

Fischer Black studies the relationship between the Beta and Return. He argued that the Fama and French interview might be misinterpreting the role of beta and the relation between average return and beta is completely flat. Moreover, other authors mentioned in this paper also find that the estimated slope of the line relating average return and risk is lower than the CAPM says it relates expected return and risk. Therefore, He set up a question and tried to argue the interpretation of other authors through his model and experiment. In my view, his research question would be “Does beta still explain the relationship between return on stocks and the line” because in this paper he wants to prove that beta is not dead and it is a good variable. In his prediction he said that the line will steepen, but that low-beta stocks will continue to do better than the CAPM says they should.

In the study, he uses the portfolio method from BJS study and procedure in this paper because it is the method that is simple, intuitive and useful when analyzing data over a long period. Since this method tries to simulate the real portfolio that investors use. They can use any data to construct the portfolio. Thus, it will lead to the more complex the portfolio, the more risk of data mining bias. So they chose securities using historical estimates of beta and many securities to diversify their factors not related to beta.

From exhibits illustrated in the paper, their results in the test have shown that Low-beta stocks and Low-beta portfolios did better than the high beta stocks and high beta portfolios and better than CAPM prediction. Moreover, from Black and Scholes(1974) they clarify the portfolio method to eliminate bias by using only information that is available at the time. So that it will be very easy to interpret the results. It also showed that different in beta will imply difference in risk and return of the stocks.

In my opinion, these findings support the prediction of the authors because they demonstrate that the beta factor is related to the return of stocks. Even though they use different sampling in each exhibit, the results are concluded in the same way.

The limitation in this case is that borrowing restrictions which include regulation in margin, bankruptcy and tax might cause low-beta stocks to have higher expected returns than the CAPM predicts. The restrictions can affect the attractiveness of the low and high beta stocks in the perspective of investors who can borrow and benefit from the tax shield.

In this case we make an application with the corporate finance. We consider the role of investors and corporations when they make more leverage, but they face borrowing restrictions. In the real world, If they think that the line is flat and flatter than CAPM, but corporations can borrow easier than individual investors. So that beta of corporation stocks will rely on assets and leverage. On the one hand, it will have 2 sides of the firm that face restrictions and no restrictions. They will have a different concern in their leverage which affects the beta to be high or low and can lead to an increased or decreased attractiveness of their stocks from using leverage. Moreover, it also affects individual investors as well because beta is the factor that investors will use to make an investment decision. Finally, for those who can borrow freely, they can use CAPM and beta to construct their portfolio and investment decision making.

