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Do High ROE Stocks Outperform the Market with Persistence: An Empirical Analysis, 2009 - 2014

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

By: Drew Imhoff
Advisors: Dr. Robert Dean and Dr. Trevor Collier

- **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)
- **Period of Analysis**: 2010 – 2014
- **The Model**: 
  \[ R_{t+1} = f(ROE_t), \]
  where: \( R_{t+1} \) = return to ith stock at \( t + 1 \)
  \( ROE_t \) = 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. On a cumulative basis, high ROE stocks generate $5 million dollars of alpha based on an original investment of $10 million
- **Data Analysis**: Table 3
  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 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