

Investor Demand on the Extensive and Intensive Margins: Learning from Prices with Subjective Beliefs on Flows

Xindi He

Allen Hu

Zigang Li*

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Abstract

We study investor demand through its extensive margin (entry and exit flows in stocks) and intensive margin (adjustments to existing positions). Using institutional and retail holdings, we show that extensive flows are large in magnitude and exhibit a less negative, often positive, estimated price elasticity. Extensive flows are driven by past returns and attention, while intensive flows reflect fundamentals, and the composition of the two helps explain variations in stock returns, volatility, and price informativeness. We develop a Grossman-Stiglitz-style model with investors learning from prices: intensive investors rebalance holdings based on fundamentals; extensive investors switch among assets and form subjective beliefs on unobserved flows into or out of assets. Subjective beliefs about flows can lead to misinference from prices and to different price elasticities across these two margins. Embedding the model in an asset demand system, we structurally estimate price elasticities and evaluate how prices and their informativeness would change in a counterfactual of reallocating capital from intensive to extensive investors. The results from structural estimation corroborate our empirical evidence.

Keywords: Investor Flows, Learning from Prices, Subjective Beliefs, Asset Demand System

JEL Classification: G12, G14, G23, G40

*He: Georgia Tech Scheller, xindi.he@scheller.gatech.edu. Hu: UBC Sauder, email: allen.hu@sauder.ubc.ca. Li: Ph.D. Candidate in Finance, Toronto Rotman, email: zigang.li@rotman.utoronto.ca. This version: November 2025. We are grateful for comments from Nick Barberis, Stefano Giglio, Song Ma, Kelly Shue, Stijn Van Nieuwerburgh, and seminar participants at Atlanta Fed, Chicago Booth, and Yale SOM. All remaining errors are ours.