Essays on Risk Premiums in Currency and Equity Markets

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Abstract – Dissertation

This dissertation compiles three essays on risk premiums in financial markets. The first essay provides profound evidence on a low-risk phenomenon in the cross-section of currencies: I discover a novel strategy that is long in currencies whose higher return moments are small relative to past levels and short in currencies with the contrary characteristic. The strategy is not spanned by traditional currency portfolios and provides a higher Sharpe ratio in comparison to them. The second essay reveals a novel timing strategy in equity markets: Managed portfolios that exploit positive first-order autocorrelation in monthly excess returns of equity factors produce large gains in Sharpe ratios. We document this finding for portfolios formed on the broad market, size, value, momentum, investment, profitability, and volatility. The value-added of the strategy survives transaction costs, carries over to multi-factor portfolios, and compares favorably to well-known timing strategies. The third essay is on moment risk premiums that are differences between realized and the associated implied moments. I provide evidence on nonzero moment risk premiums in currency markets which increases, first, in moment order and, second, in maturity of the contracts involved in the calculation of moments. The latter observation is consistent with state-of-the-art option pricing models.