Best Young Researcher in Finance and Insurance, Irina Zviadadze: « Unsystematic risk plays a massive role in asset markets. »

The 2023 award for the Best Young Researcher in Finance and Insurance IEF / SCOR Foundation pour la science was given on the 21st of March, during the second day of the Risk Forum, organized by the Institut Louis Bachelier (ILB), which took place at the Paris Chamber of Commerce and Industry. This year, the Award, sponsored by the SCOR Foundation pour la science, was given to Irina Zviadadze, Associate Professor of Finance at HEC Paris. On the sidelines of the award ceremony, she answered our questions.

Irina Zviadadze has received her award of Best Young Researcher from Didier Valet, President of Institut Europlace de Finance and Vice-President of ILB. Photo credit: Hervé Thouroude.

What does this Best Young Researcher Award in Finance and Insurance mean to you?

I was delighted to learn that I would receive the Best Young Researcher Award in Finance and Insurance this year. I am very grateful to SCOR, Institute Europlace de Finance, and Institut Louis Bachelier for this opportunity. This Award is very valuable for me, especially because it was given earlier to many of my colleagues who are my role models.

Can you detail and briefly explain the main research themes you are working on?

My research interests lie in asset pricing. I think about risks to which investors are exposed when they buy different assets (for example, stocks and bonds, both of which may be denominated in different currencies) and how these risk exposures are compensated. In my prior work, I have examined currency carry trades, extreme risk in the foreign exchange market, and interaction between monetary policy and asset markets. Also, I have developed model diagnostic methods to identify the most accurate economic models describing the risk-return tradeoff in asset markets.

Can you mention the main results of your research about asset pricing?

At the moment, I am studying the quantitative importance of unsystematic risk in asset markets. This exploration led to the working paper *What is missing in asset pricing factor models*, co-authored with Massimo Dello Preite, Raman Uppal, and Paolo Zaffaroni.

The common wisdom in financial economics is that investors require compensation for exposure to only systematic risk. Systematic risk represents common shocks to which all assets have exposure. An example of such a shock is the arrival of an economic recession. When a negative economic shock realizes, assets tend to drop in price, and an investor experiences a loss in her investment portfolio precisely when inflation spikes up, economic growth slows down, and unemployment increases. Because investors dislike losing money, especially when the economy is in recession, they require compensation for risk embedded in asset returns. This compensation translates to positive expected asset returns; the expected return is supposed to be higher for an asset with higher exposure to systematic risk.

In contrast, unsystematic risk represents idiosyncratic asset-return shocks. For example, these shocks arise because of a change in the governance of or technological innovation in an individual company. The conventional economic view is that investors do not get compensated for this type of risk because investors can dampen this risk by investing in many assets.

My co-authors and I challenge this view and show empirically that unsystematic risk plays a massive role in asset markets: investors require significant compensation for exposure to unsystematic risk. We relate this result to market frictions (e.g., some regulatory restrictions and financial constraints) that

prevent investors to form well-diversified portfolios and behavioral biases. Our insight is important for understanding and evaluating the returns on investment strategies.

How can your research results contribute to the financial sector?

Practitioners can directly apply my research insights to developing investment strategies. Speaking of my current research projects mentioned above, my co-authors and I show how to design an investment strategy exposed only to systematic or unsystematic risk. The primer strategy is exposed to business-cycle risk, whereas the latter is not. Thus, investors could, for example, combine these two strategies to gain diversification benefits and reap extra risk premia.

To conclude, what are the next topics/papers you will work on?

I would like to pursue further my research agenda on the importance of unsystematic risk. There are many questions that my research team can tackle in the future. Also, at the moment, I am very interested in the question of government debt sustainability, which has become especially topical after the COVID-19 pandemic. There is a running hypothesis that government bonds are special assets, and I am interested in evaluating this hypothesis empirically.

Biography:

Irina Zviadadze is an Associate Professor of Finance at HEC Paris. She received a Ph.D. in Finance in 2013 from the London Business School. Between 2013 and 2019, Irina served as an Assistant Professor of Finance at the Stockholm School of Economics, where she taught a core course on derivatives pricing and financial markets to BSc students, topics in asset pricing for Doctorate students, and Investments and Financial Management to students in an Executive program. In 2019, Irina joined HEC Paris, and since then, she has taught financial economics in the HEC's flagship Grand Ecole program.

Irina's research interests lie in asset pricing. She studies a risk-return tradeoff in different asset markets (equity, fixed-income, and foreign-exchange markets) and across different horizons. Her papers appeared in the Journal of Finance, Review of Financial Studies, and Journal of Financial and Quantitative Analysis; and were also presented at numerous conferences and seminars worldwide. Irina has received several research awards, including Hans Dalborg's award for excellence in research in financial economics.