Summary of "Value around the World"

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The value premium is the excess return that portfolios of stocks with high book-to-market values (value portfolios) have over portfolios with low book-to-market values (growth portfolios). As first pointed out by Fama and French (1992), the value premium is found to be consistently larger than what can be explained by the incremental risk value portfolios bear according the Capital Asset Pricing Model. Fama and French (1993) claim that value stocks bear an extra risk factor orthogonal to the market which requires a higher return.

During the previous decades many researchers and practitioners in finance have studied the value anomaly in different stock markets. For example Chan, Hamao, and Lakonishok (1991) reported a strong value premium in Japan and Capaul, Rowley, and Sharpe (1993) present the first international evidence on the value premium. Fama and French (1998), presenting a large international study on value premiums, adding supporting evidence for the existence of a value premium internationally (based on the data of 1975-1995). Finally Fama and French (2011) reports that the value premium exists in all four regions North America, Europe, Japan, Asia Pacific (based on the data 1991-2010).

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The possible explanations of the excess return of value strategies focus on two different explanations. One the one hand on the extra risk that value stocks may contain over growth stocks. On the other hand studies attribute the value premium to pricing errors caused by suboptimal investor behavior.

In this paper we explain the value premium in a standard consumption based Gordon (1959) model. We show that for reasonable parameter values of the profit growth of value and growth firms, the value premium increases - both in the degree of risk aversion as well as in the degree of time discounting. Then we give international evidence for these hypotheses by performing panel regressions across countries. By relating a large international survey of risk aversion and time preference with international evidence on the value premium we can show that both predictions of the consumption based Gordon model hold. Thus the international perspective shows that a rather standard model is able to explain the value premium.

We present strong empirical evidence that the value premium exists world wide and differences across countries can be explained by differences in risk aversion and patience values. Our results presents supporting evidence for the explanations of value premium puzzle suggested by Zhang (2005) and Lettau and Wachter (2007). In addition to the findings on effects of cultural differences by Chui, Titman, and Wei (2010) and Stulz and Williamson (2003), our study provides further empirical evidence that cultural differences might matter more than generally presumed in the finance literature. Differences in financial markets can also be the results of differences in investor behavior.