INTERVIEW

With Paul Karehnke, winner of the 2024 Best Young Researcher in Finance and Insurance IEF/SCOR Foundation for Science Award.

Paul Karehnke : « My work can help to better understand the risks of investment strategies »

The Best Young Researcher Award in Finance and Insurance IEF/Foundation SCOR for Science 2024 was awarded on 19 March during the second day of the Risk Forum, organised by the Institut Louis Bachelier, and held at the Paris Chamber of Commerce and Industry.

The prize, sponsored by the Scor Foundation for Science, was awarded to Paul Karehnke, Associate Professor of Finance at ESCP Business School. On the side-lines of the award ceremony, he answered a few questions.

How do you feel about receiving the IEF/Scor Foundation for Science Prize for Best Young Researcher in Finance and Insurance?

It's a great pleasure to receive this award, because I've been involved in the Risk Forum for a long time. I've been attending this academic event regularly since I was a doctoral student. I've also taken part by presenting research papers or as a discussant. I admire the previous award winners a lot and it's an honour to be a winner this year.

Can you tell us about your main areas of research asset pricing and portfolio choice?

Two recently published papers illustrate my research themes on portfolio choice and asset pricing.

Firstly, Frans de Roon and I published a paper on performance evaluation applied to hedge funds (Spanning Tests for Assets with Option-Like Payoffs: The Case of Hedge Funds, 2020).

In this paper, we analyse investment strategy taking into account the asymmetry of returns. To this end, in addition to using alpha, we study the relationship between the residual return and a benchmark. These two metrics enable us to take tail risk better into account. We show that fewer hedge funds outperform the market.

Secondly, together with Pedro Barroso and Roger Edelen, we have analysed the momentum strategy, which involves buying stocks that have outperformed in the past and selling those that have underperformed (Crowding and Tail Risk in Momentum Returns, 2022). Although this strategy has produced good returns, it has also suffered from episodes of sharp declines. The literature conjectures that these crashes occur when too many investors follow the same strategy. However, we refute this hypothesis by showing that crowding does not predict crashes. This paper paves the way for new explanations that can be explored in the future.

You are also working on behavioural economics and finance. Can you tell us more about this?

I'm working in particular on the preference for asymmetric returns ('skewness'), as in the case of lotteries. While there is a consensus in the research literature that people like this asymmetry, there is still a debate about the importance individuals attach to it. My current work therefore focuses on the limitations of the classical expected utility framework and its ability to describe individual choices. In particular, this work could help to assess insurers' risks.

How can your research help the financial sector?

My work on asset pricing is directly applicable to the financial sector.

My research on portfolio choice can help managers and investors construct portfolios and select investment strategies for their clients. Finally, my work can help us better understand the risks of investment strategies, particularly the momentum strategy.

To conclude, what are your next research projects?

I'm interested in questions related to the investment horizon and risk assessment. For example, I would like to study the impact of considering long time horizons on the beta of an asset, which is a metric that is usually calculated on short horizons.

This could enable us to analyse the capital asset pricing model (CAPM) from a different angle and apply it more consistently in practice.