Discussion of Lester, Postlewaite and Wright’s “Information, Liquidity and Asset Prices”

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The model

Euler equations

Comments

Nice comment/Suggestion

The diagram represents a model with a timeline from time $t$ to $t+1$. It includes two main players: Buyer and Seller. The diagram shows the decision-making process for the Buyer, who can be in one of three states: informed, uninformed, or neither. The Buyer can pay with cash or equity:

$$\phi_t M_t + (\psi_t + \delta) a_t$$

or use cash only:

$$\phi_t M_t$$

The diagram also includes elements labeled D.M. and C.M., indicating different decision-making processes or states at times $t$ and $t+1$. The arrows and nodes represent the flow of decisions and payoffs in the model.
\[ \psi_t = \beta L_{t+1}^a [\psi_{t+1} + \delta] \]
\[ \phi_t = \beta L_{t+1}^m \phi_{t+1} \]

\[ L_{t+1}^a \equiv 1 + \lambda \rho [\ell (q_{t+1}^2) - 1] \]
\[ L_{t+1}^m \equiv L_{t+1}^a + \lambda (1 - \rho) [\ell (q_{t+1}^1) - 1] \]

\[ \ell (q_t^i) - 1 = \frac{u'(q_t^i)}{z'(q_t^i)} - 1 \geq 0, \text{"=" if } q_t^i = \tilde{q} \]

In eq.: \[ q_t^1 = q (\phi_t M_t) \text{ and } q_t^2 = q (\phi_t M_t + (\psi_t + \delta) A) \]

where \[ q(x) \equiv \min \{z^{-1}(x), \tilde{q}\} \text{ and } z(q) \text{ given by bargaining} \]
The model

Euler equations

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\begin{align*}
L^a_{t+1} &\equiv 1 + \lambda \rho [\ell (q^2_{t+1}) - 1] \\
L^m_{t+1} &\equiv L^a_{t+1} + \lambda (1 - \rho) [\ell (q^1_{t+1}) - 1]
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- The theory is: Every agent can instantaneously produce a worthless equity share at zero cost, so the $1 - \rho$ fraction of “uninformed” sellers do not accept shares.
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- **Question**: When is a *story* the same as a *theory*?
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Proposition 1 (characterization of equilibrium) and Proposition 2 (effects of liquidity on equity price and return)
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Proposition 1 (characterization of equilibrium) and Proposition 2 (effects of liquidity on equity price and return)

- **Comment:** maybe these liquidity considerations could give us a new angle on the *stock-return/inflation puzzle*? e.g., Fama and Schwert (1977)
Endogenous $\rho$ is both interesting, and new in this literature

Maybe the whole paper should be about that...

- Elaborate on the idea that what looks like a cash-in-advance constraint is not policy-invariant.

- As you mention, some people have done this in CIA models... could you get something new or different?
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