Discussion of

"A Market-Based Funding Liquidity Measure"

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In a nutshell

Funding liquidity

- How much can I borrow against my assets?
  - Depends on asset and time
- Data not easily available $\rightarrow$ create proxies

Three papers for the price of one

1. A novel way to **measure** funding liquidity
2. Estimate the **price** of funding liquidity
3. Study the **impact on hedge fund returns**.
   Can managers time funding liquidity risk?

Main contribution:

- Construct a *tradable* proxy for funding liquidity

The FLS factor (Funding Liquidity Shocks)

Interesting + relevant problem

- FL as important source of risk in addition to trading liquidity
- May explain away even more HF alpha
- May help to distinguish skill vs. luck in HF returns

5 proxies for "marginability"

- **Size**, Ideosyncratic volatility, Amihud liquidity, Institutional holdings, Analyst Coverage

First analysis

- For each proxy, form 5 groups
- Inside each group, form a BAB (=betting against beta) portfolio
- $5-1$ returns large and significant

The FLS factor (2)

Step 1: extract shocks X from $5-1$ portfolios

$$X_{t,i} = r(PF_5^{\text{proxy}_i})_{t,t-1} - r(PF_1^{\text{proxy}_i})_{t,t-1}$$

$\text{proxy}_i = \{\text{Size, id.vol, amihud, inst.hold, analyst}\}$

Step 2: obtain FLS

- FLS = first principal component of X

Verify properties of FLS

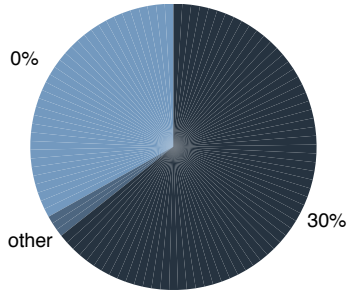
- Correlated to most other funding liquidity proxies ($0.2 \sim 0.5$)
- But also correlated to market liquidity proxies (~ 0.2)
- Not spanned by existing risk factors
- Explanatory power over and above existing risk factors

Is FLS a good proxy?

Several layers of abstraction

Interactive Brokers Data

- Only describes "marginability", no variation in size of margin



Size is main contributor in probit

	(1)	(2)	(3)	(4)	(5)	(6)
Size	2.87***					3.12***
	(0.10)					(0.13)
Idiovol		-1.88***				-1.34***
		(0.11)				(0.13)
Amihud			-0.21***			-0.01
			(0.02)			(0.01)
IO ratio				2.03***		0.25***
				(0.07)		(0.07)
Analyst					0.14***	-0.07***
					(0.01)	(0.01)
Constant	-1.11***	0.92***	0.49***	-0.63***	-0.22***	-0.72***
	(0.04)	(0.03)	(0.02)	(0.04)	(0.03)	(0.06)
Pseudo R^2	0.53	0.10	0.05	0.17	0.20	0.57

- Interpretation of institutional ownership?

Comments

Hedge Fund Data is dirty

- Backfilling, corrections, data errors, overlaps
- Need a lot of econometrics and data science, e.g.:
  Changes you can deal with? Robust HF exposure and alpha
  Camponovo/Popescu/Trojani (wp 2015)

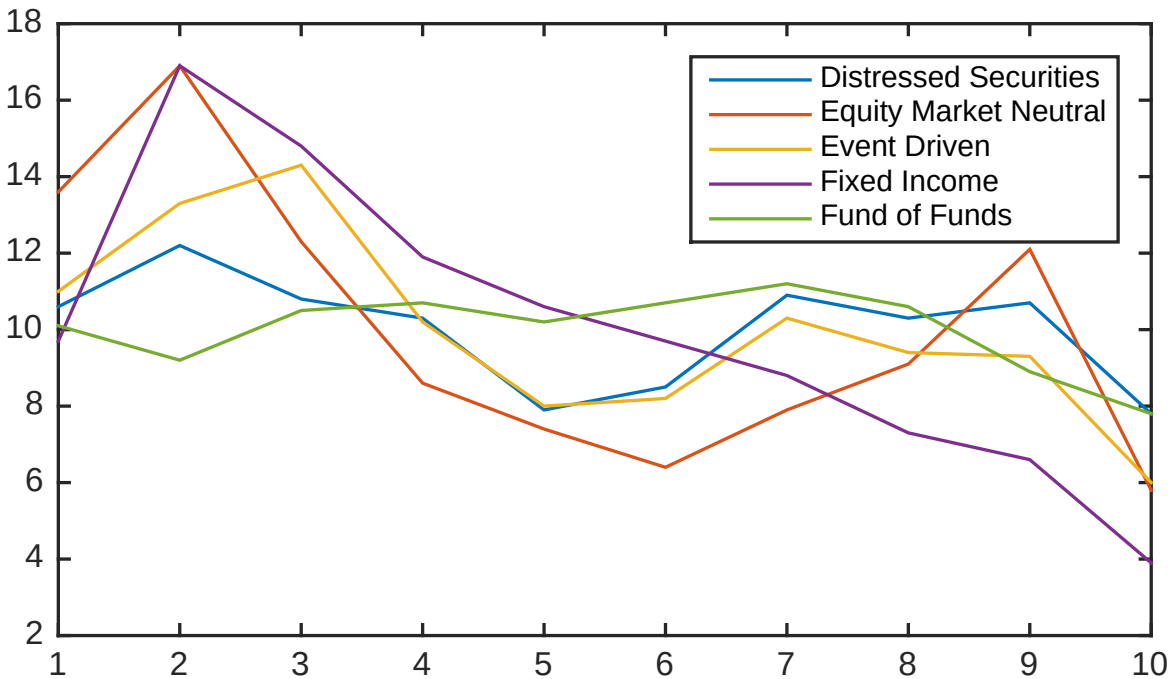
Correlation risk is an important factor

- When there is no place to hide: Correlation risk and the cross-section of hedge fund returns
  Buraschi/Kosovski/Trojani (wp 2013)

Comments (1)

Three Interesting patterns

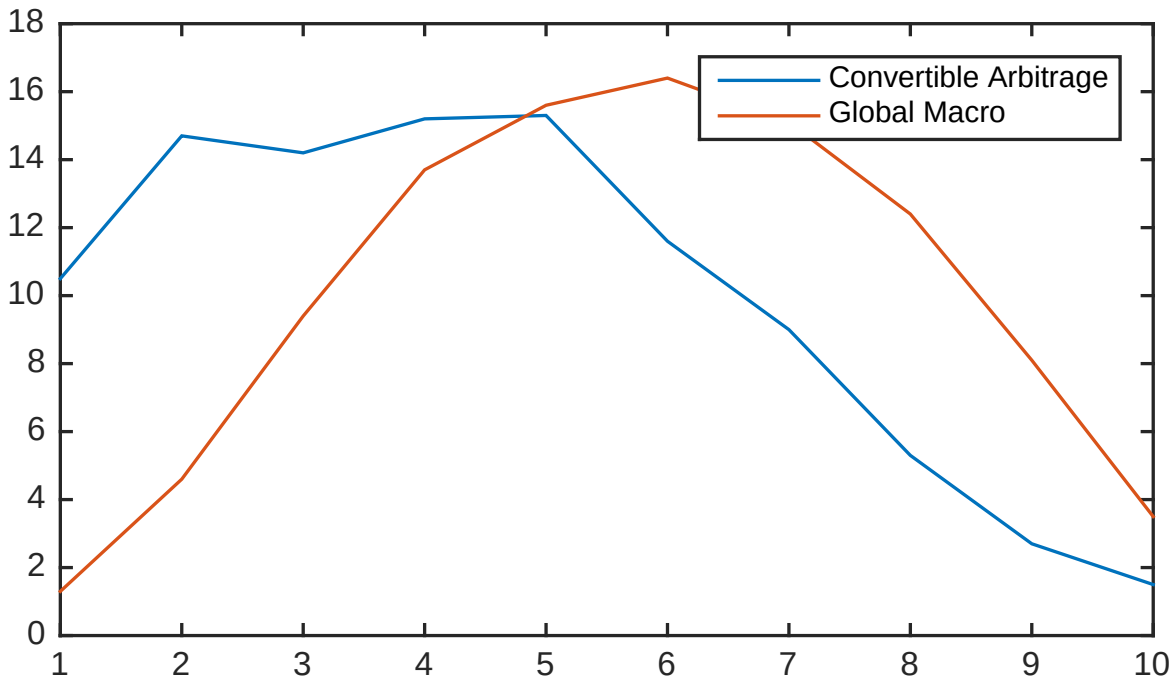
- In which portfolios do certain strategies show up?
  Assumption: linear relationship



Comments (1)

Three Interesting patterns

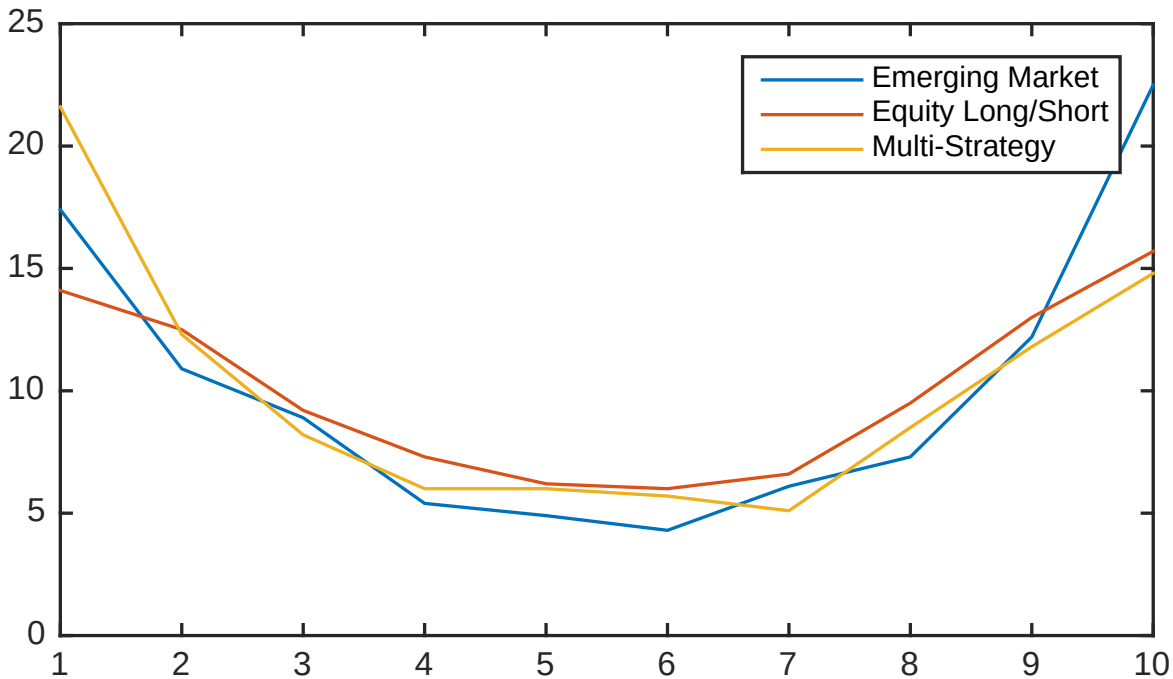
- In which portfolios do certain strategies show up?
  Difficult to understand: inverse U-shape



Comments (1)

Three Interesting patterns

- In which portfolios do certain strategies show up?
  Even more difficult to understand: U-shape



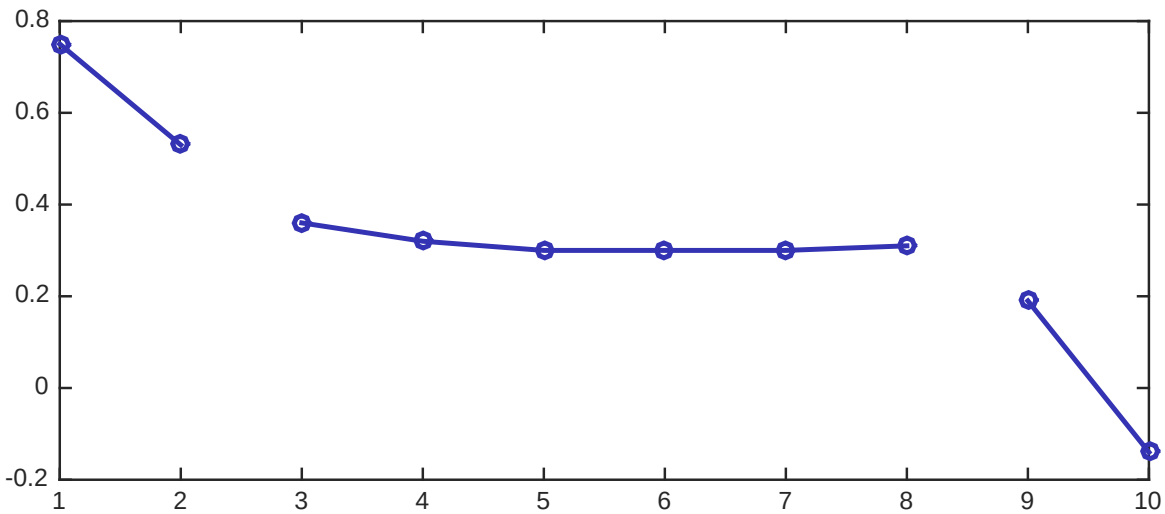
Comments (2)

Hedge fund performance

- By how much is hedge fund "alpha reduced?

Only extreme portfolios concerned

- Big difference in $10 - 1$
- Flat loading in $8 - 3$ (i.e. 60% of funds)



Conclusion

Small points

- Very long. Focus?
- Notation (e.g. R_i)
- Some details on the procedure (i.e. HF data not in the data appendix)

A mature paper