The European Journal of Finance,
Vol. 15, Nos. 5–6, July–September 2009, 447–449

Routledge
Taylor & Francis Group

Editorial

On May 29–30 2008, the conference 'Asset management and international capital markets' took place in Frankfurt am Main in Germany. This conference was jointly organized by Wolfgang Bessler (Justus-Liebig-University, Giessen), Wolfgang Drobetz (University of Hamburg), and Jan Pieter Krahnen (Goethe University Frankfurt and CFS). The objective of this two-day conference was to bring together academics and members of the asset management industry to focus on state-of-the-art academic research in the areas of investment management and international capital markets. This special issue of the *European Journal of Finance* includes seven selected articles covering a wide spectrum of investment topics ranging from risk management, performance measurement, fund characteristics and consumption risk to fixed income portfolio management. All papers were subject to the rigorous refereeing process of this journal.

The first paper 'From Markowitz to modern risk management' by Gordon Alexander extends and formalizes the ideas presented in the author's conference keynote speech. It starts with a review of the value-at-risk (VaR) concept as a measure of risk. It proceeds by focusing on the adequacy of a VaR measure and the impact on the investment outcomes of a portfolio manager who is subject to a VaR constraint. It turns out that a wide range of efficient low-risk portfolios can become infeasible under this constraint and that the manager might be forced to choose a portfolio with an unnecessarily high standard deviation. As a remedy, Alexander proposes the conditional value-at-risk (CVaR) as an alternative risk measure, which takes the shape of the return distribution below the VaR into account. The use of CVaR with properly chosen bounds avoids the perverse result that a riskier portfolio might be selected. Alexander also provides a brief review of current risk management systems in the banking industry and reveals that even the combination of the conventional VaR measure with commonly used stress tests cannot adequately determine minimum capital requirements because bank trading books usually contain short positions. Again, the CVaR measure is an important extension to the currently employed methodologies.

The second paper 'Performance measures and incentives: Loading negative coskewness to outperform the CAPM' by Alexandros Kostakis examines strategies in the fund management industry in response to the adoption of simple performance measures. The starting point of his analysis is the notion that the use of conventional performance measures, such as the Sharpe ratio or Jensen's alpha, provide an incentive for fund managers to actively load on coskewness. Using a sample of UK equity unit trusts, Kostakis documents that managers indeed gamble with their investment strategies when simple performance benchmarks, which are based only on the first two moments of the return distribution, are used. Indeed, there is evidence that coskewness risk is priced in the UK market and that most managers responded to these incentives by loading negative coskewness in order to capture part of the corresponding premium. As an alternative performance measure, the author suggests the intercept of the Harvey–Siddique two-factor asset pricing model as more appropriate for prudent investors because it incorporates conditional skewness.

ISSN 1351-847X print/ISSN 1466-4364 online
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DOI: 10.1080/13518470903037466
http://www.informaworld.com

The third paper ‘Performance and characteristics of mutual fund starts’ by Aymen Karoui and Iwan Meier investigates the performance and the portfolio characteristics of newly launched US equity mutual funds. Compared with existing funds, these new funds initially generate a superior risk-adjusted performance. There is also evidence for short-term persistence among top performing fund starts. At the same time, however, a large number of top performing funds over the first 3 years drop directly to the bottom decile over the subsequent 3 years. This decline in performance cannot be explained by diseconomies of scale alone as these funds mature and grow in size. Karoui and Meier’s results suggest that the initially favorable performance is to some extent attributable to risk taking and not due to superior skills. Specifically, they document that fund starts exhibit higher ratios of unsystematic to total risk. Moreover, portfolios of new funds tend to be less diversified in terms of the number of stocks and their industry composition, and they are also invested in smaller and less liquid stocks.

The fourth paper ‘Long-horizon consumption risk and the cross-section of returns: New tests and international evidence’ by Joachim Grammig, Andreas Schrimpf, and Michael Schuppli addresses the question whether the inclusion of long-run risk into the Consumption Capital Asset Pricing Model (CCAPM) helps to alleviate standard asset pricing puzzles. Equilibrium asset returns depend on investors’ expectations about both short- and long-run changes in consumption growth. Therefore, the covariance of returns with contemporaneous consumption growth alone might understate the risk perceived by investors. The authors use German, British, and US data and extend the model of Parker and Julliard (2005). Their results indicate that this approach does not help to explain the cross-section of asset returns. However, including a proxy for long-run consumption risk reduces the estimated coefficient of relative risk aversion in the standard CRRA framework. Grammig, Schrimpf, and Schuppli conclude that more plausible parameter estimates rather than lower pricing errors can be regarded as the main achievement of the long-horizon CCAPM.

The fifth paper ‘Diversification benefits for bond portfolios’ by Wassim Dbouk and Lawrence Kryzanowski analyzes the diversification of bond portfolios. Differentiating the investment opportunity set by issuer type, credit rating, and time-to-maturity, the authors examine the minimum portfolio size required to capture significant diversification benefits. Their results indicate that these characteristics of bonds as well as the metric used to measure the marginal benefits of additional diversification determine the minimum portfolio size. In general, the marginal benefits of further diversification are optimized with portfolio sizes of 25 to 40 bonds. Nevertheless, in contrast to equity portfolios, the untapped benefits of full diversification are still large at these portfolio sizes. Dbouk and Kryzanowski hypothesize that this result may explain the empirical observation that bond funds, unlike equity funds, generally are value-neutral for unit holders based on gross returns and value-destroying based on net returns.

The sixth paper ‘International bond diversification strategies: The impact of currency, country, and credit risk’ by Mats Hansson and Eva Liljeblom provides evidence on the diversification benefits of international investments in government bonds, emerging market debt and corporate bonds from the perspective of bond investors domiciled in different countries. In the spirit of De Roon, Nijman, and Werker (2001), they conduct mean–variance spanning and intersection tests that incorporate short-sale restrictions. The authors’ empirical results indicate that government bonds of developed markets do not improve the risk-return spectrum, irrespective of whether currency risk is hedged or not. In contrast, currency hedged international corporate bonds, and in particular emerging market debt, significantly shift the mean–variance frontier for a developed market investor and offer substantial diversification benefits even in the presence of short-sale constraint. From a practical perspective, it is interesting to observe that for the subset of developed markets' government bonds the passive global benchmarks perform as well as the optimized portfolios.

The last paper 'Conditioning information in mutual fund performance evaluation: Portuguese evidence' by Paulo Leite and Maria Céu Cortez analyzes the unconditional and conditional performance of a sample of Portuguese mutual funds in a beta-pricing framework. They report evidence that mutual fund managers do not outperform the market, presenting negative or neutral performance. They also show the importance of incorporating conditioning information in performance evaluation models, as there is evidence of both time-varying betas and alphas related to the public information variables. It is also shown that the number of lags to be used in the stochastic detrending procedure is a critical choice, as it will impact the significance of the conditioning information. Finally, compared to the unconditional performance evaluation models, Leite and Cortez observe that the conditional models generally lead to a slight improvement of the performance estimates and of the explanatory power of the models.

This special issue on 'Asset management and international capital markets' provides the reader with interesting new insights into state-of-the-art asset pricing and asset management research with a focus on international issues. All seven papers make valuable contributions to the literature and are of significant importance to the practice of asset management. We hope that you will enjoy reading this special issue of the *European Journal of Finance*.

Wolfgang Bessler and Wolfgang Drobetz

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