

Discussion: Fear of Hazards in Commodity Futures Markets

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Summary

- Behavioral finance / investor psychology for commodities. Setting of Da et al. (2015) using Search Volume Index (SVI) of Google keywords
- The 149 keywords target commodities risk (weather, disease, geopolitics etc.)
- Additional premium induced by the fear of hazards in commodities

- Use Search Volume Index (SVI) of Google to build the CFEAR variable
- Out of sample predictive power of CFEAR sorted portfolios
- CFEAR factor captures priced commodity risk beyond these of traditional factors

Results - strengths

- First paper to relate the investor fear as proxied by SVI to premium in commodities (others are about price prediction, limited to a single commodity)
- Mean excess return of 8.23 % p.a., Sharpe ratio of 0.89, both higher than previous literature portfolios formed on basis, hedging pressure or momentum
- No previously documented factors subsume the effect
- Asset pricing tests, robustness tests and control for look ahead bias well executed
- Strategy robust to transaction costs

General comments

- Model assumes a hedging asymmetry in the futures markets with speculators not willing to take as many short as long positions. But this asymmetry that shows up well in the results is not formally tested (despite the strategy is not subsumed by skewness)
- The decomposition of futures risk premium in “normal” risk premium and “fear of hazards premium” is clear in the text but not detailed in the model
- Relation with the peso problem in finance - in this case is it only a peso problem or real risk priced? Hard to disentangle

- How are taken in account weeks with zero search queries?
- Display correlation information of the ΔS_j^* . Could another method using directly the whole information included perform differently e.g., PCR or PLS? (Gao and Suss, 2015)
- Report the distribution of the β^{CFEAR} for the full sample
- Sum of β that exceeds the 1.65 t-stat threshold in abs. value. Why not sum of all β (as in robustness test) or p-value weighted β ?
- Overall there might be a problem of aggregation and loss of information

Portfolio construction

- No need to scale to compute the sorting signal $\theta_{i,t}$ as the ordering is unchanged
- Use of weekly data because of rebalancing constraints. But nothing prevents to build the index at daily freq. and rebalance weekly (or more)
- Compute some β_-^{CFEAR} and β_+^{CFEAR} sums of the positive and the negative. Is the long-short portfolio computed with one or the other perform differently? or use a β^{CFEAR} in absolute value as placebo test

Asset pricing tests

- What motivates the decision to use a full-sample regression in the portfolio cases and FMB weekly regressions for the individual commodities?
- Why are the variables AggrVar and AvgVar (already stationary) further first-differentiated?
- Structure of the tests is clear, but why split the tests of inclusion of basis, momentum, AVG and HP with these of illiquidity, basis-momentum, volatility, VIX?

- Transaction costs of Marshall et al. (2012) used (8.6 bps on average) are not time and cross-sectionally varying. There might be more (or less?) costs involved in the strategy. Use alternative low frequency measures to compute TC see, (e.g. Marshall et al., 2012; Abdi and Ranaldo, 2017)
- Placebo tests filter the keywords of geopolitical and economic hazards. Use first the same sets of keywords to compare the results with equity indices, currencies and fixed income

Minor comments and suggestions

- Computation of basis: no normalization by the time gap between two maturities
- More info on the Google trends download process + on the Google trends way of recording and reporting the data
- "... producers may take shorter hedges and consumer longer hedges" i.e. smaller hedges and larger hedges resp.?
- Include Baidu's SVI? (Kou et al., 2017)
- Comparing coffee frosts to the "Peso problem" but frosts do occur
- Han et al (2017a) authors are different than Han et al (2017b)