



Fig. 1. Optimal Search Strategies. Panels A and B show the optimal search strategies for a buyer and seller, respectively, of the spot. Variables: c is the nominal search cost per unit time; \pm is the subjective drift rate of the futures price per unit time; one search is conducted per unit time; and D is the cost of making or taking delivery in the futures contract. Customers conduct a search across dealers, employing an optimal stopping rule that equates the expected gain from searching one more dealer to the cost of search. Customers minimize the expected cost of acquisition or maximize the expected revenue from the sale of the commodity, including the search costs; for two strategies with equal costs, they choose the strategy with the lower variance. In Panel A, the buyer views a positive drift in the level of prices as undesirable, and in Panel B, the seller views a negative drift in the level of price as undesirable: in both these cases the customer will hedge in the futures market before beginning the search. When the drift in prices is favorable (negative for the buyer in Panel A, and positive for the seller in Panel B), the customer will search for the best price without hedging. When the customer takes the price level to have no drift ($\pm = 0$), search with hedging is optimal because it lowers the variance of the outcome (total revenue to the seller or the total cost to the buyer), even though the expected outcome is the same if unhedged search is conducted. If the cost of search c increases, it may become optimal to forego search completely and buy or sell futures and take or make delivery at cost D ; the critical cost points K^a and K^b are found by comparing costs of optimally searching versus forward trading. If the drift rate becomes extremely favorable, the net effective cost of search ($c + \pm$ for the buyer, $c - \pm$ for the seller) may become negative, and the optimal strategy calls for waiting until it becomes nonnegative; in this case the optimal stopping rule is unde...ned.