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**Presentation Speech for: Professor George Constantinides,
Leo Melamed Professor of Finance, University of Chicago Booth School of Business**

They say that “every cloud has a silver lining”. The case of the recent global crisis is not an exception. It has brought home issues, debates and vocabulary that in the past have been largely confined within the walls of financial and academic institutions. We now realise, for example, that things like spreads, swaps and Moody’s can affect our everyday lives. While we accept that financial markets fulfil an important function in modern market economies, we are still nevertheless puzzled by some of the emerging outcomes.

The pricing of financial assets, either primary, like stocks and bonds, or derivative instruments like options and futures, are indeed at the heart of Professor Constantinides’ academic research over the years. A distinctive theme of all his work is the relentless pursuit to understand and explain, within a rational framework, market phenomena that in the first instance appear totally incompatible with rational economic theory. The essence of some of this endeavour is brilliantly encapsulated in his intriguing “*Junior*” trilogy. The “*Junior can’t Borrow*” in 2002, the “*Junior must Pay*” in 2005 and the “*Junior is Rich*” in 2007. They share a common theme as they focus on the investment and consumption patterns across generations and their implications for the pricing of financial assets and behaviour of capital markets in general.

The *Junior can’t Borrow* looks at the significant performance differences between the stock and bond markets over time. It is reasonable of course to expect that given the risks involved in investing in stock markets that investors should demand a somewhat higher return than in a bank account. The question is how much more. History suggests that the average difference, over long time periods, is about 6% p.a. for the US, a bit less in Europe but with significant variations over time. Is this too much or too low? Just consider this: an investment in the stock market at the beginning of our working lives would be worth ten times more 40 years later in comparison to an investment in a bank’s savings account! If you are surprised by this you are not alone. It is called as the “*equity premium puzzle*”. Professor Constantinides’ explanation for this apparent paradox is based on the changing consumer patterns over a

lifecycle. The young would like to invest in stocks but they don't have the money and can't borrow; the middle-aged who have the money are not keen on stocks and choose to hold significant amounts of bonds. Without the borrowing constraint, the young would borrow and invest in equity, thus reducing the mean equity premium and increasing the rate of interest.

The *Junior must Pay* touches on another very important issue that relates to the level and security of our pensions. What may be a prudent portion of the assets of a public pension fund to be invested in equities? Or putting it differently how much it would cost you, the younger generation, to guarantee the pension benefits of my contemporaries if there is a significant drop in equity prices? Professor Constantinides develops an elegant and workable model to estimate the required rise in taxes that will safeguard a certain consumption level for the aging populations.

The *Junior is Rich* offers an additional perspective of the wider implications of the aging population on the stock markets. Over the next 10-20 years the older generation will grant to its heirs some significant amounts of economic property. The implications of such an explicit bequest are important; they could boost stock prices in the future, which may also go some way to explain the large differential between the expected returns in the stock and bond markets.

Professor Constantinides' quest to understand markets within the context of rational investors extends to other apparent "anomalies" in financial markets, both equity and derivatives. His overall message is crystal clear. He concludes that the available evidence does not support the case for abandoning the rational economic model.

This is only a small sample of his wide-ranging work that has established him as one of the most original and respected scholars in the field of financial economics. His research has been published in top-rated academic journals both in Finance and Economics. He has edited several books of readings and made his own contributions to a more than a dozen books by other authors.

In the process, he has held a number of prestigious posts. He has served as president of the American Finance Association, founding member and past president of the Society for Financial Studies, editor or associate editor of several finance and financial engineering journals; he is currently involved as Director/Trustee of the DFA group of funds and trusts and he is a research associate of the National Bureau of Economic Research. For his students and friends, however, he remains the humble, patient, charming and fun-loving George.

Professor Constantinides,

Over the last 35 years, your work has offered fundamental insights into the pricing of financial assets and our understanding of capital markets and their interaction with the real economy.

By doing this, you have inspired a generation of academics to focus on quality research of real relevance to our societies. And it is this standard that we set today for our young, newly appointed faculty of this University.

It is an honour and a privilege to be in the position here today, at the first graduation of the International Hellenic University, to ask you to come forward and receive the first honorary Doctor of Science of the University from the President of the Governing Board.

Mario Levis

8 May 2010