Rational Inattention, Misallocation, and Asset Prices

Naveen Gondhi
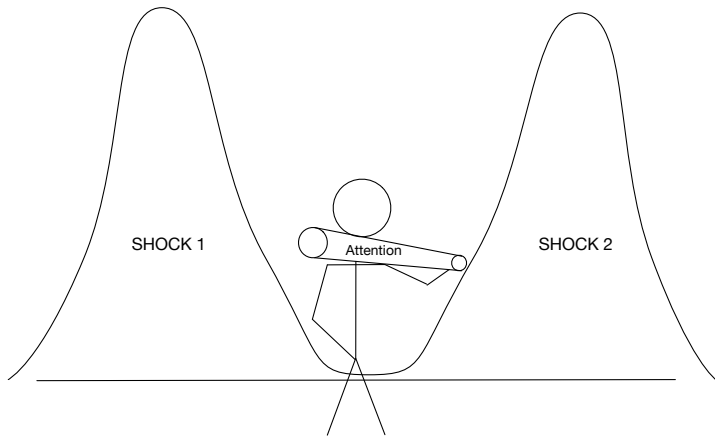
Discussion by Savitar Sundaresan
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June 3, 2018
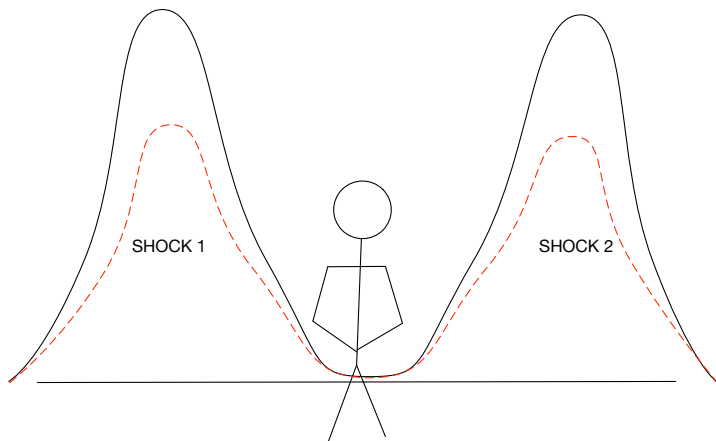
Motivation

- What drives sectoral comovement and investment decisions?

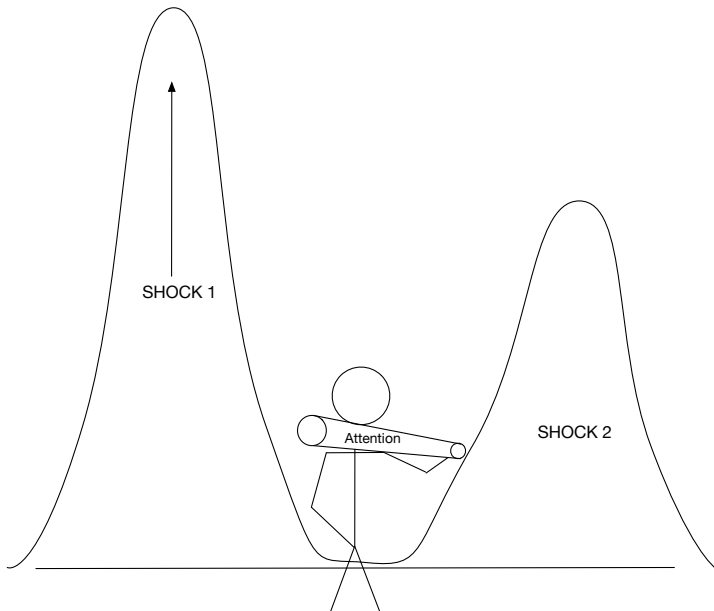- Can intuitive results come from using rational inattention?
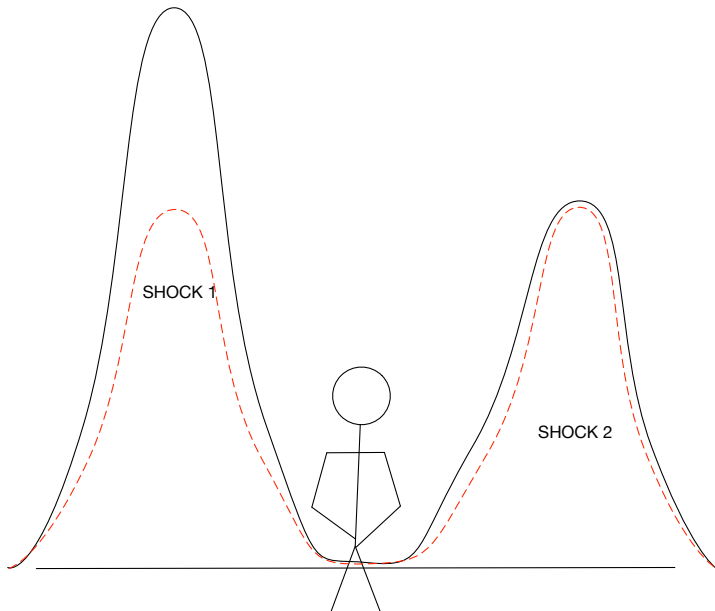
Modeling - Attentional Whack-A-Mole

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Contribution

- This has been used (fruitfully) before!

    - Mondria and Quintana-Domeque (2012) - Contagion

    - Kaceperczyk, Nosal and Stevens (2016) - Financial Investing

- So what's new?

Contribution

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- So what's new? One variable is aggregate; one idiosyncratic.

    - More attention to aggregate increases comovement, decreases dispersion.

    - More attention to idiosyncratic decreases comovement, increases dispersion.

   - Welfare implications due to real effects.

Stuff I Like

- Cool application to aggregate vs idiosyncratic tradeoff.

- Intuitive ties to comovement and dispersion results.

Comment 1 - What's up with η?

- What does it represent?
    - Noise shock?
    - Confidence Shock?
    - Commonality in Information?
- Exogenous wedge slows aggregate learning.
- Crucial for beta results, as well as relative comovements.
- Public information model? More costly aggregate info?

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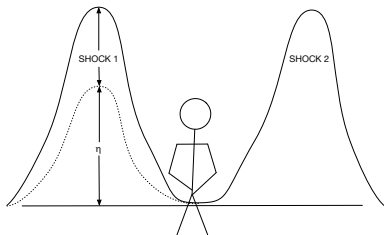
Comment 2 - What is a recession? Cyclicality?

- Assumption: Recessions have high aggregate uncertainty.

- Result: Aggregate uncertainty is countercyclical.

- Aggregate shock's variance spikes
  $\Rightarrow$ agents turn attention towards aggregate shock
  $\Rightarrow$ aggregate uncertainty declines.

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  But by how much?

- If it declines unconditionally, then aggregate uncertainty (net) decreases, so comovement (net) increases.

- If it declines conditionally, then aggregate uncertainty (net) increases, so comovement (net) decreases.

Comment 3 - Marginal Cost

- Keeping capacity fixed alters *relative* effects of shock variance.

- Under marginal cost, Theorem 5 says results are the same.

- But this implies the *absolute* effects are the same!

- Very surprising result - needs a lot more discussion.

Comment 4 - How do you think about firms vs sectors?

- In the model, agents are firms.

- Empirically, agents are sectors.

- Empirical tie is tenuous: signal acquisition is entropy reduction.

- Plausible for firms, less so for sectors.

Comment 5 - How necessary is the idiosyncratic shock?

- Comovement results come only from aggregate shock.

- Isolate the idiosyncratic to show importance.

- Characterize reaction to idiosyncratic shock if aggregate is fixed.

Conclusion

- Interesting and intuitive modeling implementation.

- Connection to real sector with aggregate/idiosyncratic split works.