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Finance

“Transmigration across price discovery categories: Evidence from the U.S. CDS and equity markets”

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Abstract

We examine credit risk price discovery between the equity market's implied credit default spreads and credit default swap (CDS) spreads for 174 U.S. non-financial investment-grade firms from 2005 to 2009. We use Gonzalo-Granger (1995) and Hasbrouck (1995) measures to sort firms into five categories of credit risk price discovery. When we forward-shift the estimation window, we uncover an interesting transmigration pattern. From Jan 2005 to Jun 2007, the CDS market influences price discovery for firms. With the onset of the global financial crisis (GFC), that number increases to 159 firms. As we move away from the height of the GFC, the number of CDS-influenced firms is reduced, albeit high relative to the pre-GFC period. Using CDS spreads as trading signals, a conditional portfolio strategy which updates the list of CDS-influenced firms produce a significant alpha against Fama-French factors. It also outperforms buy-and-hold, momentum and dividend yield strategies. Our empirical finding is consistent with theoretical arguments by Keynes (1923) and Working (1953) on the risk-sharing role of a derivative market. During the credit-crunch induced GFC, risk-averse hedgers will pay a larger premium for default protection. The substantially higher and volatile spreads present informed speculators with attractive opportunities in the CDS market that were not available before the GFC.

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Time: 15:00 – 16:30

Venue: J321

ALL ARE WELCOME!

A Short Biography of Prof. Michael Chng

Prof. Chng is the Professor from School of Accounting, Economics and Finance, Faculty of Business and Law, Deakin University, Burwood, Australia. Prof. Chng got his Ph.D., M.Com (Hons) and B.Com (Hons) in Finance, from Melbourne University between the years 1994 - 2003. He is the Associate Professor in Finance from Deakin University since 2009, as a Senior Lecturer in Finance from Melbourne University between 2006-2009 and as a Lecturer in Finance from Monash University between 2002-2006.