Abstract of Prof. D. Sraer's Paper

We provide a theory and evidence for when the Capital Asset Pricing Model fails. When investors disagree about the common factor of cash-flows, high beta assets are more sensitive to this aggregate disagreement than low beta ones and hence experience a greater divergence-of-opinion about their cash-flows. Costly short-selling then results in high beta assets experiencing binding short-sales constraints and being over-priced. When aggregate disagreement is low, the Security Market Line is upward sloping due to risk-sharing. But when it is large, the Security Market Line is initially increasing and then decreases with beta. At the same time, high beta assets in a dynamic setting also have greater share turnover, and especially so when aggregate disagreement is high. Using the dispersion of stock analysts' earnings forecasts to measure speculative disagreement, we find strong support for these predictions.