CMBS Market Efficiency: the Crisis and the Recovery

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Abstract

This paper presents a reduced form credit risk model to study CMBS pricing and CMBS market efficiency during and after the credit crisis with a comprehensive loan, bond and deal level data set. Using a model determined fair value, an automated trading strategy based on a newly determined risk ratio buys undervalued and sells overvalued CMBS. These strategies result in substantial trading profits between November 2007 and June 2015. Controlling for CMBS sector risk factors, we reject CMBS market efficiency over the entire sample period. When we split the sample into the Crisis and Recovery periods, we observe persistent abnormal returns over both subperiods, which is consistent with an inefficient CMBS market. Because the CMBS market appears to be inefficient, our results suggest that the approach presented in this paper may facilitate the increased financial stability of the CRE sector through the better pricing and risk management of CMBS.

Key Words: CMBS, CMBX, credit crisis, financial crisis of 2008, market efficiency, recovery

JEL Code: G12, G13

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