4-9-2015

Retained Earnings as a Determinant of the Cross Section of Returns

Michael M. Raleigh
University of Dayton, stander@udayton.edu

Follow this and additional works at: http://ecommons.udayton.edu/stander_posters

Part of the Arts and Humanities Commons, Business Commons, Education Commons, Engineering Commons, Life Sciences Commons, Medicine and Health Sciences Commons, Physical Sciences and Mathematics Commons, and the Social and Behavioral Sciences Commons

Recommended Citation
http://ecommons.udayton.edu/stander_posters/620

This Book is brought to you for free and open access by the Stander Symposium at eCommons. It has been accepted for inclusion in Stander Symposium Posters by an authorized administrator of eCommons. For more information, please contact frice1@udayton.edu, mschlagen1@udayton.edu.
Retained Earnings as a Determinant of the Cross Section of Returns 2006-2014

By: Mike Raleigh
Advisors: Dr. Bob Dean, Dr. Trevor Collier

Study Objectives
1. Determine if retained earnings is a priced in factor in the cross section of returns
2. Determine if a combination of price and retained earnings weighted portfolios outperformed their benchmarks

Research Approach
1. Sort S&P 500 into deciles of 50 stocks by firm size
2. Divide top 50 stocks by size into 2 portfolios of 25 stocks each based on price to book
3. Utilize 3 portfolio weighting strategies
   a) Price Weighted
   b) Retained Earnings per Share Weighted
   c) Combination of Price and Retained Earnings per Share Weighted Portfolios

Model Specification
1. **Price Weighted**
   \[ (Pw_i) = \frac{P_i}{(\sum P_i)/N} \]
2. **Retained Earnings Weighted**
   \[ (REw_i) = \frac{RE_i}{(\sum RE_i)/N} \]
3. **Combined Weighted**
   \[ (Cw_i) = .5Pw_i + .5REw_i \]

Hypothesis
- Pwᵢ outperforms benchmark
- REwᵢ outperforms benchmark
- Cwᵢ outperforms benchmark

Findings:
- **LCG** – All weighting models generated alpha. RE had highest alpha
- **LCV** – All 3 weighting models generated alpha. Price Weighted had highest alpha
- **Rebalanced** – LCG: all 3 models outperformed. RE had highest alpha
  - LCV: Price and combined weighted outperform while RE does not

Conclusions:
- Retained earnings appears to be priced-in factor for growth portfolios but not for value portfolios