# Companies in states with weaker economies provide investing opportunity, study finds

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Companies located in more economically-troubled states provide a greater opportunity for investors than companies in other states according to new research by the University of Miami School of Business Administration. The study reveals that investors in states with high unemployment and a relatively depressed housing sector tend to sell more stocks during these tough economic times, and because people invest disproportionately in companies close to home, the stock prices of firms in those states suffer disproportionately.

The research, to be published in the June issue of the *Journal of Finance*, finds that these firms underperform for a few successive quarters, providing a buying opportunity.

In fact, the study shows that a portfolio of stocks of companies headquartered in depressed states have an average monthly annualized return that is around 3 percent higher than a benchmark portfolio with similar stocks.

Similarly, stocks of firms in booming states (i.e., those with low unemployment and a strong housing sector) underperform compared to similar stocks.

"This research makes it clear that investors are missing out if they simply view the United States as one big economy," said Alok Kumar , the Gabelli Asset Management Professor of Finance at the University of Miami School of Business Administration. "The U.S. economy is

actually a collection of 50 small economies connected like a web and investors should consider it as such," added Kumar, who conducted the study with George Korniotis , an assistant professor of finance at the School of Business.

The researchers studied the performance of firms in booming and depressed states between 1978 and 2009. Specifically, they constructed a trading portfolio as follows: at the end of each quarter, they ranked all U.S. states based on their economic activity to determine which states were expanding and which states were contracting. They then longed the stocks of companies in the three states with the worse economic outlook and shorted the stocks of companies in the three states with the best economic outlook. They kept the portfolios' composition constant over the quarter. Then, at the end of the quarter, they re-examined the economic performance of the states, determined which states were then the worst and best in terms of economic outlook and rebalanced the portfolio accordingly.

The researchers found that this trading portfolio with a holding period of a quarter earned 5 percent higher monthly annualized returns relative to a benchmark portfolio with similar stocks. This portfolio remained profitable when the holding period extended to 6 to 12 months.

"Advice for the average investor based on these findings would be to a) know that the location of a firm affects its performance; and then b) have your money manager diversify your portfolio geographically to guard against these vulnerabilities in your local economy," said Korniotis.

Provided by University of Miami

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