Realized Semi Betas in Currency markets and other asset classes

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**Abstract**

CAPM does not perform well in pricing the cross-sectional returns from the currency carry trade and factors such as volatility innovation (Menkhoff et all, 2011) or downside risk (Dobrynskaya, 2014) have been used to solve this problem.

In this paper, we argue that market return could be used as the solo factor to price the cross-sessional carry trade – however it needs to be decomposed into four semibetas that depend on the signed covariation between the market and individual asset returns.

We show that surprisingly, semibetas attributable to positive market and negative asset return covariation predict significantly higher future returns, while semibetas stemming from negative market and negative asset return covariation predict significantly lower future returns. The latter is consistent with the pricing implications from a mean-semivariance framework, and the former picks up the pricing power of market return in the situation of positive market and negative asset return covariation, which has been omitted by the “popular” downside risk literature.

**Keywords**: carry Trade; asset pricing; market return

**JEL Classification**: F3, G12, G15