Discussion of "News Shocks and Asset Prices" by Bretscher, Malkhozov and Tamoni

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What's news?

- **News** = anticipated innovations to fundamentals (TFP)

$$\Delta ln(A_t) = (1-\rho)\mu + \rho \Delta ln(A_{t-1}) + \epsilon_{0,t} + \epsilon_{\mathbf{1,t-1}}$$

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- Why news? (for macroeconomists)

  Empirics: measured TFP innovations do not induce business-cycle comovement (Basu, Fernald and Kimball, 2006)

  Theory: fluctuations without large movements in fundamentals (Pigou, 1927)

The goal of this paper

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  Kurmann and Otrok (2013): term structure of interest rates

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   - $\mathbb{E}\left[r^e_{i,t}\right] = \lambda_0 + \beta_i \lambda_1$
   - β_i is loading of portfolio i on $m_{t,t+1} - \mathbb{E}_t[m_{t,t+1}] = m'_\epsilon \epsilon_{t+1}$
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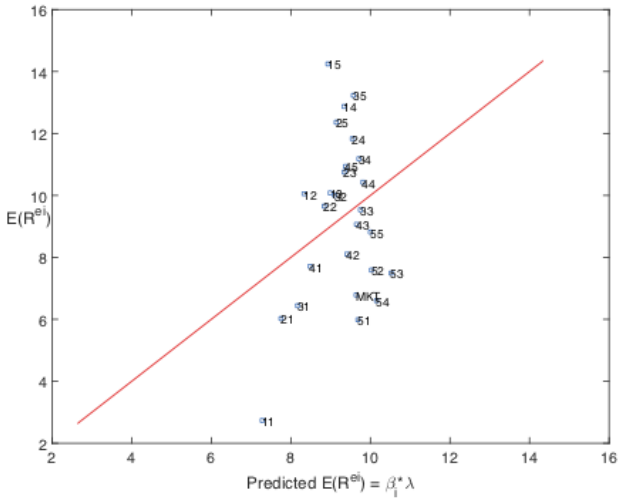
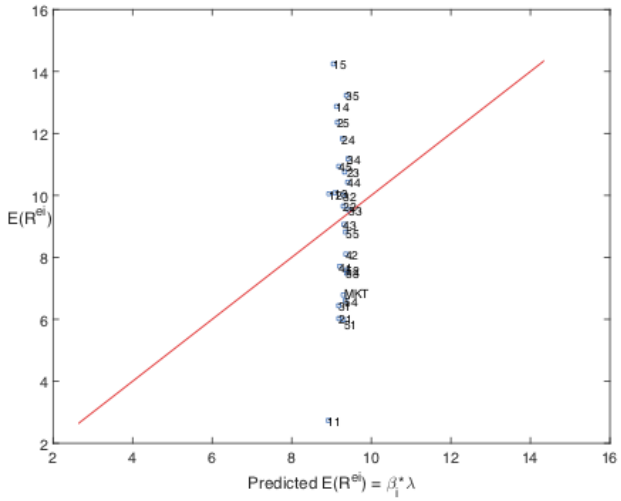
   - m_ϵ from structural model
3. Slightly separate: effects of ϵ_t on natural rate r^*_t
   - $cov(\epsilon_t^{(news)}, r^*_t) > 0$
   - $cov(\epsilon_t^{(news)}, r_t) \approx 0$
   - monetary policy is excessively accomodative

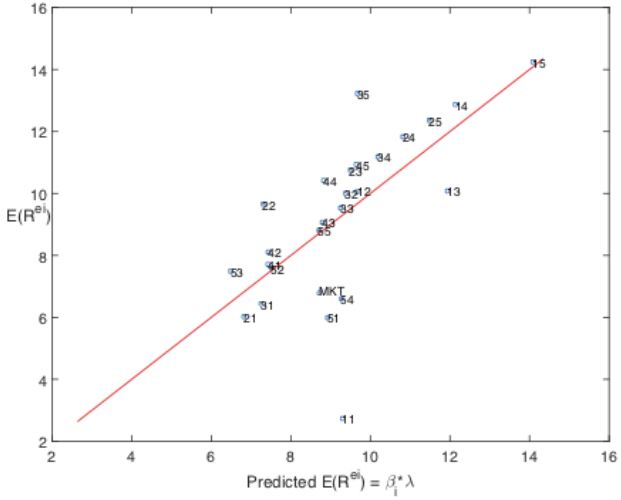
The cross-section of stock returns



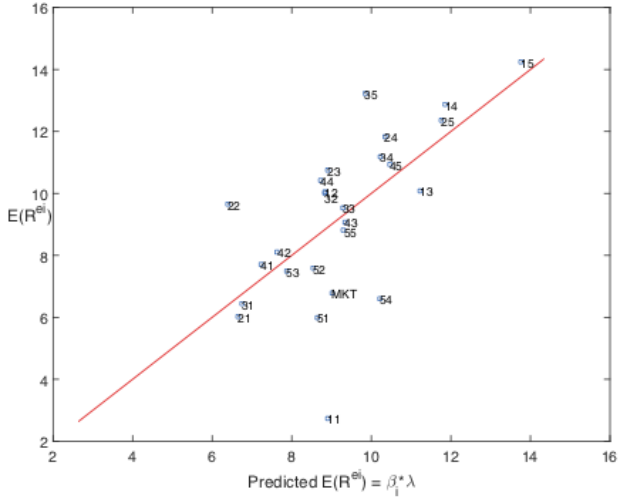
A CAPM.



B C-CAPM.



C Consumption innovations.



D SDF innovations.

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- Quite a bit of disagreement in the macro literature on:
  - how to estimate news shocks
  - how important they are for business-cycle volatility
- How do the shocks estimated here compare?
  - impact comovement puzzle still there
  - what about LR FEV? (Beaudry and Lucke, 2010)
- Effect of *other* news shocks on cross-section of returns?
  - understudied question
  - for total effect, need both ϵ_t and m_ϵ
  - but could see if priced in isolation, as in the paper

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- Paper convincingly shows that the findings extend to:

  industry portolios

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  good news lower MU of current and future consumption

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- What do we learn from this? (for macro)
  - good news lower MU of current and future consumption
  - assets that covary more with news command higher ER
- ***Which*** assets covary more with news, and why?
  - does ***cross-sectional*** variation in β_i "make sense"?
  - e.g.: which industries covary more strongly with news?
  - does it line up with identified news as TFP?

Comment 3: the relationship with long-run risk

- Long-run risk: small but persistent shocks to consumption growth

  Bansal, Dittmar, Lundblad (2005): cross-section of returns

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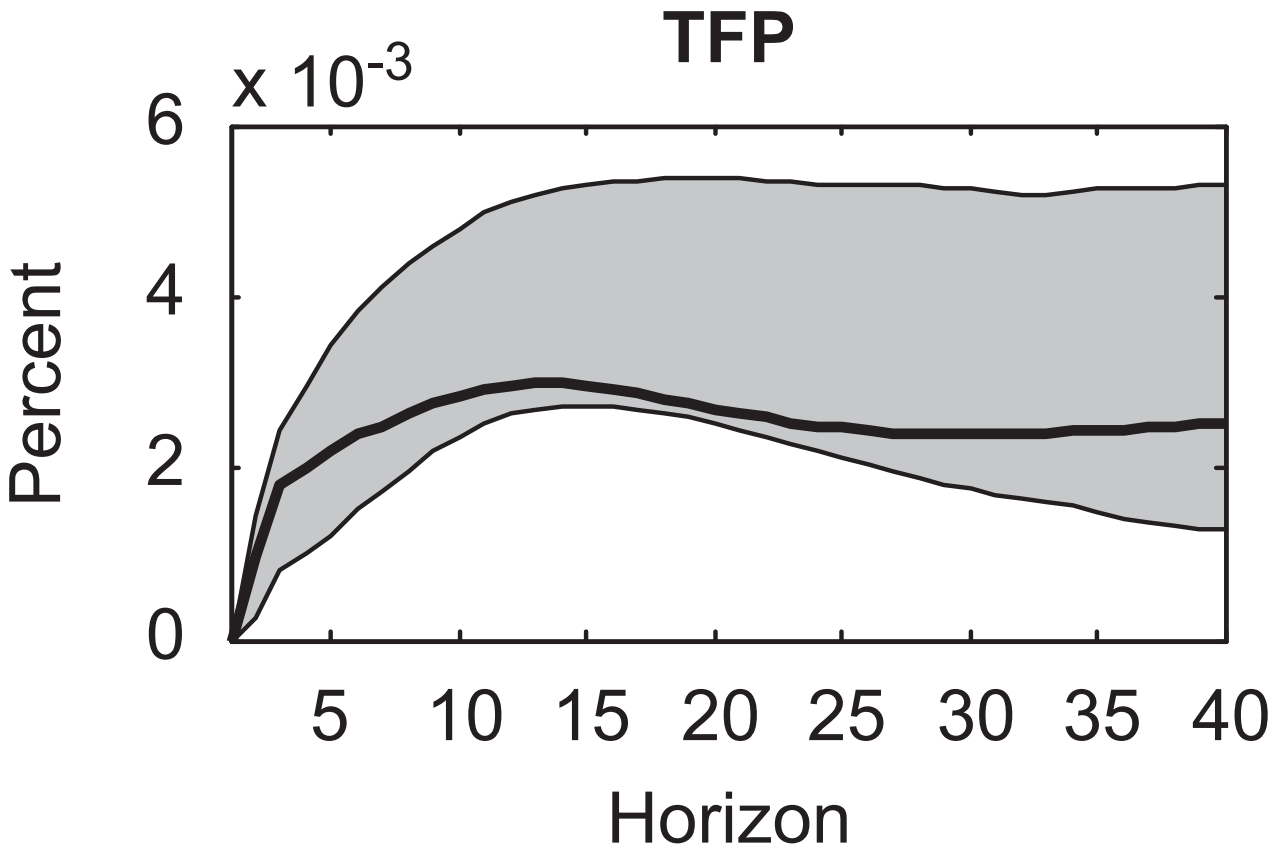
Reduced-form news shocks



$\mathbb{E}_t[ln(A_{t+k})] - \mathbb{E}_{t-1}[ln(A_{t+k})]$

Barsky and Sims (2011) identification, after Uhlig (2004)

Potentially similar to C_t IRF in Bansal and Yaron (2005) case I model

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- Is it just about the horizon/frequency?

  model short-run (1 to 8-quarter) shocks

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- Or is there a substantial (economic) distinction?

  news: all changes in C_t growth need not be priced (e.g. if they're expected)

  does this make a difference? model-based comparison?

Comment 4: implications for monetary policy

- Natural rate moves substantially more than policy rate

  gap is largely driven by news

- Problem 1: how to measure news shocks?

  this paper (and the rest of the literature): asset prices

  other forward-looking variables (quantities)? e.g. inventories (Crouzet and Oh, 2016)

- Problem 2: how to react to news shocks?

  news are "supply-side" shocks — i.e. expansion + deflation

  tighening in the face of (expected) deflation? (see paper)

  react to asset prices?

Conclusion

- Great paper — a new macro to finance "bridge"
- Super clear, super well-executed
- Lots of open questions:

  are "other"news shocks priced in the cross-section of returns?

  what do we learn about news from the cross-section?

  what is the relationship between news and long-run risk?

Smaller comments:

- why GMM?
- report times series for $\epsilon_t^{(news)}$