

Intuition – main forces at work

■ Investment:

■ *Scale up*

- Scalable profitable investment opportunity
- Higher leverage (borrow at r)

■ *Scale back*

- **Precaution:** - don't exploit full (GE) debt capacity – “dry powder”
 - Ultimately, stay away from fire-sales at p_t
 - Debt can't be rolled over if $d > k_t p_t$ (note, price is depressed)
- Ways to scale back:
 - Internal disinvestment, limited by $\Phi(\cdot)$
 - External disinvestment, sale of assets (price impact $f(\text{others' leverage})$)

■ Consumption

- Consume *early* and borrow $r < \rho$
- Consume *late* to overcome investment frictions