

Institutional Investors and Information Acquisition

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Outline x 3

- Overview of Paper's Mechanisms
- Comment 1
- Comment 2
- Comment 3
- Suggestions for Extensions

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- ~~Comment 1~~ This paper's
- ~~Comment 2~~ going to
- ~~Comment 3~~ the RFS!!
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Case 1: Mean-Variance (Compensation)

Continuum of investors, compensated relative to a benchmark:

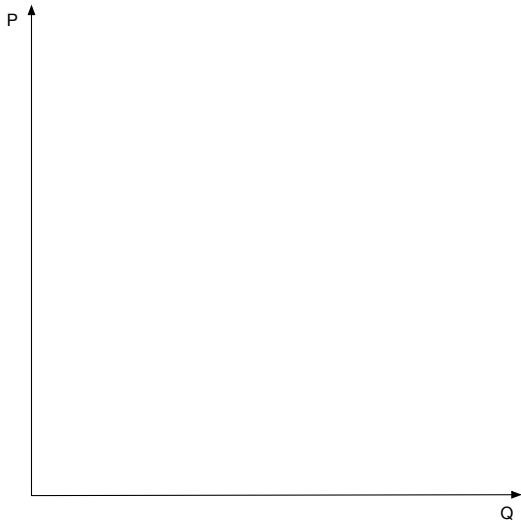
$$C_i = \underbrace{W_i}_{\text{Terminal Wealth}} - \underbrace{\gamma_i W_0 R_B}_{\text{Benchmark Performance}} - \underbrace{\chi_i}_{\text{Information Expenditure}}$$

Case 1: Mean-Variance (Demand)

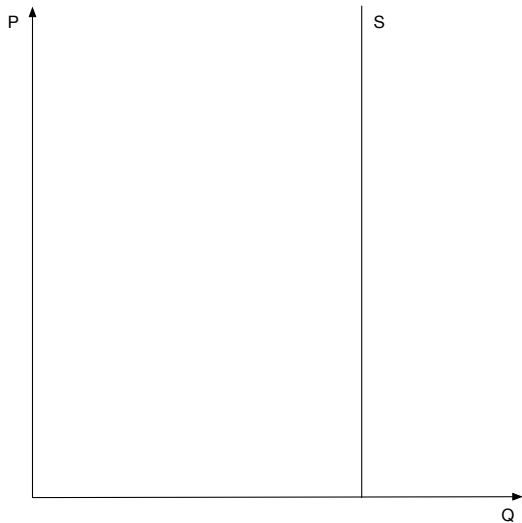
Demand can be decomposed into two parts:

$$\text{Demand}_i = \underbrace{\frac{\hat{\mu}_i - PR_f}{\rho \hat{\sigma}_i^2}}_{\text{Speculative}} + \underbrace{\gamma_i}_{\text{Hedging}}$$

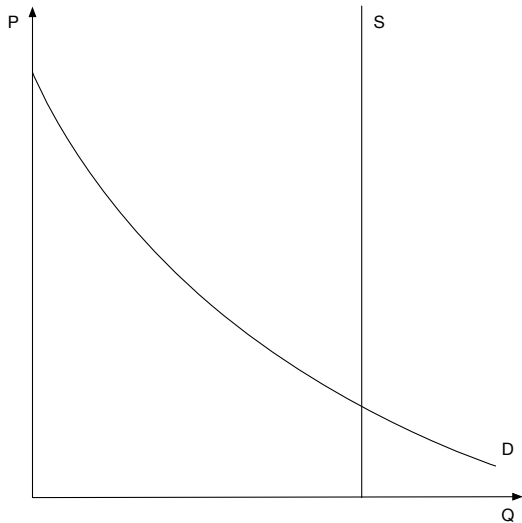
Case 1: Mean-Variance (Equilibrium)



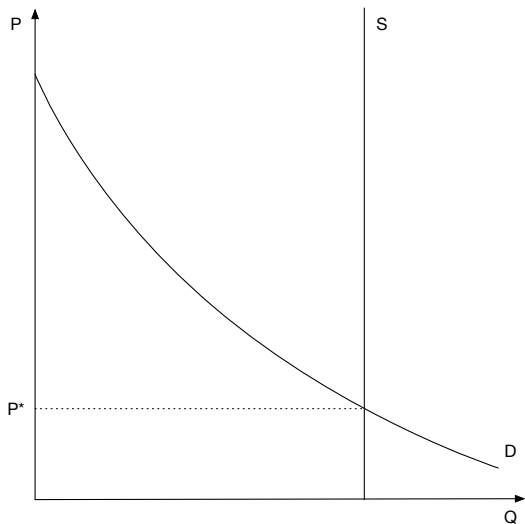
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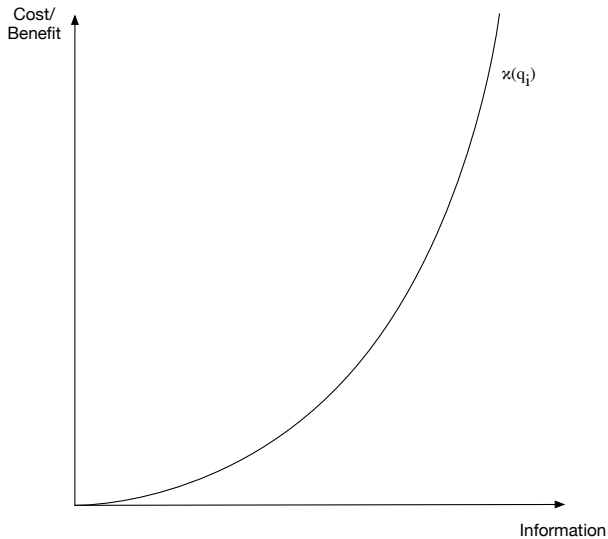
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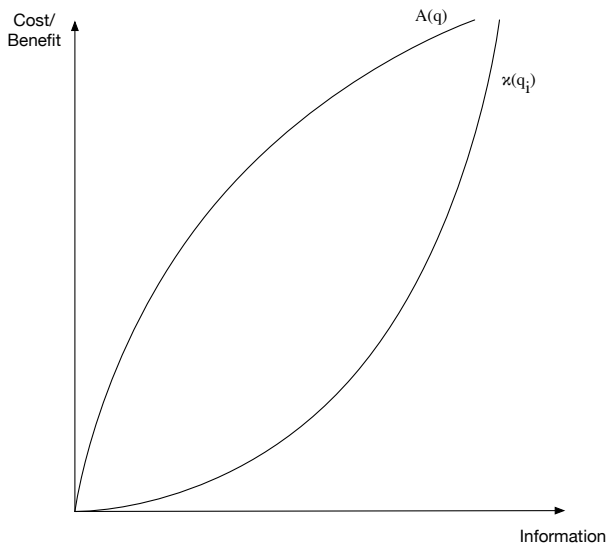
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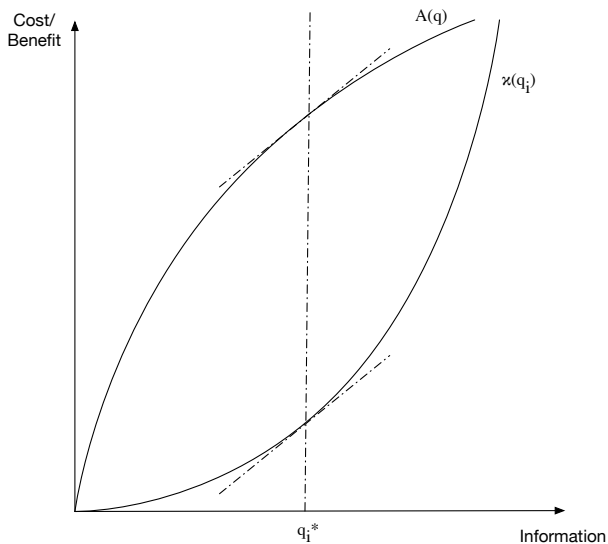
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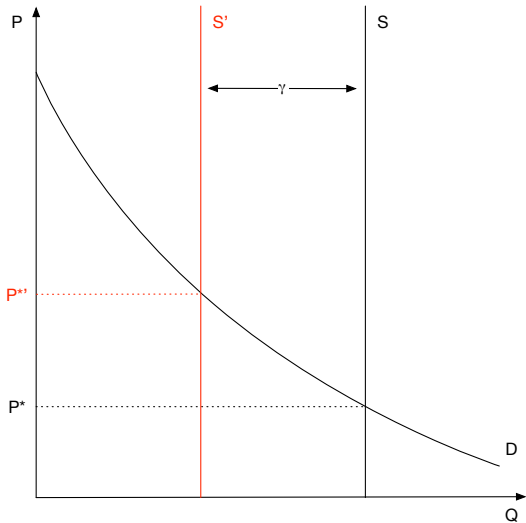
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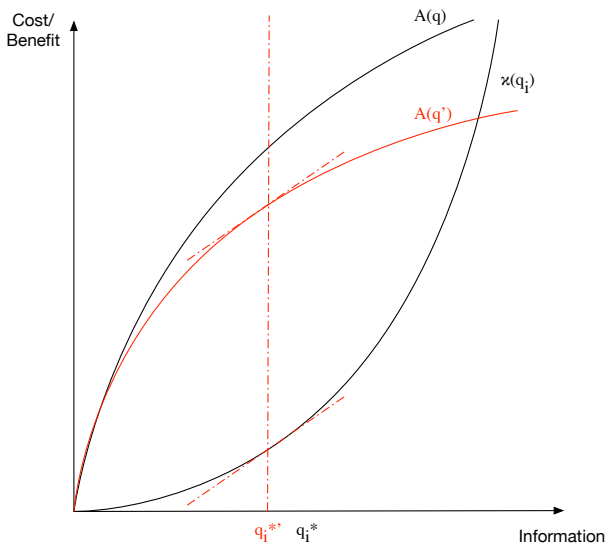
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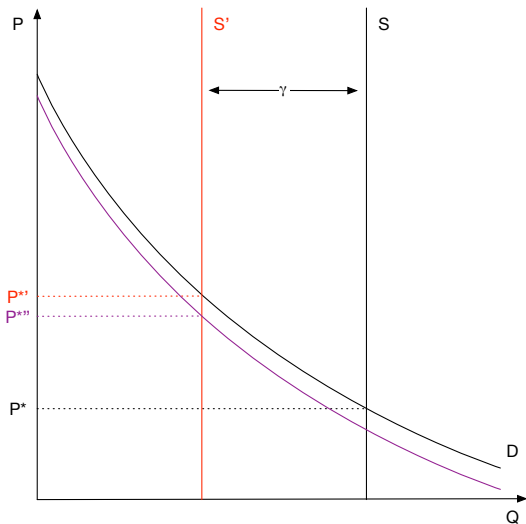
Case 1: Mean-Variance (Increase Benchmarking)



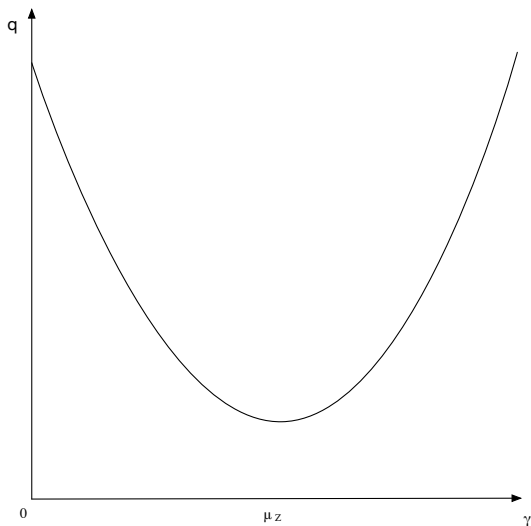
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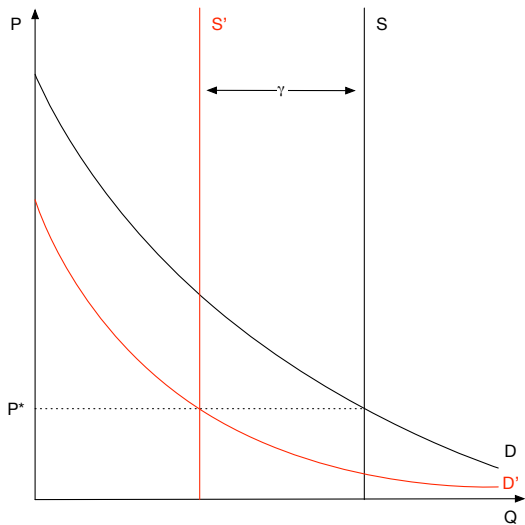
Case 1: Mean-Variance (Increase Benchmarking)



Basic Mechanism (with Mean Variance)



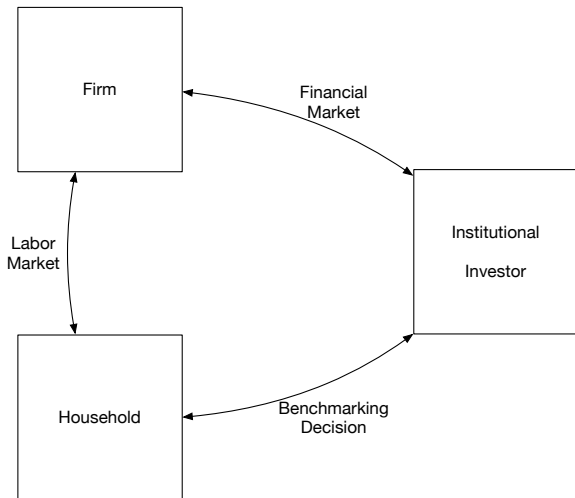
Basic Mechanism (with CRRA)



Lots of possible next steps

- Multiple Assets
- Asymmetric Compensation
- Endogenous Benchmarking
- Market Power of Institutions
- Alternative Information
- Dynamic Setting

Endogenous Benchmarking



Endogenous Benchmarking

- Continuum of households, firms, and investors.
- If households are optimistic about their firm:
 - Higher expected wage
 - More willing to gamble with savings
 - Lower demand for benchmark
- If households are pessimistic about their firm:
 - Lower expected wage
 - Less willing to gamble with savings
 - Higher demand for benchmark
- Households *don't internalize that optimism is shared.*

Endogenous Benchmarking

- Optimism \Rightarrow Low Benchmarking \Rightarrow Low Volatility.
- Pessimism \Rightarrow High Benchmarking \Rightarrow High Volatility.

Dynamic Endogenous Benchmarking

In a Mean-Variance framework - could it be dynamic?

Optimism \Rightarrow Low Benchmarking \Rightarrow Low Volatility \Rightarrow Low Prices

\Rightarrow Pessimism \Rightarrow High Benchmarking \Rightarrow High Volatility \Rightarrow High Prices

\Rightarrow Optimism!