

Modification 3: asset pricing (cross section)

- Correlation increases with σ^p
 - Extend model to many types j of capital

$$dk_t^j/k_t^j = (\Phi(i_t^j/k_t^j) - \delta)dt + \underbrace{\sigma dZ_t}_{\text{aggregate shock}} + \underbrace{\sigma' dz^j}_{\text{uncorrelated shock}}$$

- Experts hold diversified portfolios
 - Equilibrium looks as before, but
 - Volatility of $p_t k_t$ is $\sigma + \sigma^p + \sigma'$
 - For uncorrelated z^j and z^l
correlation $(p_t^j k_t^j, p_t^l k_t^l)$ is $(\sigma + \sigma^p)/(\sigma + \sigma^p + \sigma')$
which is increasing in σ^p