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Science-Based Investing? Take Alpha and Shove It.

Wesley R. Gray, PhD March 3, 2017

Johnny Paycheck has a great country song centered around the following lyric:

Take this job and shove it...I ain't working here no more...

Campbell Harvey, in the 2017 AFA Presidential Address, elaborates an analogous comment on the current state of the financial economics field:

Take this alpha and shove it...I ain't publishing this research no more...

Prof. Harvey is rightly concerned that the incentives to publish “strong significant results” are super high in finance and economics and this is skewing our true understanding of reality. In short, Campbell has the intellectual fortitude to state plainly what many of us have known — or indirectly sensed — data-mining is probably rampant in financial economics.

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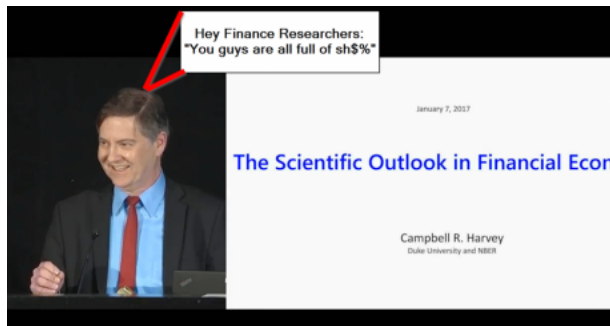
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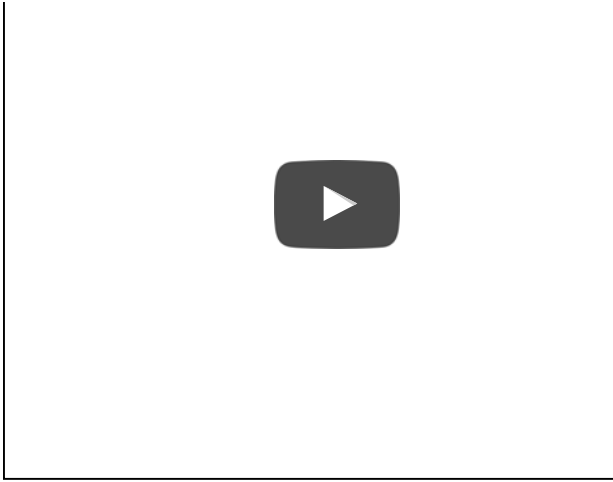


harvey calling out finance

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To be clear, Campbell is not saying that all research is bogus, he is just saying that we need to be much more skeptical, have much higher standards, and develop more sensible techniques, when determining if a specific research finding is robust and reliable. For example, here are past posts we've done on the top

- [Overfitting bias](#)
- [Digging into the "factor zoo"](#)
- A need to focus on [sustainable active investing](#) and identify the "pain," to understand the potential gain.

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Prof. Harvey also points out the following regarding our discussion on their "factor zoo" paper, which looks at over 300 published findings and identifies that the majority of these findings are false, because the t-stat need to be adjusted above 3:

...raise the threshold for discovering a new finding to $t > 3$...

In this new discussion from Harvey, he makes an even more compelling point:

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LiveScience.com

I would like to make the case today that making a decision based on $t > 3$ is not sufficient either.

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- across several market cycles,
- Be **pervasive** across a wide variety of investment universes, geographies, and sometimes asset classes;
- Be **robust** to various specifications;
- Have **intuitive** explanations grounded in strong risk and/or behavioural arguments, with reasonable barriers to arbitrage; and,
- Be **implementable** after accounting for market impacts and transaction costs.

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Why Should We Be Weary of “Evidence-Based Investing”

Some of the most interesting research I’ve done has never been published, probably because the work wasn’t that good, but also because the results showed a “non-result.” For example, one of my favorite research projects involved the [investigation of the so-called “limited attention” hypothesis](#). Limited attention is a core concept behind our tweak on momentum investing (the [“frog in the pan” concept](#)). We collected a new dataset of all NYSE bell events, which served as an “attention shock,” and allowed us to do a relatively clean test of “limited attention” and question our core assumption that this bias influences asset prices.

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Here is a short-hand version of what we found:

White House says it doesn’t matter if Tru Bharara he would stay on

CNBC

...limited attention has little influence on asset prices.

Here is a direct comment from the referee report we received from the journal:

*Regardless of the economic story, I think the **weak/no result** in price movement makes the paper a tough sell and hurts its potential contribution.*

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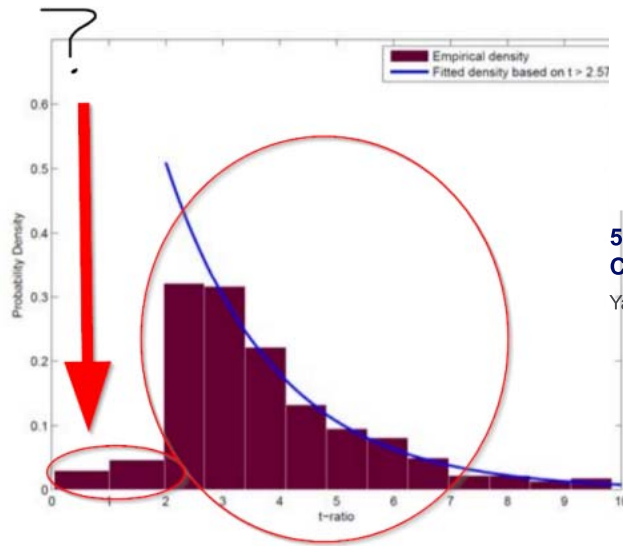
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potentially a normal operating procedure.

**Mark Cuban: The world's first trillionaire
an artificial intelligence entrepreneur**

First, the figure below shows the distribution of t-stats associated with research published on so-called “factor studies.” (See [here](#) for a discussion on factor invest

CNBC



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where are the t stats

Note that there are very few papers published, which show that something doesn't work, but a ton of papers published showing that something does work. But one would think that knowing what doesn't work is as important as knowing what does work — not according to the journal editors.

Next, we look at the broader academic research fields to see if this is “standard,” or unique to finance/economics. To address this question, Prof. Harvey looks to research from [Fanelli \(2010\)](#). Fanelli examines how likely various research fields will publish research that have “positive” findings related to a particular hypothesis:

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