



Behavioral Finance

Sell-Side School Ties

August 1, 2010

In the equities market, security analysts are among the most important agents in revealing information to investors. A large part of an analyst's job is to research, produce and disclose reports forecasting companies' prospects, and to make buy-or-sell recommendations. Therefore, it is critical to know how, or from whom, analysts obtain information.

In this paper, we study ties between sell-side analysts and management of public firms, and compare them with the subsequent performance of analysts' recommendations. We use attendance at the same educational institution to identify firms where analysts are more likely to gain direct access to senior managers. One advantage of this approach is that ties are formed long before the information likely being transferred across them, and thus the underlying tie (alumni link) is not directly related to the type of information likely being transmitted years later (company-related information).

Our main goal is to test the hypothesis that analysts gain a comparative information advantage through their social networks; specifically, through educational ties with senior officers and board members of the firms that they cover.

We find that analysts outperform by up to 6.60% per year on their stock recommendations when they have an educational link to the company. Pre-Reg FD, this school-tie return premium was 9.36% per year, while post-Reg FD it is nearly zero. In contrast, in a market that did not change selective disclosure regulation (the U.K.), the school-tie premium is large and significant over the entire sample period.

This document is not intended to, and does not relate specifically to any investment strategy or product that AQR offers. It is being provided merely to provide a framework to assist in the implementation of an investor's own analysis and an investor's own view on the topic discussed herein.

This document has been provided to you solely for information purposes and does not constitute an offer or solicitation of an offer or any advice or recommendation to purchase any securities or other financial instruments and may not be construed as such. The factual information set forth herein has been obtained or derived from sources believed by the author and AQR Capital Management, LLC ("AQR") to be reliable but it is not necessarily all-inclusive and is not guaranteed as to its accuracy and is not to be regarded as a representation or warranty, express or implied, as to the information's accuracy or completeness, nor should the attached information serve as the basis of any investment decision. This document is not to be reproduced or redistributed to any other person. The information set forth herein has been provided to you as secondary information and should not be the primary source for any investment or allocation decision. Past performance is not a guarantee of future performance. Diversification does not eliminate the risk of experiencing investment losses.

This material is not research and should not be treated as research. This paper does not represent valuation judgments with respect to any financial instrument, issuer, security or sector that may be described or referenced herein and does not represent a formal or official view of AQR. The views expressed reflect the current views as of the date hereof and neither the author nor AQR undertakes to advise you of any changes in the views expressed herein.

The information contained herein is only as current as of the date indicated, and may be superseded by subsequent market events or for other reasons. Charts and graphs provided herein are for illustrative purposes only. The information in this presentation has been developed internally and/or obtained from sources believed to be reliable; however, neither AQR nor the author guarantees the accuracy, adequacy or completeness of such information. Nothing contained herein constitutes investment, legal, tax or other advice nor is it to

be relied on in making an investment or other decision. There can be no assurance that an investment strategy will be successful. Historic market trends are not reliable indicators of actual future market behavior or future performance of any particular investment which may differ materially, and should not be relied upon as such. Diversification does not eliminate the risk of experiencing investment losses.

The information in this paper may contain projections or other forward-looking statements regarding future events, targets, forecasts or expectations regarding the strategies described herein, and is only current as of the date indicated. There is no assurance that such events or targets will be achieved, and may be significantly different from that shown here. The information in this document, including statements concerning financial market trends, is based on current market conditions, which will fluctuate and may be superseded by subsequent market events or for other reasons.