

Title: **BETTING AGAINST CORRELATION:
TESTING THEORIES OF THE LOW-RISK EFFECT**

Speaker: **CLIFF ASNESS**
AQR Capital Management, LLC

Importance: Why this matters:
They introduce a new factor Betting-Against-Correlation (as an alternative to the more widely accepted (Betting-Against-Beta). Because the low-beta anomaly is widely accepted and widely used by investors, it is important to know whether it is due to over-priced high volatility stocks (leverage constraint), or due to underpricing of stocks with low correlations with the market (lottery effect).

Investigation: "Speaker analyzed XXX data to address the questions yyy, zzz, etc."
Stock betas are determined by their volatilities and their correlation with the market. Asness tested competing explanations for the low beta effect in the U.S. and globally. High volatility stocks as a source of leverage (leverage aversion theory) depends on beta (volatility x correlation). High volatility stocks as lottery tickets depends on idiosyncratic volatility (volatility x skew).

In regressions against other low-risk variables and control variables, BAC and SMAX exhibited statistically significant alphas. BAV had a negative alpha, and LMAX and IVOL were statistically insignificant.

Innovation: Are there new techniques of interest in the data or approach to the problem?
Introduced BAC – betting against correlation as a new factor. Used 2-way sorts: volatility then correlation to disentangle the volatility versus correlation contributions to performance. Long low correlation, short high correlation portfolios within volatility quintiles had significant alphas (CAPM and FF 3-factor), while long low volatility, short high volatility within correlation quintiles did not.

Calculated SMAX and LMAX (short and long-term MAX / volatility) as improved measures of short and long-term skew. The exhibited significant alphas in regressions using the FF 5-factor model in the US. (The global results were weak.)

Insights: 1-2-3, what are the three most important things the speaker offered?

1. Both leverage constraints and behavioral effects play separate roles.
2. BAC (Betting against Correlation) and SMAX (scaled MAX) had significant Sharpe Ratios (.93 & .78), and significant 5-factor alpha t-stats (5.45 & 4.78).
3. Leverage aversion seems to be the better explanation for BAB. The performance of both BAB and BAC are related to dealer margin, not sentiment. Correlation is needed for leverage aversion, but not for lottery effect.

Audience rating: 4.36