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Factor or risk premium investing has been one of the most important developments in the asset management area in the past decade. It was once believed that the only source of risk premium in the securities market, or at least equity markets, was the market risk premium. That is, the only thing an investor had to do was to adjust her exposure to the broad market to achieve a desirable risk–return profile. With the advent of factor or risk premia investing that line of thinking is no longer accepted. Research has identified a large number of risk premia sources. However, compared to the market risk premium, these newly identified sources of risk premia are far less stable, which means dynamic allocations among them (i.e., factor timing) may pay off, even more so than market timing.

The first section of this issue has two excellent articles on risk premia, and they offer two contrasting views. In “Business Cycle–Related Timing of Alternative Risk Premia Strategies” by Scherer and Apel, the authors first argue that for a factor return to represent a risk premium, there must be time variation in the risk premium. If a factor provides a positive return regardless of business conditions, then it would be an arbitrage opportunity. Therefore, time variation in risk premia reflects time-varying economic rewards. By analyzing macroeconomic sensitivities of risk premia, the authors show that time-varying returns of certain alternative risk premia strategies are significantly related to economic conditions. An important practical implication of these findings is that based on the identified return patterns, one can construct a risk premia timing strategy that adds statistically significant marginal performance with low turnover.

In the second paper of this section, titled “Sources of Return Dispersion in Alternative Risk Premia” Kuenzi searches for sources of potential return dispersion across portfolios of risk premia strategies. The importance of this article’s findings is that an asset manager may experience vastly different returns from the source of risk premium depending on how the portfolio that is supposed to capture that risk premium has been constructed. Using simulated results, the article shows that returns of simulated portfolios can be quite different from one another as a result of altering just a few of these sources of risk premia return dispersion. The implication for asset managers is that not only exposure to the right factor is important but how that exposure is constructed could be equally if not more important.

The next section of this issue has two papers related to commodities and real assets. Since the financial crisis, there have been increased efforts

among academics, policymakers, and industry leaders to develop measures of economic uncertainty. One of the objectives is to provide policymakers and asset managers with early signals about whether economic uncertainty is on the rise or not. The uncertainty indices rely on market data such as price volatility of financial instruments and commodities and are constructed using various measures of realized and expected volatility. In the article titled “Can Commodity Price Uncertainty Indexes Be Improved by Capturing Media Information? *The Case of Oil Price Uncertainty*,” Bonaparte, Fabozzi, and Koslowsky present an improved commodity price uncertainty index, an oil price uncertainty index which includes information from news articles and social media. The article shows the superior performance of the new index compared to existing indexes that do not include news and social media information. They also create an oil price volatility forecasting model based on media coverage and use it to trade an oil volatility portfolio, obtaining a return that exceeds the average monthly growth of oil price volatility. The authors report that the index displays predictive power regarding the future behavior of oil markets.

From general commodities we move to a very specific commodity that does not have an active futures market—wine. In “Diversification Benefit of Actual Investing in Fine Wine,” Nahmer examines whether wine can be considered an alternative asset class by focusing on the cost of allocating to this asset class. As the author mentions, the results are sobering. Even if one ignores the high cost of investing in wines, the inclusion of a wine index in the typical portfolio does not result in any meaningful improvement in the risk-return profile of the portfolio. Once such costs are considered, wine as a viable alternative asset class loses much of its appeal.

The articles appearing in the third section of this issue cover hedge fund strategies and performance evaluation. In “Rethinking Capital Structure Arbitrage: *A Price Discovery Perspective*,” Avino and Lazar tackle a particular capital structure arbitrage strategy, where traders attempt to exploit the discrepancies between the credit default swap and equity markets. Given the estimated lead-lag relationship between credit and equity markets, the authors build on the price discovery literature and develop a time series of information share indicators.

They introduce three new alternative strategies that exploit the information provided by the time-varying price discovery of the equity and credit markets and the cointegration of the two markets. They implement the strategies for both US and European obligors and find that these strategies outperform traditional arbitrage trading strategies during the financial crisis. Furthermore, the returns of the new strategies have a lower correlation with market returns than the standard capital structure arbitrage, offering diversification benefits.

In the second article of this section, Yang and Kazemi attempt to use the information content of hedge funds’ holdings to identify the source of hedge managers’ skill and potentially provide a mechanism through which investors can improve the performance of their own equity long-short strategies. In the article titled “Holdings Concentration and Hedge Fund Investment Strategies,” the authors examine the risk-return performance of concentrated positions of hedge funds in large-cap and small-cap stocks. The results indicate that hedge fund managers use their security selection skills to create concentrated portfolios, especially in small-cap stocks. The article’s findings have two practical implications: (a) hedge funds that hold concentrated positions in small-cap stocks may outperform their peers and (b) investors may be able to improve the performance of their equity portfolios by monitoring hedge funds’ positions in small-cap stocks.

In “Performance Dispersion Risk Assessment in Alternatives and Active Strategies,” Soni argues that lack of a holistic investment framework to incorporate alternatives in a traditional portfolio poses a challenge for investors. One problem is that traditional risk-return-based approaches, when used alone, over-allocate to alternatives. This over-allocation is a result of underestimation of risks resulting from a) significant manager dispersion and b) smoothness in the pooled return indices utilized for alternatives. In particular, managers’ return dispersion is a serious risk when one notices that the difference between the top and bottom quartile for hedge funds could exceed 30% per year over 10 years. To account for this risk, the author provides a practical solution. The article describes a methodology that allows asset allocators to incorporate manager dispersion risk into their portfolio construction processes.

Perhaps the most important financial innovation of the last 20 years has been the development of exchange-traded funds (ETFs). The pace of innovation in this space has accelerated in recent years and the creation of Hedge Fund ETFs (HETFs) is one such result. HETFs allow retail or long-only institutional investors an opportunity to invest in various hedge fund strategies but with the advantages that ETFs offer, such as instant liquidity and transparency. In “The (Under) Performance of Hedge Fund ETFs,” Favreau, Kane, and Shelton investigate the performance of HETFs and find that they broadly underperform hedge fund benchmarks and exhibit subpar risk-adjusted returns. Their results highlight that investors should pay attention to HETFs manager experience when considering these instruments as they appear to have a meaningful impact on their performance on the performance of the HETFs.

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