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Iclif Executive Education Center

Leadership/Management & Entrepreneurship

ALPHANOMICS:
THE SCIENCE OF ACTIVE INVESTING

Prof. Eric C. So, Sloan Distinguished Professor of Financial Economics in the Economics, Finance, and Accounting Area of MIT's Sloan School of Management

Date: 26 - 30 September 2022
Time: 9:00am - 5:00pm
Program Fee: RM16,000 before SST

IN - PERSON

PROGRAM OVERVIEW

This course covers investment decisions in the presence of noisy market prices. Our starting point is the observation that, with costly information, equilibrium market prices invariably reflect some mispricing (i.e., noise) relative to fundamental values. The existence of mispricing introduces a role for informational arbitrage, whereby some agents invest resources to become informed about the mispricing, with hopes of profiting from it. We review recent evidence on this process and reflect on its implications for financial markets and the importance of firms' financial statements. We also discuss how researchers might help lower information/ arbitrage costs. Most of the topics covered in this course derive from financial economics (market efficiency, cognitive constraints, limits to arbitrage) and accounting-based research (equity valuation, fundamental analysis, and the role of financial analysts).

Topics include: Value investing, quantitative stock selection, behavioral finance, retail investors, MEME stocks, investor sentiment, fraud detection, mis-reaction to news.

This is an introductory course and interdisciplinary in nature. Our goal is not only to describe the building blocks of active investing in the presence of noisy prices, but also to stimulate new work in the area. As such, I expect it will be of primary interest to those in the intersections between, and applications of, finance, accounting, and economics. Given our focus on return prediction and the role of information in arbitrage strategies, this course should be of particular interest to those wishing to better understand the relation between information flows and market pricing dynamics.

TARGET AUDIENCE

Fund managers who wish to understand information flows and market pricing dynamics as well as individuals interested in developing simple tools for investing and have a better understanding of how capital markets work. Class participants will include MBA students.

PRE-READINGS

Participants must be ready to discuss assigned readings which will be distributed ahead of time.

SOFTWARE FOR ANALYSIS

For class work involving dataset analysis, you can choose a software that you like. Most analysis can (probably) be done on Excel but it is recommended that you use a programming-based language namely, one of the following: SAS, Stata, R.

SOME KEY TAKEAWAYS

1 What is Alphanomics? What role does fundamental accounting information play in markets with both noise traders and rational arbitrageurs?

2 How can we reconcile the assumption of no-arbitrage conditions in classical asset pricing models with the practice of professional arbitrageurs on Wall Street and elsewhere?

3 How does active investing in practice differ from classical asset pricing models?

4 How do we use regression for forecasting?

5 What is "alpha" and how does it relate to fund performance? Why is alpha important?

6 What role is played by researchers in discovering new potential sources of alpha? What do researchers contribute to the process of active investing?

7 What is assumed in models of information processing?

8 What role do cognitive biases play in the way that we react to information signals? Are cognitive biases relevant in a world of automated trading?

9 What is the common link among successful value investors?

10 What are alternative approaches to value investing and why is it important to use contextual information when determining firms' quality and cheapness?

11 What do classical asset pricing models tell us about the role of supply and demand in determining asset prices? By contrast, what do we observe in practice?

12 Why is demand pressure important for active investors in terms of generating alpha?

13 What is earnings management?

14 What are the common links among firms that manipulate financial reports? How have researchers learned to profile problematic firms?

15 How are price reactions related to expected returns?

16 Why is it important to continually identify and test potential sources of deviations between fundamental values and market prices?

PROGRAM OUTLINE

DAY	SESSION	TOPIC
1	1	Overview of Alphanomics
	2	Active Investing
	3	Learning from Data
	4	Assignment Session: Shiller Model
2	1	All About Alpha
	2	Behavioral Finance I
	3	Behavioral Finance II
	4	Assignment Session: Alpha Testing
3	1	Investor Sentiment
	2	Value Investing I
	3	Value Investing II
	4	Assignment Session: Value Investing
4	1	Trading Costs
	2	Earnings Game
	3	Earnings Quality Screens
	4	Assignment Session: Analyzing the Analyst
5	1	Mis-reaction to News
	2	Conducting Event-Studies
	3	Synthesis & Wrap-Up
	4	Assignment Session: Final Project

Prof. Eric C. So

Sloan Distinguished Professor of Financial Economics in the
Economics, Finance, and Accounting Area of MIT's Sloan School of Management

Prof. Eric C. So is a financial economist and tenured full professor at MIT Sloan. Eric is the Sloan Distinguished Professor of Financial Economics in the Economics, Finance, and Accounting Area of MIT's Sloan School of Management.
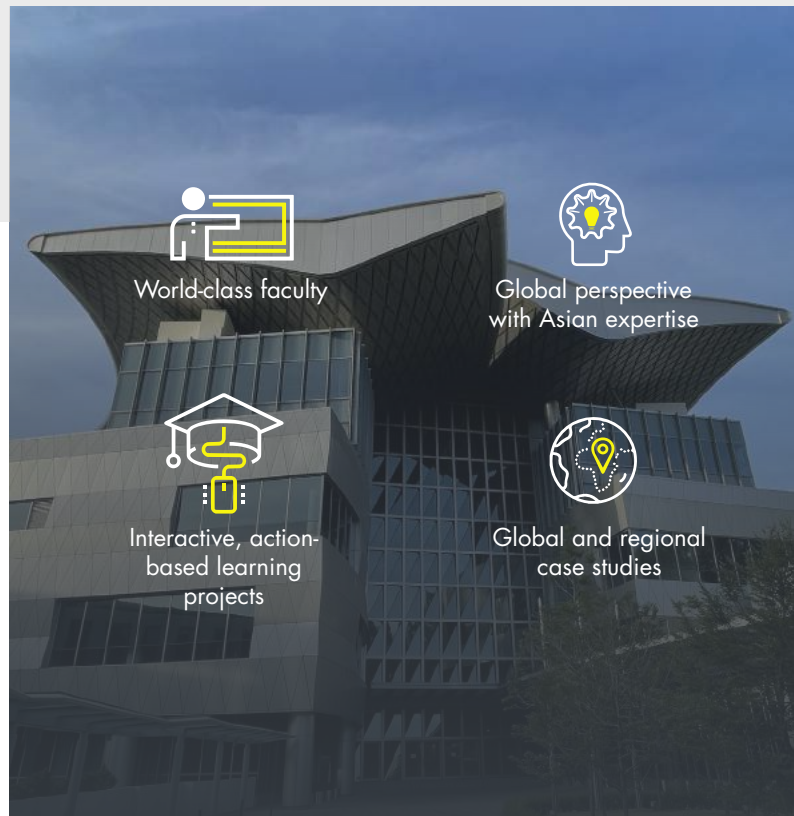
Eric also serves as the Co-Director for the Asset Management Initiative at MIT Sloan. His research interests include equity valuation, asset pricing, limits to arbitrage, and market microstructure with a focus on the forces and mechanisms that shape the information content of market prices.

Prior to joining Sloan, Eric received his PhD in Business Administration from Stanford University's Graduate School of Business as well as a Masters in Economics from Cornell University. Currently, he serves as an academic economist for Full-Thaler Asset Management and as an Editor for Management Science. Prior to completing his graduate degrees, he worked as a research analyst at the Nasdaq Stock Market in the Economic Research department.

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