Discussion of "Portfolio Inertia and the Equity Premium" by Christopher Gust and David Lopez-Salido

Alex Michaelides
Central Bank of Cyprus and London School of Economics

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Goal and results

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- (Not emphasized in paper but could be emphasized: can a model without habits, long run risk or various frictions generate sizeable risk premia?)
- Key result: portfolio inertia arising from heterogeneous fixed cost makes marginal investor the one that adjusts and can generate countercyclical and sizeable risk premia in response to shocks (both monetary and real)

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- Volatility of returns will be volatility of productivity plus volatility of price of capital (equation (6))

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- SDF determined by (22)

$$m(s^{t+1}) = \beta \frac{U'[c_A(s^{t+1})]}{U'[c_A(s^t)]}$$

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- No risk free rate puzzle either because one does not rely on high risk aversion to explain equity premium (although not clear whether growth exists in the economy)

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- Positive Technology shock means c_A adjusts a lot more because not bound by cash in advance constraint as c_I.. Higher consumption vol of adjusters who follow PIH logic
- Increase in monetary growth means lower c_I due to cash in advance, and that means comparison utilities imply a higher fraction of rebalancers, decreasing consumption vol of rebalancers and generating a lower equity premium (if everyone rebalances back to RA model)

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- Reference to Parker - Vissing Jorgensen (2009) slightly misleading because they compute different statistics

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Malloy, Moskowitz and Vissing-Jorgensen (JoF, 2009) find such response for 16 quarters needing long run risk. Table 1 (reproduced below) in that paper regresses consumption for different groups at horizon S on aggregate consumption:

S=	1	4	8	16
Stockholder	0.68	1.21	1.57	2.12
Top Stockholder	0.70	1.56	2.14	2.88
Non-Stockholder	0.51	0.59	0.84	0.96

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- What matters is not the number of households bearing the risk but their value-weighted contribution in terms of holding capital

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- Here endogenous because size of adjustment is chosen but γ is exogenous. In particular, due to cash in advance constraint, difference in money holdings (which determines consumption) determines participation. So in my mind closer to the exogenous stock market participation literature (a rich household might not adjust if it holds low money balances)

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- What if the rebalancers are wealth weighted (eg the really rich adjust)? Would the results continue to hold?

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- Are all households eventually stockholders at some point in the model?

Small Comments

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- Today's paper with Lochstoer and Kaltenbrunner (2010)

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