



For Immediate Release

**IRRC INSTITUTE ANNOUNCES TWO \$10,000 AWARDS
FOR BEST RESEARCH ON POST-MODERN PORTFOLIO THEORY**

Research findings on fiduciary duty and ambiguity have potential to change how institutions invest

NEW YORK, NY, February 21, 2012 - The Investor Responsibility Research Center (IRRC) Institute today announced the first recipients of a new annual research competition that examines the interaction of the real economy with investment theory. A blue-ribbon panel of judges selected two papers - one practitioner and one academic - for the new IRRC Institute Research Award. The authors of each research paper received a \$10,000 award.

Steve Lydenberg received the practitioner award for research entitled, *Reason, Rationality and Fiduciary Duty*. A 30-year veteran of the asset management industry, Lydenberg is the founding director of the Initiative for Responsible Investment at the Hauser Center for Nonprofit Organizations at Harvard University and partner with Strategic Vision for Domini Social Investments. The research examines the benefits of fiduciaries' use of thought termed "reasonable" as opposed to "rational" in making investment decisions. Reasonable fiduciaries understand the implications of investments decisions in relation to others and the real world, while the rational fiduciary consider only the impact in relation to the financial performance of their portfolios. The paper finds that an increasing number of institutional fiduciaries are uncomfortable with a purely rational approach, and are incorporating the reasonably oriented universal-owner, sustainability, and international-norms approaches into decision-making. The paper argues that a combination of reason and rationality - consideration of others and the norms of society as well as of self-interested advantage - is necessary for a comprehensive undertaking of fiduciary practice.

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The academic award is for research entitled, *Asset Pricing and Ambiguity: Empirical Evidence*, co-authored by Professor Menachem Brenner and Dr. Yehuda Izhakian at New York University Stern School of Business. This research finds that stock prices are impacted by ambiguity, the unknown probabilities that generate risk. Ambiguity, known to academics as Knightian uncertainty, is distinct from risk, as that term is conventionally understood. The paper demonstrates that risk is positively correlated to the market equity risk premium while ambiguity tends to be negatively correlated. Thus, adding the ambiguity factor to asset pricing models has key implications for finance issues such as investment management, risk management and performance evaluation.

“The new IRRIC Institute Research Award encourages research that integrates investment theory and the real world,” said Jon Lukomnik, executive director of the Institute and award coordinator. “We are confident that the two winning papers serve as valuable tools for investors, policymakers, academia, and other stakeholders. In the coming weeks, we will announce details and dates for the 2013 competition,” said Lukomnik.

Reason, Rationality and Fiduciary Duty is a thoroughly researched, logical, and artful argument that modern portfolio theory posits the rational investor as the standard for economic action when in fact investors are reasonable,” said Jim Hawley, award judge and professor at St. Mary’s College of California and director of the Elfenworks Center for Fiduciary Capitalism. “Lydenberg finds that modern portfolio theory is disconnected from how investors actually behave in the real world of economic action, and that fiduciaries in fact are warned that anything other than a rational approach to investment is a breach of duty. Instead, the research indicates that a standard of reasonableness is needed as a modification to the core assumptions of modern portfolio theory, a finding that well may have a significant impact on the investment world,” Hawley added.

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Award recipient Steve Lydenberg said, "As a long-time practitioner of responsible investment, I have often sought a vocabulary to adequately express the theory that rests behind our daily practices." "*Reason, Rationality and Fiduciary Duty* enabled me to work through the distinction between a reasonable approach to investment and the narrower self-interested rationality of today's financial world. The result is research that provides a just and sustainable path for fiduciaries as they exercise their important duties of care and loyalty on behalf of their beneficiaries," he added.

"One of the thorniest problems practitioners face is how to understand and incorporate into the investment process what Keynes called irreducible uncertainty," said Bill Miller, award judge and Legg Mason Capital Management's chairman and chief investment officer. "*Asset Pricing and Ambiguity: Empirical Evidence* represents a significant advancement by formally deriving a measure of ambiguity - uncertainty over the probability space - and showing its impact on the equity risk premium. The research results are consistent with psychological theory and observed investor behavior, and should spur additional research in this critical area," Miller said.

"Modern Portfolio Theory assumes, unreasonably, that financial decision makers know precisely the probabilities of investment outcomes as if they are rolling a fair dice," said Menachem Brenner and Yehuda Izhakian, co-authors of *Asset Pricing and Ambiguity: Empirical Evidence*. "In reality, however, the probabilities of outcomes are not known, referred to as 'ambiguity'. In our study we incorporate this ambiguity into equity pricing theory. This research may have practical implications for financial decision making," they said.

The following panel of renowned judges reviewed the submissions and selected the two winning papers:

- **Mark Anson**, Managing Partner & Chief Investment Officer, Oak Hill Investment Management
- **Robert Arnott**, Chairman, Research Affiliates
- **Collette Chilton**, Chief Investment Officer, Williams College
- **James Hawley**, Professor & Director, Elfenworks Center for Fiduciary Capitalism, St. Mary's College
- **Bill Miller**, Chairman, Chief Investment Officer & Portfolio Manager, Legg Mason Capital Management

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Both papers are available at <http://www.irrcinstitute.org/projects.php> and on the Social Sciences Research Network at <http://www.ssrn.com/>.

Biographies of the judges are available here:

<http://www.irrcinstitute.org/award.php?page=judges>

About The IRRC Institute

The IRRC Institute is a not-for-profit organization that provides thought leadership at the intersection of corporate responsibility and the informational needs of investors. More information is available at www.irrcinstitute.org.

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