

1 Q. Reference: CA-NP-94

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3 Can Mr. Coyne answer the question, which was can he provide any empirical
4 research that utility betas revert to 1.0? Note the 1975 Blume study he references
5 includes all companies, where by definition the average beta is 1.0.
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7 A. Mr. Coyne believes that the findings of the 1971 and 1975 Blume studies he cites in the
8 response to Request for Information CA-NP-094 do apply specifically to low risk
9 companies such as utilities. The 1971 Blume study examined all common stocks listed
10 on the NYSE and found a tendency for a regression of betas towards 1.00, especially for
11 those stocks of companies with the lowest risk profiles, such as utilities. Blume
12 concluded that:

13
14 *“...there is obviously some tendency for the estimated values of the risk*
15 *parameter to change gradually over time. This tendency is most*
16 *pronounced in the lowest risk portfolios, for which the estimated risk in*
17 *the second period is invariably higher than that estimated in the first*
18 *period. There is some tendency for the high risk portfolios to have lower*
19 *estimated risk coefficients in the second period than in those estimated in*
20 *the first. Therefore, the estimated values of the risk coefficients in one*
21 *period are biased assessments of the future values, and furthermore the*
22 *values of the risk coefficients as measured by the estimates of β_i tend to*
23 *regress towards the means with this tendency stronger for the lower risk*
24 *portfolios than the higher risk portfolios.”¹ (emphasis added)*

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26 In 1975, Blume revisited the topic, measuring the statistical significance of the regression
27 tendency. He concluded:

28
29 *“A comparison of the portfolio betas in the grouping period, even after*
30 *adjusting for the order bias, to the corresponding betas in the immediately*
31 *subsequent period discloses a definite regression tendency. This*
32 *regression tendency is statistically significant at the five percent level for*
33 *each of the last three grouping periods, 1940-47, 1947-54, 1954-61. Thus,*
34 *this evidence strongly suggests that there is a substantial tendency for the*
35 *underlying values of beta to regress towards the mean over time.”²*
36 (emphasis added)

¹ Marshall E. Blume, *The Journal of Finance*, Vol. 26, No. 1. (Mar., 1971), page 7-8.

² Marshall E. Blume, *The Journal of Finance*, Vol. 30, No. 3. (Jun., 1975), page 794.