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iQuant

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EMPOWERING CHANGEMAKERS FOR A BETTER SOCIETY

## **FUNDAMENTAL VOLATILITY AND FINANCIAL STABILITY**

**STÉPHANE GAUTHIER - PSE**



### **ABSTRACT**

Financial investors choose the capital they invest into risky firms based on the return they expect. The actual return depends on the aggregate investment, which gives rise to beauty-contest issues.

The paper characterizes how the ability of investors to solve these issues relates to the amount of fundamental uncertainty. It exploits this link to provide a quantitative assessment of the contribution of fundamentals to market volatility.

Volatility would be driven by fundamentals in most markets. If out-of-equilibrium beliefs matter, however, they significantly contribute to observed volatility.



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