The Performance of High and Low ROE Stocks: An Empirical Analysis 2010 - 2014

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- Study Purpose: to determine if ROE is a predictor of stock excess returns
- Research Design: establish portfolios of high (40%) and low (5%) ROE stocks and compare their returns to the S&P 500 (SPY)
- The Model:
  \[ R_{t+1} = f(ROE_t), \]
  where: \( R_{t+1} = \text{return to ith stock at } t + 1 \)
  \( ROE_t = \text{return on equity for ith stock at time } t \)
- Hypotheses:
  (1) High ROE stocks outperform the market
  (2) High ROE stocks outperform low ROE stocks
- Data Analysis: Table 1
  (1) High ROE stocks outperform SPY in all 5 years
  (2) High ROE stocks generate strong alpha in the trading range year 2011 and the growth year 2013
- Data Analysis: Table 2
  (1) Low ROE stocks have negative alpha in 3 of the 5 years
  (2) Positive alpha was generated in the rebound year 2010 and the growth year 2013
- Data Analysis: Table 3
  (1) On a cumulative basis, high ROE stocks generate $5 million dollars of alpha based on an original investment of $10 million
- Data Analysis: Table 4
  (1) On a cumulative basis, low ROE stocks generate $673,467 of excess returns on an original investment of $10 million
- Conclusions:
  (1) High ROE stocks outperform the market
  (2) High ROE stocks outperform low ROE stocks
  (3) During the 2010 – 2014 period, both high and low ROE stocks generated excess dollar returns