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Intermediary asset pricing: New evidence from many asset classes☆

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Abstract

We find that shocks to the equity capital ratio of financial intermediaries—*Primary Dealer* counterparties of the New York Federal Reserve—possess significant explanatory power for cross-sectional variation in expected returns. This is true not only for commonly studied equity and government bond market portfolios, but also for other more sophisticated asset classes such as corporate and sovereign bonds, derivatives, commodities, and currencies. Our intermediary capital risk factor is strongly procyclical, implying countercyclical intermediary leverage. The price of risk for intermediary capital shocks is consistently positive and of similar magnitude when estimated separately for individual asset classes, suggesting that financial intermediaries are marginal investors in many markets and hence key to understanding asset prices.

JEL classification: G12, G20

Keywords: Sophisticated asset classes, Primary dealers, Intermediary capital, Leverage cycles

1. Introduction

Intermediary asset pricing theories offer a new perspective for understanding risk premia. These theories are predicated on the fact that financial intermediaries are in the advantageous position of trading almost all asset classes, anytime and everywhere. For instance, Siriwardane (2015) shows

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