BORDEAUX WINE AS AN INVESTMENT HEDGE

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This research examines the returns and risks associated with wine as an alternative investment vehicle. Sanning, Shaffer, and Sharratt (2008) demonstrate that investment grade wines benefit from low exposure to market risk factors, thus offering a valuable dimension of portfolio diversification. Using monthly data gathered from repeat wine transactions, we analyze the level and quality of Bordeaux wine returns using the Fama-French Three-Factor Model and the Capital Asset Pricing Model. The results from these empirical models suggest that wines in our sample exhibit large, positive excess returns along with low exposure to commonly recognized market risk factors. However, other risk factors are priced beyond those used in the CAPM and Fama French factors.

Fung and Hsieh (1997a) document that hedge funds provide non-linear returns that have low exposure to traditional sources of market risk, including risk factors in the linear CAPM and Fama French models. These models do not capture the non-linear returns typically seen in hedge funds. Thus using them to measure the risk of hedge funds would produce low correlation with the linear factors. This would suggest that hedge funds possess little or no systematic risk, which is not true. This could provide an alternative explanation to the Sanning, Shaffer, and Sharratt (2008) results which suggest that wines have low risk and positive excess returns.

This research uses seven risk factors to analyze the level and quality of wine returns and assesses the extent to which wine actually serves as a hedge for a portfolio constructed of standard assets. Following the methodologies of Fung and Hsieh (2001) and Fung and Hsieh (2004) we use three ‘trend-following’ risk factors: bond, currency, and a commodity factor. In addition to the trend-following factors, two equity factors are
used, including a market factor and a size factor, similar to those used in the Fama French model. Two bond factors are used: bond-maturity factor and credit spread. Finally, an emerging market factor is used. These risk factors help identify and reveal the sources of risk present in wine returns and may help explain the excess returns documented previously.

Hedge fund investors are typically wealthy individuals or institutional investors (Fung and Hsieh, 2001). One might suspect that wealthy individuals buy and hold investment grade wines. If wines exhibit low correlations with market factors (as documented previously) and also show low correlation with hedge fund factors, then wine may provide one additional source of diversification for individual investors. If wines exhibit low correlation with market factors and high correlations with hedge factors, wines may be a superior investment with hedge like features, assuming that large positive returns persist. This paper will answer these questions and add to the extant literature about the wine returns and the risk associated with investment grade wines.
References:


