

Exploited by Complexity

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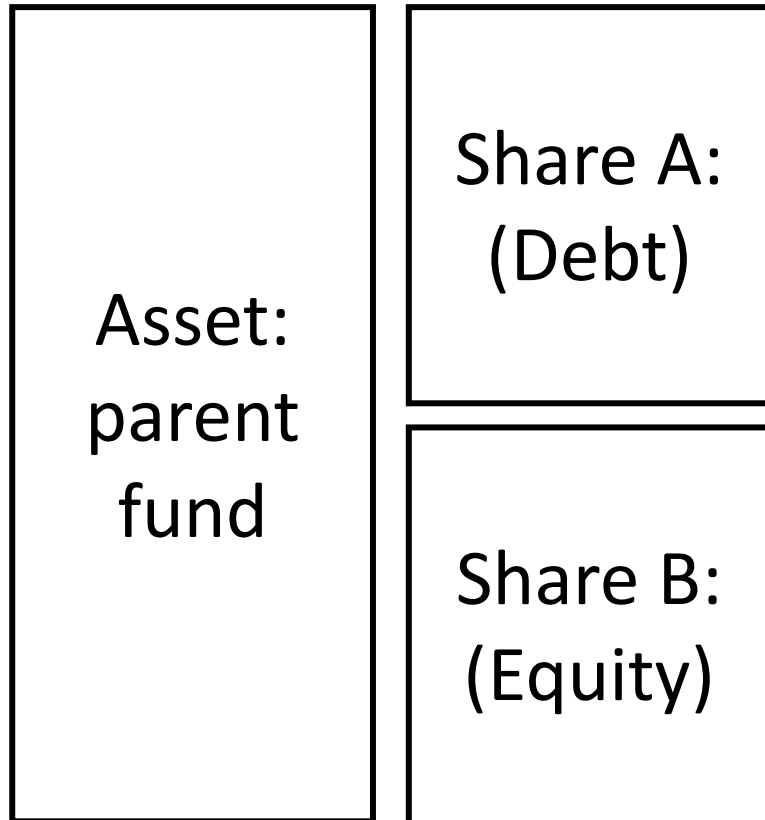
Overview

- Traditional view of structured products: risk sharing
 - However, recent work shows that many naïve investors do not understand the complexity and are harmed
- This paper shows an interesting instance of this type of harm using A/B funds during the 2015 Chinese stock market crash
 - During market downturns, the restructuring clauses of B shares will be triggered, causing a decline in value
 - The relatively sophisticated investors sold ahead of time
 - The naïve ones didn't sell on time (even bought more). This led to a 1 billion RMB (\approx \$144 million USD) wealth transfer

My discussion

- Discussants are often expected to tear up papers
- However, I find the paper's analysis to be quite compelling
 - Caveat: I'm also not an expert in this field
- Therefore I'll focus on
 - 1) Explaining what I see as the key empirical facts to take away
 - 2) Making a few suggestions to improve the paper

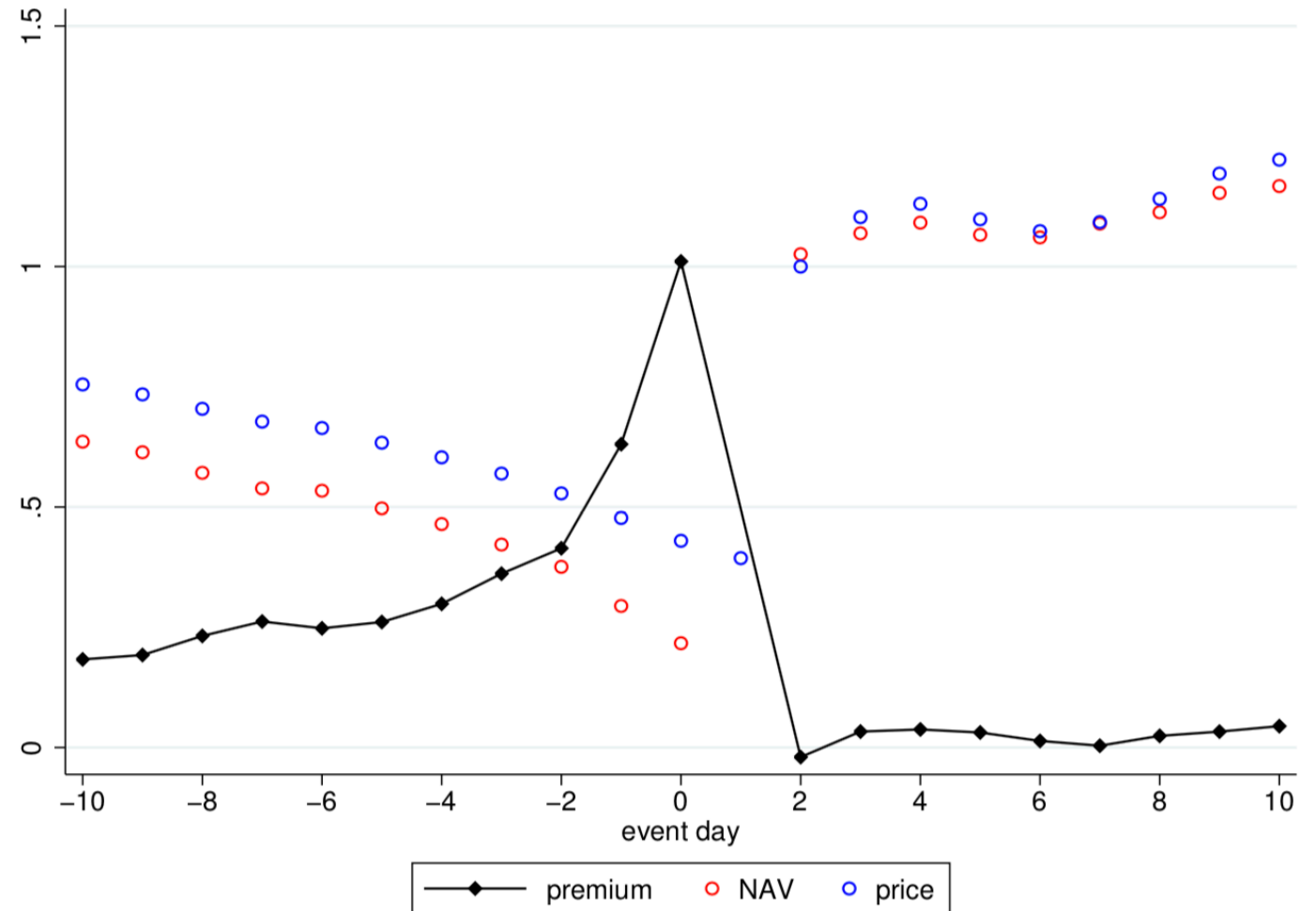
The A/B fund share product



- B share thus has embedded leverage
 - Many investors like this leverage, so B shares trade at a premium (relative to NAV)
- If parent fund value ↓, B share leverage ↑ and so does premium
- However, if parent fund value drops below a pre-defined threshold, B shares will be restructured and leverage ratio restored to lower levels
 - → Premium will vanish

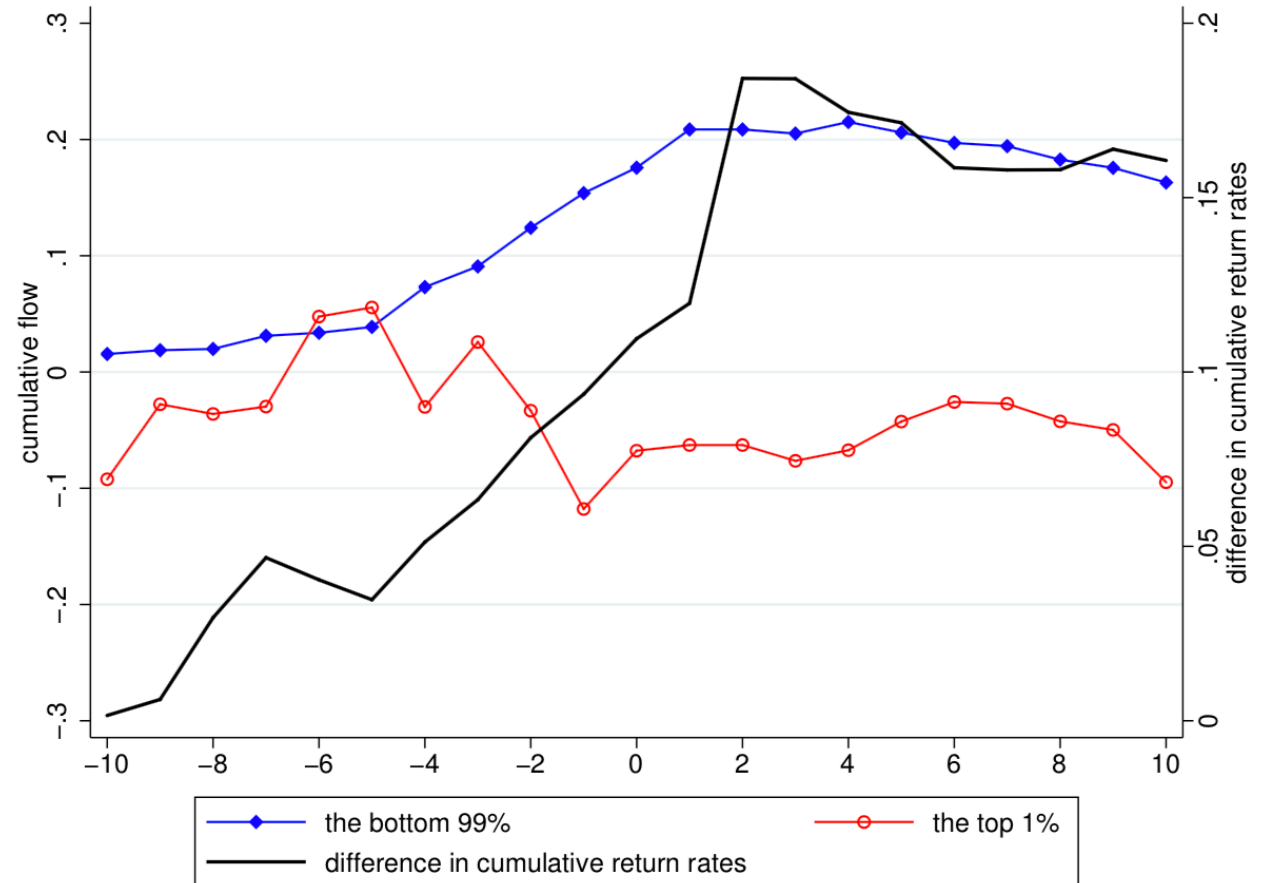
Restructuring destroys the B-share premium

- Question: do investors understand this?
- The authors separately analyze sophisticated vs. naïve retail investors, separating them using account size, experience, etc.



The more sophisticated ones got out on time...

- The naïve ones doubled down!



As a consequence, their returns differed

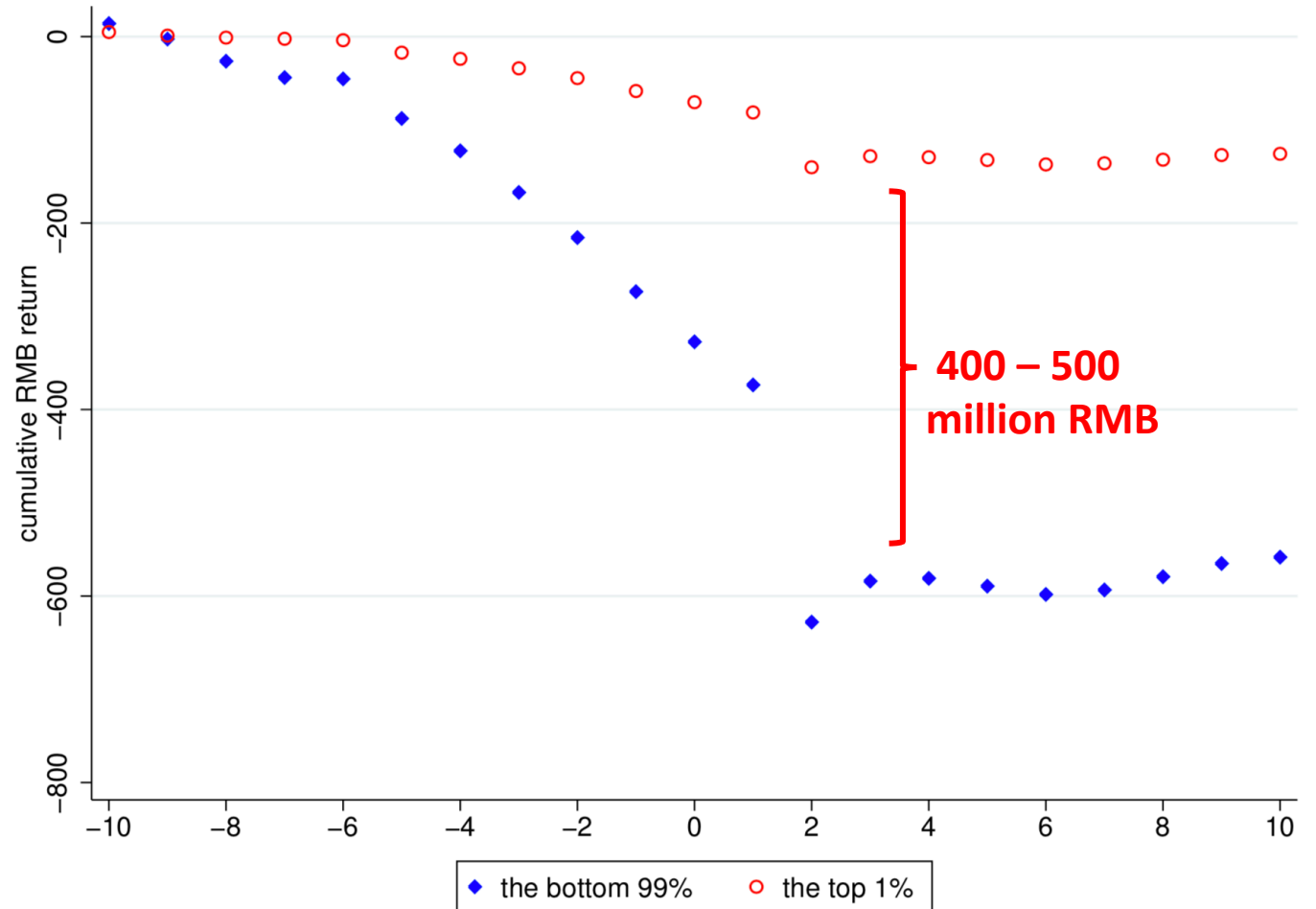


Figure 13: Wealth Redistribution During Restructuring Events

Suggestions for the authors

1. Shed light on investor knowledge and intent

- For instance, did sophisticated investors exit on purpose?
 - The authors tried to address this using many indirect ways
- One direct way (even through anecdotal): what did they say?
- Zhihu (the Chinese version of Quora):
 - Question: “B share is about to restructure, what should I do?”

知乎 首页 发现 等你来答 《花木兰》取消北美院线上映 提问

股票 股票市场 基金 分级基金

分级基金B即将下折，怎么操作？

分级基金创业板B即将下折，跌停封板无法卖出。这时候该怎么操作？买入A等下折？还是买入A再合并为母基金赎回？新手误入分级基金大坑。求救。

关注问题 写回答 邀请回答 好问题 1 添加评论 分享 ...

The top answer posted

- The top answer walks through a case study, and concludes:
- 1) Best approach: if you see your B share approaching the restructuring threshold, sell
- 2) Second best: buy A shares, combine, and redeem as the parent fund share
- ...



ericcson

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2 人赞同了该回答

福利：下折时的逃生技巧

如果你很不幸，快要下折的时候用7块钱买入了2块5的坑货，而且此时B已经跌停，又无法卖出止损怎么办？

这里有个小技巧可能可以让你少亏一些，但也只是可能少亏一些。

拿最近7月9号下折的有色B来讲，7月8日时母基净值0.633元，有色B收盘净值0.248元，触发下折；有色A现价0.861元，有色B现价0.551元。

假设这时你持有B 1000股参与下折，500多块钱折完只剩248元，亏损达54%；

如果此时买入1000股A，合并为母基金赎回，虽然多花了861元，但最终亏损只有146元，加上手续费大概155左右，亏损10%。

虽然亏损变少了，但这里有一点需要注意，在合并前先查查基金公司是否关闭了赎回通道。通常来讲，折算日当天会关闭，像上面有色B的话就是7月9日，之前都是正常开启的。然而基金赎回操作总是需要两个交易日才能完成的，即使上交所的分级当天合并当天可赎，但资金到账也需要等到第二天。因此，当发现你持有的分级B净值接近0.25元并认为后期不太可能涨回来时，最好提前操作，规避下折风险。

Another example

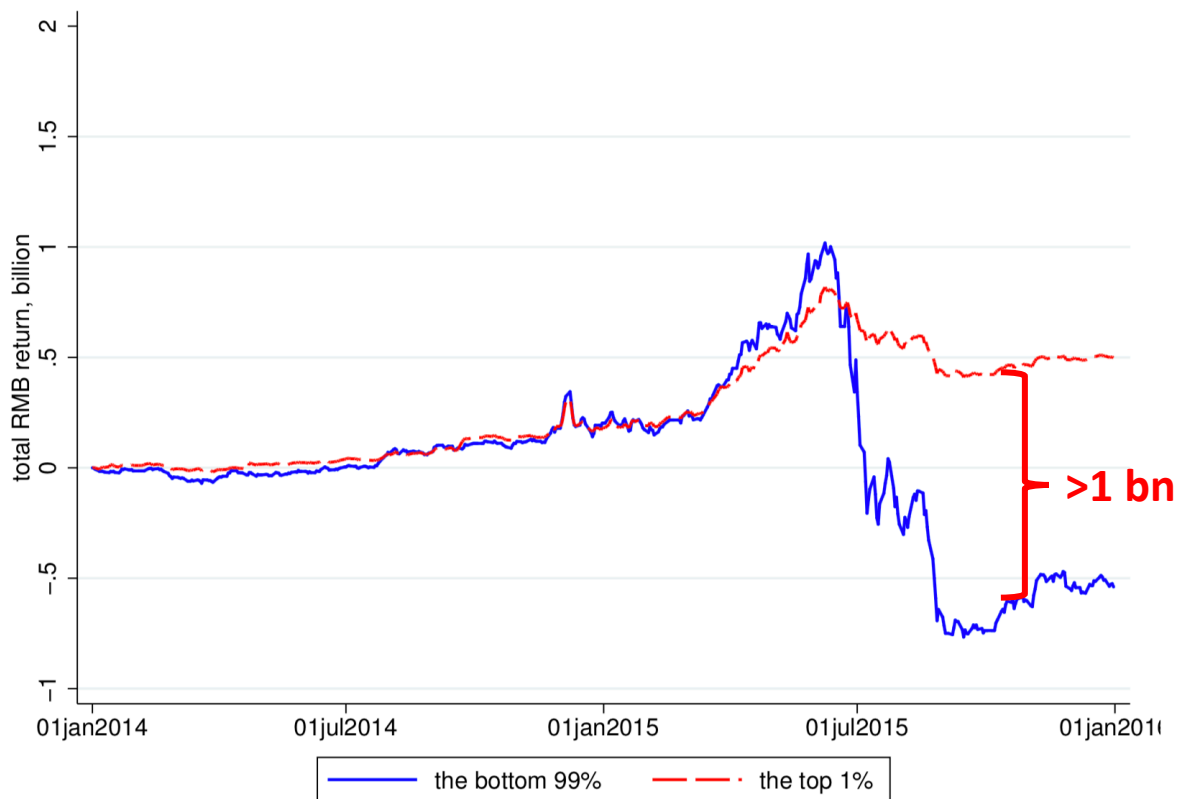
- Does B share premium come from investor demand for leverage?
- The most popular Zhihu column on B share premium:
- ...B类的净值越低，溢价水平反而越高，杠杆也越高。”
 - *...The lower the B share NAV, the higher the premium and leverage...*
- On explaining why B shares lose money upon restructuring:
 - “损失的原因...换成新B后溢价率降低了（低杠杆给的低溢价）”
 - *“the loss ... is because premium declined after restructuring (low post-restructuring leverage means lower premium)”*

Bottom line

- This is probably the closest you can achieve in terms of “getting into the heads of investors”
 - I listed the writings of sophisticated investors.
 - There are also naïve ones. Would be good to know what they are thinking.
- In addition to anecdotal evidence...
 - ... perhaps it is even possible to do a more formal textual analysis on investor forums

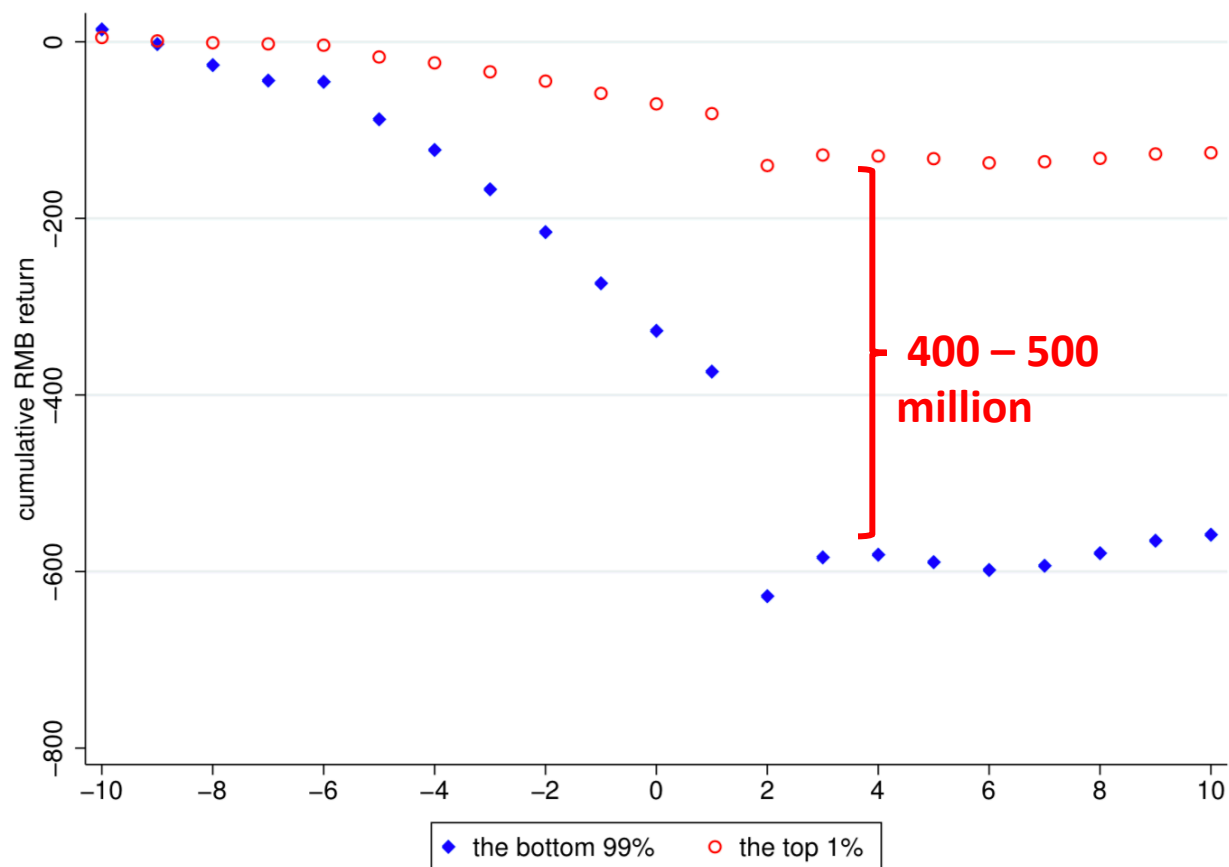
Comment 2: what explains the return gap?

- Total return gap $\approx 2 \times$



(a) RMB return for size groups

Return gap around restructuring



Where does the remaining return gap come from?

- I suggest a decomposition of investor returns following Lo (2008), “Where do alphas come from?”
- An accounting identity decomposition of active returns:
 - Active returns = static security selection + dynamic trading
 - In this context, static selection means the choice of B shares
- The current paper suggests that the return gap arises from dynamic trading, and especially around restructuring events
 - This can be tested formally

Summary

- This is a well executed paper on an important research topic
- The authors put in *enormous effort* obtaining data, administering surveys, and analyzing data
- I learned a lot reading this paper and wish them the best in the publication process