



Finance Speaker Series

Alberta School of Business
Department of Finance

Presents:

Byungwook Kim
Ohio State University

Topic:

Correlated Demand Shocks and Asset Pricing

Wednesday, September 21, 2022
3:30pm – 5:00pm

Location: BUS 4-06

ABSTRACT

This paper proposes a mechanism through which institutional investors' correlated demand shocks provide a source of risk in asset pricing. Institutional investors have a mandate to beat a similar market index (e.g., S&P 500). Consequently, when the market index performs well, they have a higher incentive to perform better to catch up with the market performance. I show that this incentive induces procyclical risk-taking behavior for institutional investors, generating correlated demand that causes stocks to excessively comove with the market. I develop and estimate a model and show that stocks with higher exposure to these correlated demand shocks have higher market betas and risk premia due to their amplified market risk. This endogenous risk commands an 8.52% annual return premium in decile portfolios, which is fully explained by the differences in market betas across the portfolios. Quasi-experiments using exogenous changes in index membership provide causal evidence of the mechanism.