Discussion by Xiao Qiao

Paraconic Technologies US Inc.¹

¹The views expressed are those of the discussant and do not necessarily reflect official positions of Paraconic Technologies US Inc.
Paper Summary

Idea

- Investors “reach for income”: demand high D/P stocks in low interest rate environments

Evidence

- Retail brokerage: 1% decrease in Fed Funds rate (FFR) → 1% increase in high D/P stock holdings for next six months
- Mutual funds: 1% decrease in FFR → 5.18% increase in AUM for high-income mutual funds for three years

Theory/Explanation

- Asset pricing model with hyperbolic discounting as microfoundation
Contributions

- In addition to the areas mentioned in the paper...
- Add to the discussion of monetary policy effects on portfolio choice and asset prices
  - More broadly, Bernanke and Kuttner (2005), etc.
- Barber and Odean (2000) data to study monetary policy
Investors Need Commitment Devices

- Friedman (1953): Forget realistic assumptions, just make good predictions
  - This paper has a very realistic assumption
- Market participants appear to exhibit hyperbolic preference

\[
\max_{\{C_t, \theta_t\}_{t=1}^{T-1}} u(C_t) + \mathbb{E}_t \sum_{\tau=t}^{T} \beta^{\tau+1-t} u(C_{\tau+1})
\]

- Hedge funds often have lock up periods
  - Investors may overreact to small changes in portfolios compared to their overall goals
  - Interventions are empirically suboptimal
  - Need commitment device to realize volatile risk premiums
What About Value?

- High dividend yield stocks have high returns: value effect
- Attribute high D/P returns to different channels

Maybe also interaction → monetary policy affects value stocks?
- Neuhierl and Weber (2018): FOMC does not affect FF value
- Dividend yield is a fundamentally different measure from other price ratios?
  - Investor can eat dividends
  - What happens to high BE/ME, low D/P stock?
$\frac{E}{P} = Y$, “money illusion” as a potential explanation (Asness, 2003)

Compare to Figure 2 in the paper, which shows D/P to be more stable than E/P
Paper tries to identify investor demand, and cleverly uses information besides asset prices to help identification

Supply curve is not perfectly elastic in practice

Who’s on the other side of these trades?
  - Should “reach for income” have pricing implications?
  - Microstructure is often of first-order importance in practice

Is there a liquidity premium for demanding high D/P stocks?
  - Liquidity effect not large enough to offset impact on asset prices
A Dividend-Yield Timing Strategy

Long D/P-based value strategy when rates decline, short when rates rise:

- A timing strategy on value!
- Hedge out HML, what is the Sharpe? Isolate monetary policy part
Any fixed income instrument investors use to fund consumption should be impacted.

Investors with larger allocation to bonds should react more?
- Double sort on consumption needs and percent invested in bonds.

Reaching for income = f(level of interest rates, aggregate dividend yield)
- Level or change in interest rates?
Conclusion

- Very interesting paper that explores the intersection of behavioral economics and monetary policy effects
- Intriguing interplay with value is worth additional attention
- Why are prices affected?