Speculative betas

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[Abstract] We provide a model for why high beta assets are more prone to speculative overpricing than low beta ones. When investors disagree about the common factor of cash-flows, high beta assets are more sensitive to this macro-disagreement and experience a greater divergence-of-opinion about their payoffs. Short-sales constraints for some investors such as retail mutual funds result in high beta assets being over-priced. When aggregate disagreement is low, expected return increases with beta due to risk-sharing. But when it is large, expected return initially increases but then decreases with beta. High beta assets have greater shorting from unconstrained arbitrageurs and more share turnover. Using measures of disagreement about stock earnings and economic uncertainty, we verify these predictions. A calibration exercise yields reasonable parameter values.