STANFORD UNIVERSITY

DEPARTMENT OF STATISTICS

DEPARTMENTAL SEMINAR

4:15 p.m., Tuesday, January 06, 2004
Sequoia Hall Room 200
(Cookies at 3:45 in 1st Floor Lounge)

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Statistical Arbitrage

Abstract:

Some hedge funds offer consistent out-performance relative to standard benchmarks which is difficult to explain using either risk-premia, the accumulation of tail-event risks, or selection bias. Such systematic out-performance is theoretically possible only provided that financial markets are (and remain) substantially less efficient than standard economic models suggest. One academic explanation is provided by behavioral finance, which postulates that even small deviations from market "perfection" may be sufficient to generate substantial price "disturbances". I give a brief summary of some of these models and discuss trading opportunities which theoretically result in a behavioral economy. In the second part of the talk, I test these "naive" strategies on real market data to illustrate some of the emerging practical and mathematical problems.

Finally, with a view to students who consider hedge funds as a possible career path, I attempt to give some advice about the work in this line of business.