Information Acquisition and the Pre-Announcement Drift

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Abstract: We present a dynamic Grossman-Stiglitz model with endogenous information acquisition to explain the pre-FOMC announcement drift. Because FOMC announcements reveal substantial information about the economy, investor's incentives to acquire information are particularly strong in days ahead of announcements. Information acquisition partially resolves the uncertainty for uninformed traders, and under generalized risk sensitive preferences (Ai and Bansal (2018)), lowers the discount rate and results in a stock market run-up. Because our theory does not rely on the leakage of information, it can simultaneously explain the low realized volatility during the pre-FOMC announcement period and the lack of predictability of announcement return by pre-announcement drifts.

Keywords: Macroeconomic Announcement Premium, Pre-FOMC Announcement Drift, Asymmetric Information, Trading Volume.

JEL Code: D83, D84, G11, G12, G14

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