

Discussion of “Short-Term Momentum and Long-Term Reversal in General Equilibrium” by Pablo Beker

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Overview

- The paper focuses on explaining, qualitatively and quantitatively, the time-series momentum and reversal, via (versions of) Lucas (1978) and Alvarez and Jermann (2000) models
- As any theory piece, it consists of a) assumptions, b) solution methodology, and c) results. In this discussion, I will focus on a) and c) (for me, b) is magic)
- Key ingredients for quantitatively matching the momentum and reversal: borrowing constraints, belief heterogeneity, pessimism
- Other model features: infinite horizon, complete market, exchange economy with infinitely-lived agents
- Overall assessment: what I like most is that this is an interesting, ambitious paper, in terms of methodology and goals

Main Comments

- Given infinite horizon and the presence of irrational agents, two natural questions are why they survive and why they have price impact. The paper states that wealth and consumption of each agent are non-degenerate, but...
- We know from Kogan et al. (2006) that:
 - absolute and relative survival are different things
 - survival and price impact are different things
- Kogan et al. mentions that constraints could play an important role for survival/price impact, so the paper seems like a nice setting to explore this

Main Comments

- Related to the previous slide—the issue of market completeness
- Heterogeneous beliefs is one of the key ingredients for explaining momentum and reversal \Rightarrow Both agent types should survive to avoid the homogeneous case
- Several papers demonstrate that market completeness is an important factor for survival
- How important is market completeness in this setting, for survival and/or for the ability to explain the empirical regularities of interest?
- Keyword in the abstract: “Endogeneously incomplete markets.” I couldn’t find in the paper the associated discussion

Main Comments

- Some not directly observed parameters can be either calibrated from the data, or treated as flexible and then chosen to best match the data
- The paper treats pessimism as flexible. How justified is this?
- Recently, it is becoming standard that pessimism cannot be freely chosen, but needs to be backed out from the data. There are indices for pessimism (or, more generally, for “investor sentiment”)— see, e.g., Baker and Wurgler (2007)
- In this paper (as in Cecchetti (2000)), assume pessimism about the persistency of expansion. What do pessimism indices tell us about this assumption? Also, from Moskowitz et al. (2012): “we fail to find a link between time series momentum and measures of investor sentiment”

Other Comments

- Authors mention three key ingredients: pessimism, belief heterogeneity, and limited enforceability. But the presented model has other ingredients I would call non-standard, like stochastic time-discount factor ρ . (The paper calls it SDF—is it really the “pricing kernel”?) Maybe, the readability would be improved if the baseline model has only those features that are really crucial.
- What is the time step here? Would be interesting to see more detail an analysis of various time intervals looking in the past and in the future. E.g., Moskowitz et al. (2012) looks at patterns such as using past 12 months returns to predict the *one-month* ahead return.