

Haugen's views

- Orthodox financial theory is wrong
- Arbitrage does not lead to correct & uniform pricing of risk--APT is false
- Investors generally do not use Markowitz to optimize--CAPM is false
- Anomalies rule market pricing
- 5 families of risk factors explain returns

Haugen on Beta

- Studies find positive returns to beta as theory predicts
- But results of studies collapse if small & large companies are analyzed separately
- Returns to beta are entirely a small cap effect
- Small caps have high beta & high returns

Upshot

- Haugen says it is possible to beat the market with less than average risk
- How? Buy value stocks and small caps
- Best is small cap value stocks
- Value stocks have low beta risk
- Small caps deliver excess returns controlling for beta

You can do even better

- To get even better returns, Haugen suggests subscribing to his own statistical model, which he sells
- To see Haugen's pitch, go to his web site
- Haugen's model employs 5 families of risk factors

5 Families of Risk Factors

- Market risk factors
- Liquidity risk factors
- Measures of cheapness
- Measures of profitability
- Technical factors

Market Risk factors

- market risk
- -interest rate spreads
- -inflation
- -% change in industrial production
- -debt/equity
- -times interest earned
- -earnings volatility

Liquidity Risk Factors

- -market cap
- -trading volume
- -stock price

Measures of cheapness

- Levels & trends in:
 - -P/E
 - -P/B
 - -P/S
 - -P/dividends
 - -P/cash flow

Measures of profitability

- -ROE
- -ROA
- -Earnings growth
- -capital turnover (Sales/Assets)

Technical Factors

- -Excess return over S&P index in last 1, 2, 3, 6, 12, 24, 60 months