Human Capital, Endogenous Information Acquisition, and Home Bias in Financial Markets

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Summary

Considerable attention has been devoted in the financial literature to excessive portfolio concentrations in domestic risky assets relative to those predicted by standard finance models – generally identified as "home bias" – across international markets. The innovation we offer is ascribing home bias to endogenous information acquisition, or "asset management" (see EHY 2008), resulting from variations in human capital endowments. We develop discriminating hypotheses about the roles of "specific" and "general" human capital endowments and the direct and opportunity costs of asset management in determining how home bias varies among individual investors and across financial markets. Our model also provides insights concerning differences across countries in the degree to which their domestic asset prices are "information revealing". These hypotheses are tested against 8 national probability samples of individual portfolio compositions in the US over 1992-2007, and 7 international samples over 2001-2007 including 23 countries. The findings are consistent with our hypotheses.