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Conference Notes: Chicago Quantitative Alliance Fall Conference 2011
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Institutional ownership is more important than fundamentals in predicting stock performance in the short run, but that relationship reverses in the long run. That is what UC Berkeley professor Richard Sloan said in his recently published paper (co-authored with Scott Richardson and Haifeng You) titled "What Makes Stock Prices Move – Fundamentals vs. Investor Recognition". This was one of the most interesting presentations at the conference and especially relevant to SGA as a manager interested in alpha generating research.

The two main findings are that more than 50% of the variation in stock prices is due to investor recognition (defined in this paper as breadth of institutional ownership) rather than earnings-related information, and that investor recognition dominates over short horizons (less than one year) while fundamentals dominate over long horizons (multi-year).

Sloan measured breadth of institutional ownership from 13F filings by taking the ratio of the number of institutions holding a stock by the number of institutions holding any stock in the U.S., adjusted for company size. Companies such as Google and Apple have very high investor recognition by this measure. Including this institutional ownership measure and a dividend discount valuation measure (as the proxy for "fundamentals") in a multi-factor regression against stock returns, Sloan found through a that about 40% of the variation of stock returns annually over the 23-year period of their study was due to fundamentals and about 60% was due to investor recognition.

The second finding was that investor recognition is important in the short term but fundamentals dominate over the long term. Additionally, they found that these two factors explained much more of the variation in stock returns over five year horizons than three month horizons, meaning that over the short term there are many other factors at work that ultimately mean revert. At SGA, we prefer to take longer-term view given the high transactions costs in the international markets. Our alpha model focuses on fundamentally-based factors, which based on the intuition of this work, supports our goal of generating alpha with longer holding periods.

The conference had presenters on a variety of other investment topics including the use of computer algorithms to judge investor sentiment by "reading" social media web postings and parsing company earnings releases and other published news articles. The afternoon of the second day was dedicated as it is every year to the academic competition, where three non-tenured academics (pre-screened down from 30+ applicants) present findings from a recent research paper. One interesting paper by Nitish Ranjan Sinha titled "Underreaction to News in the US Stock Market" found that an investment strategy based on using a score that systematically measures the tone of news articles can be profitable, even after adjusting for book to market, company size, and price momentum.

This conference and other CQA events offer opportunities to keep up to date with new and interesting investment research and discussions of best practices from other investment practitioners. We are also fortunate at SGA to have two leading academics (Michael Brennan, PhD, and Richard M. Franekl, PhD) on our Advisory Board. They are in tune with the latest academic research and bring new ideas to us on a regular basis. This constant learning and research is part of the culture of SGA and helps us look for new ways to improve our investment process through innovation.

Note: *The Chicago Quantitative Alliance (CQA) is an investment management industry organization whose members are primarily quantitative portfolio managers and analysts who are predominately from buy-side institutional firms. The remainder of members consists of plan sponsors, sell-side quantitative strategists, quantitative data and software providers, and academics. The group has 350 members and about 175 people attended this 2-day conference. In addition to this fall conference, the CQA also has a 2-day spring conference, several other smaller events, and ad-hoc e-mail exchanges from members on questions that members bring up.*