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How Well Does Duration Measure Interest Rate Risk and Does the Convexity Adjustment Matter?

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Abstract

This paper examines how well duration estimates the interest rate risk of government bonds and whether the standard convexity adjustment matters. Specifically, we duration match 14 convex barbells to zero coupon bonds and then compare the price performance using 32 years of weekly and daily yield curve changes. The mean and median difference in performance between the barbell and the zero coupon bond is nearly zero, the interquartile range is small and there is no bias in the difference. We conclude that the standard convexity measure does not capture the inherent nonlinearity in the bond price function.

Keywords: Duration, Convexity, Term Structure

JEL Classifications: G11

Nonparametric Tests for Event Studies under Cross-sectional Dependence

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Abstract

We propose two nonparametric tests for the null of no event-induced shifts in the location parameter of the distribution of cross-sectionally dependent stock returns and develop their distributional approximation theory. We compare size and power of our test statistics to 18 tests found in the relevant literature in a controlled simulation experiment where returns are bootstrapped from the constituents of the S&P100 and NASDAQ stock indexes. One of our tests turns out to be the most reliable in terms of size, while in terms of power, the other test we propose ranks in the top group of tests with an acceptable actual size. The test comparison presented in this paper is one of the most comprehensive and up-to-date available in the literature. Some tests in the comparison have been adapted to the cross-sectional dependence case by us. A real-world application of the tests to assess how U.S. banks' stock prices have reacted to early warnings of the 2008 financial crisis completes the article.

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Selling, General and Administrative Cost Stickiness and GDP Predictions

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Abstract

This study examines whether selling, general and administrative (SG&A) cost stickiness is informative in predicting GDP growth and in explaining GDP forecast errors. Prior research has examined how accounting earnings growth is informative in predicting GDP. However, up to this point there has been a lack of research examining how accounting cost behavior is informative in predicting GDP growth. Managers make SG&A cost decisions based on projections of future demand, so the main hypothesis of this study is that cost stickiness has an informational role in predicting GDP growth and in explaining GDP forecast errors. The empirical findings of this study support the hypothesis by showing that cost stickiness is a predictor of future GDP growth and is also informative in explaining GDP forecast errors. This study has the potential to contribute to the improvement of GDP growth forecasts.

Key Words: Accounting, Cost Stickiness, Gross Domestic Product (GDP)
JEL Classifications: E00, E01, M41

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Added Pressure to Perform: The Effect of S&P 500 Index Inclusion on Earnings Management

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Abstract

We investigate earnings management around Standard and Poor's 500 Index (S&P 500 Index) additions for added firms and their peers. We use discretionary accruals as a proxy for earnings management and find upward earnings management for added and peer firms prior to the S&P 500 Index addition announcement. Following Index addition, we find divergence in the earnings management activities of added and peer firms. Added firms continue with upward earnings management with

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