

Review of “Market Dynamics when Participants Rely on Relative Valuation,” by S.M Lavelle

This paper applies relative valuation principle for valuing an asset. The idea is that an analyst computes the price of a firm relative to some indicator and then compares this with some average market value of all firms with similar attribute. If the market value of the firm exceeds the average value, the trader sells the firm and otherwise it buy the firm. This buying and selling gives rise to some dynamics of the market value of the firm. The author then simulates the price behaviour using this principle and points out anomaly such as systematic undervaluation of firms.

I find the theoretical foundation of this paper rather shaky. The equilibrium foundation of this kind of market valuation is not spelled out. The price dynamics laid out in equation 3 is quite ad hoc. Why is it optimal for the traders to follow such a relative valuation strategy? I don't understand what determine the price movement C ? Why does one use a harmonic mean to aggregate the valuations?

The entire simulation is based on an ad hoc price dynamics. The paper is also very poorly written. It is difficult to comprehend the precise research question while reading the paper.