Impact of Volatility Shocks on Attention Allocation Across Uncorrelated Assets

Eun-Seok (Ian) Lee[1]

[1]Ph.D. Candidate in Economics, Duke University

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Abstract

This paper explores the attention reallocation dynamics of international investors focusing on a total return which is a single linear combination between two uncorrelated assets, especially when one faces a volatility shock. Instead of being restricted to a fixed information capacity, I allow agents to choose the amount of information they use, subject to a fixed marginal information cost. By emphasizing the decomposition of attention rather than the relative signal weights of the two assets, I can provide an objective measure for each type of attention. My research shows that an asset, even without direct shocks, can attract more attention through information channels, even in the absence of strategic motives by the agents. This surge in attention stems from agents intensifying the perceived subjective correlation between the two uncorrelated assets when one becomes more uncertain. To validate my findings, I look at how international investors behaved in two separate markets: the Latin American and Asian markets during the 1997 Asia Crisis. Using the daily news article count from the Financial Times as a proxy for attention, the empirical evidence supports the implications of the model. The model provides general mechanisms of volatility spillover and the pivotal role of information structure choice in these processes.