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Interview with Professor Jeffrey Wurgler

We interview Professor Jeffrey Wurgler, the Nomura Professor of Finance at New York University Stern School of Business to gain his insights on the current issues related to stock price. Professor Wurgler is an expert on corporate finance, capital markets, asset pricing, and behavioral finance. His research includes topics such as stock performance and the impact of investor sentiment.

What are the main drivers of stock price changes?

A helpful way to visualize the drivers of stock price changes is a tree with two main branches. The first branch represents the "fundamental" factors driving a stock's price, or the rational and justified reasons for a change in price, such as the changes in expected cash flows. This branch can be further subdivided based on company-specific and non-company-specific fundamentals.

The second branch, which has not been researched or understood until more recently, represents price changes that occur due to "non-fundamental" factors. These are factors affecting the price of a stock that are not supported by a justified or tangible reason for the stock price change.

Non-fundamental drivers of stock price include factors such as microstructure-type frictions including the bid-ask spreads. Throughout the day when many trades take place, prices fluctuate even though nothing at all has happened to the company. Another, and perhaps the most important non-fundamental driver of stock prices, is investor sentiment.

Can you explain how investor sentiment drives stock prices?

Investor sentiment is a belief about fundamentals that isn't derived from a rational analysis of all the facts. While all stock prices are driven in some part by investor sentiment, the degree to which investor sentiment drives the value of the stock varies depending on company type.

A company with stock that is very straightforward to value is likely to be less affected by sentiment than a company where the price is extremely difficult or impossible to accurately value. For companies that are very difficult to value, such as a company with many intangible assets, investor sentiment can drive large fluctuations in stock prices both positively or negatively.

Can a stock price be driven by both fundamental and non-fundamental factors?

Absolutely. For example, if a stock price changes following a newsworthy company announcement, there can be a component of both rational expectations and irrational investor sentiment. Even if all investors agree that the news is good or bad, the magnitude of the justified change in price due to fundamental factors may not be immediately clear.

How do fundamental and non-fundamental factors play into the concept of market efficiency?

It is commonly misunderstood that a stock that is traded frequently on exchange ensures that the price truly reflects all fundamental drivers of a stock price and guarantees market efficiency. However, from an economic perspective, a market is efficient when prices accurately reflect the fundamental drivers of stock prices. Even if the stock is traded numerous times through the day, non-fundamental factors such as sentiment may be driving the stock price.

Are there any sectors currently being dramatically affected by sentiment?

Currently, there is a lot of discussion regarding a possible social media bubble. Social media companies are hard to value because it is difficult to know what metrics to use in determining stock prices. The prices tend to fluctuate a great deal more than prices that are relatively straightforward to determine.

There is a lot of research about company announcements in industries that are caught in bubbles. In those cases, stocks can have large drops or large increases. A bubble in the social media sector could explain some of the major fluctuations in stock prices that we are seeing.