

ASYMMETRIC INFORMATION AND THE EXCESS VOLATILITY OF STOCK PRICES

by

Benjamin Eden  
University of Iowa, and  
Technion-Israel Institute of Technology

and

Boyan Jovanovic  
New York University

September 1992

ABSTRACT

This paper argues that some of the volatility of stock prices in excess of fundamentals results from fluctuations in the amount of public information over time. The model assumes that dividends and consumption are constant in the aggregate but that there are good firms and bad firms whose identity may be unknown to the public, as in Akerlof's "lemons" problem. The paper then shows that the collective valuation of the constant dividend stream depends on the degree of informational asymmetry.

We thank the C.V. Starr Center for Applied Economics for technical assistance and financial support and the NSF for financial support. Part of the research on this project was completed while the first author was a visitor at the Starr Center in September of 1987 and September of 1988.