal of Banking and Finance*, 31, (2007), pp. 335-360
- ▶ “Why Are IPOs Underpriced? Evidence from Japan’s Hybrid Auction-Method Offerings,” (K. Kutsuna, F. Kerins and *Richard Smith*), *Journal of Financial Economics*, 85 (3), (September 2007), pp. 637-666
- ▶ “Why the Middle is Unstable: The Political Economy of Exchange Rate Regimes and Currency Crises,” (*Thomas Willett*), *The World Economy*, 30 (5), (May 2007), pp. 709-733
- ▶ “Currency Crises,” (Eric Chiu, Stefanie Walter, Josh Walton and *Thomas Willett*), forthcoming, *Princeton Encyclopedia of the World Economy*
- ▶ “Contagion,” (Priscilla Liang and *Thomas Willett*), forthcoming, *Princeton Encyclopedia of the World Economy* ▲

Financial Economics Institute Fall 2007 Student Research Analysts

During fall 2007, fifteen Student Research Analysts are assisting faculty members with research projects. The following is a list of students, the topics they are researching, and their faculty advisors:

SCOTT ARNOLD '09, *The Effect of Insider Trading on Stock Prices*, with Professor Lisa Meulbroek

ASAF BERNSTEIN '08, HMC, *Do "Common" Corrections to Financial Statements Help Predict the Odds of Default or the Correct Valuation of a Company?*, with Professor George Batta and Professor Ananda Ganguly

NICK BURNETT '09, *The Impact of Gifts on Undergraduate Department Rankings*, with Professor Joshua Rosett; *Real Estate Futures Trading on the Chicago Mercantile Exchange*, with Professor Ludwig Chincarini (POM)

TEJAS GALA '09, *The End of the Real Estate Recession*, with Professor Ludwig Chincarini (POM); *Comparing Performance Evaluation Systems within Multi-National Firms*, with Professor Marc Massoud

KEVIN HESLA '09, *The Impact of Advertising Costs and Duration of Commercials on Prime-Time Television Show Ratings*, with Professor Michelle Goeree

DANIEL JÄGER '08, *Is Fundamental Analysis a Better Predictor of Value than Market Price?*, with Professor George Batta; *Are Analysts' Earnings Growth Forecasts Really Forecasting Future Prices?*, with Professor Eric Hughson

MARIA LÖHNER '10, *How New Policies Targeting Large Biotechnology and Pharmaceutical Firms have Unanticipated Consequences on Small Firms*, with Professor Darren Filson

TINSLEY LOWE '08, *The Relationship between Firm Performance and Institutional Monitoring*, with Professor Janet Smith

CATHERINE POWERS '08, *The Restructuring Benefits of Managerial Turnover*, with Professor Janet Smith and Professor Robert Pedace (CGU)

ALEXANDER REICHERT '11, *The Relationship between Firm Performance and Corporate Governance*, with Professor Janet Smith

RAYMOND (KURT) SHELIN '08, *The Impact of Gifts on Undergraduate Department Rankings*, with Professor Joshua Rosett

ASEEM VYAS '08, *Spending Rates of University Endowment Funds: How Changes in Spending Affect the Ranking and Quality of Students at an Institution*, with Professor Janet Smith

BRITTNEY WATSON '09, *How Unethical Decisions Impact the Relationship between Employees and Management*, with Professor Marc Massoud; *Adjustments Firms Make to their Financial Statements after Issuing Bonds*, with Professor George Batta, Professor Ananda Ganguly, and Professor Joshua Rosett

FELICIA WU '08, *Measuring the Welfare Effects of Hypothetical Mergers between Large TV Networks with New Econometric Methods*, with Professor Michelle Goeree

YANG (AMANDA) YANG '10, *The Relationship between Firm Performance and Institutional Monitoring*, with Professor Janet Smith; *How New Policies Targeting Large Biotechnology and Pharmaceutical Firms have Unanticipated Consequences on Small Firms*, with Professor Darren Filson ▲



From left: Alexander Reichert '11, Brittney Watson '09, Nick Burnett '09, Maria Löhner '10, Kevin Hesla '09, Catherine Powers '08, and Asaf Bernstein '08 (HMC). Not pictured: Scott Arnold '09, Tejas Gala '09, Daniel Jäger '08, Tinsley Lowe '08, Kurt Sheline '08, Aseem Vyas '08, Felicia Wu '08, and Yang (Amanda) Yang '10.

FEI Board of Advisors Profile: Gregg E. Ireland '72

Senior Vice President, Capital Research and Management Company

By Tinsley Lowe '08, FEI Student Research Analyst

Q CAN YOU DESCRIBE YOUR CAREER PATH SINCE GRADUATING FROM CMC?

A I took a job at Capital Research Company as an investment analyst immediately after graduation in 1972. In those early years, very few CMC students were at all interested in the stock market or the investment business. Real estate was the “hot” sector, and I recall that many CMC graduates took jobs as accountants or went on to business or law school.

In the early years, I was responsible for analyzing the capital goods and energy sectors. In the 1980s, I transitioned into portfolio management. I gave up the deep analytical work of an analyst to become a generalist. At a time when investing in foreign markets was new to American investors, I spent time working in our global funds. I traveled and gained experience in developed and developing markets around the world—even before the term “emerging markets” was coined in the late 1980s.

Q WHAT ARE SOME OF YOUR RESPONSIBILITIES AT CAPITAL RESEARCH AND MANAGEMENT COMPANY? WHAT DO YOU LIKE MOST ABOUT YOUR WORK?

A Today, I manage assets in our flagship funds, New Perspective and Growth Fund of America. I am a Senior Vice President of Capital World Investors, a unit of Capital Research and Management, and a Vice Chairman of the New Perspective Fund. My portfolios are full of companies that benefit from growth around the world; and, to answer one of your questions, what do I like most about my job, it is the exposure that I get to businesses, different cultures and the enormous changes we are seeing everywhere today, around the world.

If it were not for my job and travel, I would not have seen, and therefore understood from first-hand observation,

the initial fall of Communism (I was there when the Berlin Wall came down and I visited companies in Eastern Europe and Russia before most investors did), or the rise of the 1990s communication revolution (when traveling I was early to notice people using cell phones to link up with the rest of the world in unlikely places like remote Southeast Asia or the former Soviet Union), or the economic rise of China (I see no reason why China will not match the US in economic power in my children’s lifetime).

Q WHEN LOOKING AT COMPANIES, WHAT CRITERIA DO YOU USE TO HELP YOU DECIDE WHETHER OR NOT TO INVEST?

A I am a long-term investor, meaning that my horizon is generally five to ten years. I like to invest in companies that are well-positioned to benefit from the growth that I see now and in the future. It’s a fundamental approach, using a combination of top down analysis (I ask: What will the world be like in 5 or 10 years? Where will the best growth opportunities come from?), and bottom up company work (Which companies are best positioned to take advantage of the positive change? Which have the best products or services to offer? Which are well managed and flexible to adjust to the changing business landscape, as the world moves forward?).

Q WHAT QUALITIES DO YOU FEEL ARE IMPORTANT IN ORDER FOR SOMEONE TO BE SUCCESSFUL IN YOUR INDUSTRY?

A I think the qualities that are important for success in my occupation are a strong sense of curiosity, an interest in getting to the facts or the truth, and an interest in learning. I think it also helps to be a bit of a maverick or contrarian; someone who can ignore conventional wisdom, go against the grain and invest in unpopular



situations when appropriate. Often, the best investment opportunities come from anticipating change and when conventional wisdom has it wrong. For the long-term investor, it also helps to be someone who does not need immediate or constant reinforcement from the results of his/her investments. Successful long-term investing takes patience and time.

In my business, no one is perfect, and everyone is wrong a fair amount. I tell younger associates, it is better to spend one’s time owning the effort than taking credit for positive results, especially short-term results. In our business, we put our chips down and we do not have control over the results. As my mentor and long-time friend at Capital, Bob Kirby, used to say, “Mr. Market makes the man; the man does not make Mr. Market.” It takes someone who can balance humility with ego, in order to survive the inevitable humbling experiences of our business.

Q DO YOU HAVE ANY ADVICE FOR CMC STUDENTS LOOKING TO START A CAREER IN ASSET MANAGEMENT?

A The advice I would give to CMC students interested in our business is to study and prepare—but, also, don’t wait to start investing. The best lessons are taught by the markets and experience, rather than the classroom.

Another piece of advice is to think about your own personality and strengths, and match those with the job that you seek.

See Gregg Ireland on page 12

Wall Street Weekend

DURING THE WEEKEND OF OCTOBER 12TH AND 13TH, students from the Claremont Colleges hosted the inaugural Wall Street Weekend which included a finance conference and networking events. FEI Student Research Analysts Asaf Bernstein and Catherine Powers were instrumental in organizing the Wall Street Weekend events.

On Friday, October 12th, students and alumni from the Claremont Colleges gathered at the Claremont Doubletree Inn to enjoy a networking reception and dinner. The following morning, over 150 students, alumni, and guests attended a conference in which two panels of experts discussed issues pertaining to private equity and hedge funds. FEI Director Janet Smith moderated the panel on private equity which featured Paul Efron (POM '87), an Advisory Director at Goldman Sachs in NYC; Kristin Horne (POM '93), a Managing Director at Morgan Stanley in San Francisco; and James Quella (CMC Parent '08), a Senior Managing Director and Senior Operating Partner of The Blackstone Group in

NYC. The hedge fund panel was moderated by FEI affiliated faculty member Professor Ludwig Chincarini (POM) and included Scott Barker (POM '87), a Portfolio Manager for Analytic Investors, Inc. in Los Angeles; Dana Hobson (HMC '85), a Senior Vice President of Quantitative Research at Bailard in San Francisco; and Peter Sasaki (POM '91), the Founder and Managing Member of Logos Capital Management, LLC in NYC.

Following the conference, the attendees enjoyed an FEI-sponsored luncheon at the Marian Miner Cook Athenaeum which featured a presentation by CMC's Chairman of the Board of Trustees, Harry McMahon '75. Mr. McMahon's talk was entitled, "Investment Banking Still Rocks!" After lunch, the guests participated in a networking session at the Drucker School of Management where the day's activities concluded. ▲



Front row, from left: Faye Andriejanssen (CMC '10), Laurel Horne (SCR '08), Valerie Whitacre (SCR '08), and Catherine Powers (CMC '08). Back row, from left: Holly Poole (SCR '09), Sayre Craig (POM '08), Asaf Bernstein (HMC '08), and Geoffrey Lewis (POM '08).

Upcoming Events

New York City Networking Trip

JANUARY 14 – 18, 2008

Fifteen students will visit prestigious firms in NYC to gain exposure to various job opportunities in the financial markets and to establish relationships with CMC alumni working at these companies.

Conference

“The Future of Securities Fraud Litigation”

FEBRUARY 8, 2008

The FEI is jointly sponsoring the conference with the RAND Corporation. John C. Coffee, the Adolf A. Berle Professor of Law at Columbia Law School, will be the keynote speaker for the conference.

FEI Speaker Series

MARCH 4, 2008

Laura Starks, Charles E. and Sarah M. Seay Regents Chair of Finance and Director, AIM Investment Center in the McCombs School of Business at the **University of Texas at Austin**

MARCH 31, 2008

Josh Lerner, Jacob H. Schiff Professor of Investment Banking at **Harvard Business School**

FEI-Sponsored Seminars

DECEMBER 14, 2007

Micah S. Officer, Assistant Professor of Finance and Business Economics in the Marshall School of Business, **University of Southern California**

APRIL 25, 2008

Neil Pearson, Professor of Finance and Harry A. Brandt Distinguished Professor of Financial Markets and Options in the College of Business, **University of Illinois at Urbana-Champaign**

Gregg Ireland from page 10

Many students fail to understand that the job of a hedge fund manager or Wall Street trader is very different than that of a long-term investor. Whereas the hedge fund manager or trader looks at data and must make quick, short-term bets on temporary market inefficiencies, the long-term investor must take a slower and more thoughtful approach, examining companies and the value-creation potential of businesses over time.

If students want to become investors, they should find a job where they will spend their time learning how to research the markets and companies, as opposed to working on daily transactions.

Q FOR STUDENTS WHO WILL BE STARTING THE INTERVIEW PROCESS SOON, DO YOU HAVE ANY SUGGESTIONS FOR THEM? ARE THERE ANY SPECIFIC SKILLS OR CHARACTERISTICS THAT YOU LOOK FOR IN POTENTIAL EMPLOYEES?

A My main piece of advice for the interview process is to be yourself and be honest and as natural as possible. It does not help when you try too hard to sell yourself. Students should recognize that the first job is important, but not everything in one's career or life. Rejection is a part of the process. It is okay if you do not get the job offer. If you go into an interview with this attitude, you will come across as confident and will be more attractive to employers. ▲



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The Exchange newsletter is published by the Financial Economics Institute at Claremont McKenna College. If you would like copies of previous issues, or if you wish to have your name added or removed from our mailing list, e-mail FEI@cmc.edu or write to the Financial Economics Institute, Claremont McKenna College, 500 E. Ninth Street, Claremont, CA 91711 with your request.