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The Hazards of Propping Up: Bubbles and Chaos

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In the current environment of financial distress, many governments are likely to soon become major holders of financial assets, but the policy debate focuses only on the likelihood and extent of short-term market stabilization. This paper shows that government intervention and propping up are likely to lead to long-term bubbles and even wildly chaotic behavior. The discontinuities occur when the committed capital reaches a critical amount that depends on just two parameters: the market impact of trading and the target exposure percentage.

Subjects: **General Finance (q-fin.GN)**; Portfolio Management (q-fin.PM); Risk Management (q-fin.RM)

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