

A Demand System Approach to Asset Pricing

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We develop an asset pricing model with flexible heterogeneity in asset demand across investors, designed to match institutional and household holdings. A portfolio choice model implies characteristics-based demand when returns have a factor structure and expected returns and factor loadings depend on the assets' own characteristics. We propose an instrumental variables estimator for the characteristics-based demand system to address the endogeneity of demand and asset prices. Using US stock market data, we illustrate how the model could be used to understand the role of institutions in asset market movements, volatility, and predictability.