Finance for Financial Journalists
Using Data to Find the Truth

Jun Pan

Shanghai Advanced Institute of Finance (SAIF)
Shanghai Jiao Tong University

October 22, 2021
Financial Journalism

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Financial Journalism

- Financial systems: institutions, regulators, and investors.
- Financial markets: price discovery and efficient allocation of capital.
- Financial theories: pricing risk.
- Financial journalists: Use data to find and communicate the truth.
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\textit{The Wall Street Journal}:
\begin{itemize}
  \item LIBOR Manipulation.
\end{itemize}
Bankers Cast Doubt On Key Rate Amid Crisis

By Carrick Mollenkamp
April 16, 2008 12:01 am ET

LONDON -- One of the most important barometers of the world’s financial health could be sending false signals.

In a development that has implications for borrowers everywhere, from Russian oil producers to homeowners in Detroit, bankers and traders are expressing concerns that the London inter-bank offered rate, known as Libor, is becoming unreliable.
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- *The Wall Street Journal*: 
  - LIBOR Manipulation.
  - The Enron Scandal.
For a distinguished example of explanatory reporting that illuminates a significant and complex subject, demonstrating mastery of the subject, lucid writing and clear presentation, Seven thousand five hundred dollars ($7,500).

Staff of The Wall Street Journal

For its clear, concise and comprehensive stories that illuminated the roots, significance and impact of corporate scandals in America. (Moved by the jury from the Public Service category.)
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Jun Pan 2 / 11

**Scandal Reaches Far and High**

It Took Many Bad Apples to Taint Fund Industry’s Reputation Amid Continuing Probes of Share-Trading Abuses

By Tom Lauricella

**JAN. 08, 2004**

**Two-Tier System**

For Staid Mutual-Fund Industry, Growing Probe Signals Shake-Up

Investigators Find Indications Of Widespread Abuses Hurting Small Investors

Unfair Pricing for Big Players

By Tom Lauricella

**OCT. 20, 2003**

The mutual-fund scandal is spreading, as it becomes clear that players throughout the $7 trillion industry could face scrutiny and improved practices that are turning the way analysts at brokerage firms operate, now says he intends to use the mutual-fund investigation to clean up another part of the financial world that has favored large clients at the expense of smaller ones, including millions of workers and retirees. The Securities and Exchange Commission, scrambling to keep up with him, as it did during the investigation of Wall Street analysts, is now filing civil suits of its own and is considering possible new rules aimed at preventing misbehavior in mutual-fund trading.

Industry heads have begun to roll.
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Portfolio Theory (Markowitz)

1961

Two-Fund Separation (Tobin)

Investments and Capital Structure (Modigliani and Miller)

1965

CAPM (Sharpe)

1964

Efficient Markets Hypothesis (Samuelson, Fama)

1970

Index Mutual Funds (Bogle)

Rise of Junk Bonds (Michael Milken)

First Stock Index Futures

1981-1982

First US Options Exchange, CBOE

1973

Option Pricing Theory (Black, Scholes, Merton)

1971

Birth of Index Funds (McQuown)

Mortgage Backed Securities (Fannie Mae)

1994-1995

Large Derivatives Losses

Enron Scandal

2000-2001

Dot-Com Peak

2000

LTCM Crisis

1995-1998

Credit Derivatives (CDS)

1989

S&L Bailout Collapse of Junk Bonds

1987

First TIPS

1979

Chinese Stock Market Crash

2015-2016

Trade War

2017-2018

Asian Crisis

2011

European Sovereign Crisis

2010

Enron Scandal

2002

Financial Crisis

2007

WorldCom Scandal

2001

Dodd-Frank

2013

Credit Derivatives (CDS)

2010

First Stock Index Futures

2000

OTC Derivatives Interest Rate Swaps

1998

Stock Market Crash

1996

S&L Bailout Collapse of Junk Bonds

1994

Credit Derivatives (CDS)

1992

Chinese Stock Market Crash

1990

Enron Scandal

1988

Large Derivatives Losses

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1972

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1968

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1960

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1955

Credit Derivatives (CDS)

1950

Credit Derivatives (CDS)

1945

Credit Derivatives (CDS)

1940

Credit Derivatives (CDS)

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Credit Derivatives (CDS)

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Credit Derivatives (CDS)

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Credit Derivatives (CDS)

1920

Credit Derivatives (CDS)

1915

Credit Derivatives (CDS)

1910

Credit Derivatives (CDS)

1905

Credit Derivatives (CDS)

1900

Credit Derivatives (CDS)
China’s Capital Markets and Asset Management

GDP in USD Trillion

Ratio of Stock to GDP (%)

Ratio of Bond to GDP (%)  

Ratio of Mutual Fund to Stock + Bond (%)
Credit Allocation in China: SOE vs Non-SOE

- Credit misallocation with respect to state-owned enterprises (SOE):
  - Allocational inefficiency drags on aggregate growth (Hsieh and Klenow (2009)).
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Our paper uses bond pricing to uncover the extent of credit misallocation in China:
- The SOE premium: difference in credit spreads between non-SOEs and SOEs.
- Time-varying SOE premium and the importance of government support.
- The presence of government support on price discovery.
- The real impact of allocational inefficiency: profitability and financial health.
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- $0.1 trillion in 2008, $4.5 trillion in 2020, second only to the US ($7.3 trillion).
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- Two landmark events: March 4, 2014 and Apr 27, 2018.
The Time-Varying SOE Premium

\[
\text{CreditSpread}_{i,t} = a + b \text{NSOE}_{i,t} + c \text{Rating}_{i,t} + \sum_k \text{Controls}_{i,t}^k + \epsilon_{i,t}
\]
The SOE Premium and Credit Cycles

\[ \text{CreditSpread}_{i,t} = a + b \text{NSOE}_{i,t} + c \text{Rating}_{i,t} + \sum_{k} \text{Controls}_{i,t}^k + \epsilon_{i,t} \]
Summary of Results and Recent Developments

- From 2010-2020, we find a market of evolving and improving price discovery:
  - Post 2014Q1, credit quality becomes important in credit pricing.
  - Post 2018Q2, the extent of government support becomes more important.
    - The main driver behind the explosive SOE premium.
    - The beginning of the end: “faith” in the SOE label.
    - Distortions to price discovery with respect to credit quality.

- The real impact of the allocational inefficiency.
  - Post 2018Q2, non-SOEs lost their advantage over SOEs in profitability.
  - The explosive SOE premium is a reflection, not the unique cause.
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- Ongoing Developments:
  - Nov 2020: wave of defaults by large local-government SOEs (e.g., Yongmei).
  - Sep 2021: China’s Evergrande moment.
Main Takeaways

- Journalism: Writing for impact.
  - Not a mere marketer or information distributor.
  - Short-term intensity and long-term impact.

- Finance for financial journalists:
  - Financial theories and insights.
  - Financial markets, institutions, and policies and policy makers.
  - Use financial data to find the truth.