

# A Sentiment-based Explanation of the Forward Premium Puzzle: discussion

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- This paper
  - provide theoretical framework to explain  $\beta \ll 1$ ;
  - provide empirical evidence to support this theory.

# Roadmap

- 1 Main idea with log-preferences.
- 2 Sentiment vs Long-Run Risks?
- 3 Alternative interpretation of the model.
- 4 Empirical evidence: Should we worry about sentiment spread?

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**Ex ante** UIP regression slope equals 1

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**Can sentiment act as the long-run risk?**

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Annual persistence = 0.737  $\Rightarrow$  Monthly persistence  $\approx 0.975$ .

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- Omitted variables literature: the answer depends on
  - 1  $\text{corr}(s_t, s_t^*)$
  - 2  $\sigma(s_t^*)/\sigma(s_t)$

# Results: $t - stat(\tilde{\beta})$

		$\sigma(s_t^*)/\sigma(s_t)$					
		1.00	1.20	1.40	1.60	1.80	2.00
$corr(s_t, s_t^*)$	0.50	-37.96	-27.43	-18.35	-10.50	-6.16	2.03
	0.60	-32.64	-21.45	-10.25	-1.41	5.21	11.13
	0.70	-26.12	-9.92	-1.16	7.68	16.70	23.03
	0.80	-16.90	-1.92	9.56	18.81	28.26	40.61
	0.90	-8.85	7.17	22.89	37.79	47.83	60.36
	1.00	-0.12	19.80	40.64	58.90	79.97	96.40

## Suggestions

- What matters is the volatility of the extent to which sentiment predicts consumption!
- This could be an issue: why keep us wondering about it?
- Use international sentiment data in Baker, Wurgler, and Yuan (2009) to test the actual prediction of the model!

**The data are available: just do it!**

## Concluding remarks

- A very nice paper!
- Be more ambitious: the paper doesn't have to be about sentiment!
- Empirical evidence should focus on the cross-country spread of predictable components!