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# ASSET EMBEDDINGS

Xavier Gabaix
Ralph S. J. Koijen
Robert J. Richmond
Motohiro Yogo

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## ABSTRACT

Firm characteristics, based on accounting and financial market data, are commonly used to represent firms in economics and finance. However, investors collectively use a much richer information set beyond firm characteristics, including sources of information that are not readily available to researchers. We show theoretically that portfolio holdings contain all relevant information for asset pricing, which can be recovered under empirically realistic conditions. Such guarantees do not exist for other data sources, such as accounting or text data. We build on recent advances in artificial intelligence (AI) and machine learning (ML) that represent unstructured data (e.g., text, audio, and images) by high-dimensional latent vectors called embeddings. Just as word embeddings leverage the document structure to represent words, asset embeddings leverage portfolio holdings to represent firms. Thus, this paper is a bridge from recent advances in AI and ML to economics and finance. We explore various methods to estimate asset embeddings, including recommender systems, shallow neural network models such as Word2Vec, and transformer models such as BERT. We evaluate the performance of these models on three benchmarks that can be evaluated using a single quarter of data: predicting relative valuations, explaining the comovement of stock returns, and predicting institutional portfolio decisions. We also estimate investor embeddings (i.e., representations of investors and their strategies), which are useful for investor classification, performance evaluation, and detecting crowded trades. We discuss other applications of asset embeddings, including generative portfolios, risk management, and stress testing. Finally, we develop a framework to give an economic narrative to a group of similar firms, by applying large language models to firm-level text data.

Xavier Gabaix
Department of Economics
Harvard University
Littauer Center
1805 Cambridge St
Cambridge, MA 02138
and NBER
xgabaix@fas.harvard.edu

Ralph S. J. Koijen
University of Chicago
Booth School of Business
5807 S Woodlawn Ave
Chicago, IL 60637
and NBER
Ralph.koijen@chicagobooth.edu

Robert J. Richmond
Stern School of Business
New York University
44 W. 4th Street, 9-81
New York, NY 10012
and NBER
rrichmon@stern.nyu.edu

Motohiro Yogo
Department of Economics
Princeton University
Julis Romo Rabinowitz Building
Princeton, NJ 08544
and NBER
myogo@princeton.edu

## 1. Introduction

Artificial intelligence (AI) and machine learning (ML) have revolutionized our understanding of complex unstructured data such as text, audio, and images by representing these objects with high-dimensional latent vectors called embeddings. Despite their success, the application of these methods to economics and finance remains largely unexplored. Our contribution is to introduce asset embeddings to represent firms and investor embeddings to represent investors and their strategies. Economists commonly use firm characteristics, based on accounting and financial market data, to explain complex economic outcomes such as relative valuations, the comovement of stock returns, and institutional portfolio decisions. We show theoretically that portfolio holdings contain all relevant information about firms, which can be recovered under empirically realistic conditions. We show empirically that asset embeddings explain these complex economic outcomes much better than firm characteristics.

A word embedding is a vector representation of a word that captures its meaning, extracted from text data by natural language processing (NLP). Similarly, we define an asset embedding as a vector representation of a firm. We could use different data sources to estimate asset embeddings, including stock returns, text data (e.g., 10-K filings, earnings calls, and news articles), and portfolio holdings. Our first contribution is to develop a simple asset pricing model in Section 2, which shows that portfolio holdings contain all relevant information about firms and are ideal for estimating asset embeddings. We represent an investor's log dollar holding of an asset as the dot product of the investor embedding and the asset embedding. The asset embeddings are latent characteristics that capture differences in expected profitability or risk exposure across assets. The investor embeddings capture heterogeneity in preferences for the asset embeddings across investors. We can identify the asset embeddings with sufficient variation in the investor embeddings, which is the empirically relevant case with heterogeneity in the investment strategies. The central insight that holdings embed all relevant information extends to more general models of asset demand, although it may require nonlinear methods to invert the asset demand system to infer asset and investor embeddings.

In Section 3, we apply various NLP models to estimate asset embeddings with portfolio holdings data. Our central insight is simple yet powerful. Just as documents structure words in ways that allow us to estimate word embeddings, investors structure portfolios in ways that allow us to estimate asset embeddings. We consider three classes of models. The first is recommender systems, which include principal component analysis (PCA) models. The second is shallow neural network models such as Word2Vec. The third is transformer models used in large language models (LLMs) such as the Bidirectional Encoder Representations

from Transformers (BERT) (Devlin et al., 2019) and the Generative Pre-Trained Transformer (GPT) (Radford et al., 2018). Thus, this paper is a bridge from recent advances in AI and ML to economics and finance.

To adopt Word2Vec and the transformer models to our application, we need to convert numerical values of portfolio holdings to discrete words that these models use as inputs. Our second contribution is to propose a solution to this problem, unlocking the power of transformer models to a wider set of applications in economics and finance. We order the assets in an investor's portfolio in a decreasing order of portfolio weights and simply represent the name of each asset as a token. This procedure exploits the fact that investors assign similar portfolio weights to assets with similar asset embeddings, according to the portfolio theory underlying the asset pricing model in Section 2. We then train the BERT model to predict a masked asset (e.g., the second largest position), given the other assets in an investor's portfolio. This training procedure is analogous to the training of the original BERT model by masked language modeling. For example, the BERT model has to predict the missing word in a sentence like "The Fed decided to ____ the target rate to fight inflation."

Our third contribution is introduce three benchmarks to evaluate the various models of asset embeddings. First, we predict relative valuations in the cross section of firms. Second, we explain the comovement of stock returns. Third, we predict masked assets in the managed portfolios of mutual funds, exchange-traded funds (ETFs), and hedge funds. This benchmark tests a core prediction of the portfolio theory that investors assign similar portfolio weights to assets with similar asset embeddings. Our benchmarks satisfy three important criteria. First, the asset pricing model in Section 2 predicts that the portfolio holdings data are informative for these benchmarks. Second, these benchmarks are at the heart of asset pricing and portfolio theory, for which we have existing models (e.g., the Fama-French five-factor model) that establish a high hurdle. Third, these benchmarks require only a single quarter of data. This criterion facilitates a true out-of-sample test to measure progress in real time. For example, we could imagine an annual competition to evaluate new models on these benchmarks, just like the ImageNet Large Scale Visual Recognition Challenge.

Our fourth contribution is to estimate and to evaluate the various models of asset embeddings. We use US stock holdings data for mutual funds, ETFs, closed-end funds, variable annuity funds, and hedge funds over a quarterly sample period from 2005.Q1 to 2022.Q4. Based on the three benchmarks, we compare the performance of the asset embeddings, firm characteristics, and text-based embeddings from Cohere and OpenAI, which are leading AI companies. Three main insights emerge from this analysis.

First, all models of asset embeddings significantly outperform firm characteristics on the relative valuation and managed portfolio benchmarks. For example, a base model of

four-dimensional asset embeddings explains over 50% of the variation in relative valuations, whereas a set of four leading firm characteristics explains only 15%. The performance of the asset embeddings easily scales in their dimension. When we train a large model of 128-dimenstional asset embeddings by ridge regression with cross validation, we explain over 70% of the variation in relative valuations. A base model of six-dimensional asset embeddings performs well on the return comovement benchmark, but it falls slightly short of a high hurdle of a set of characteristics in the Fama-French five-factor model and momentum.As before, the performance improves when we use higher-dimensional embeddings and this model surpasses the five-factor model.

Second, we find important performance gains from using different models for different tasks. The recommender systems perform well on the relative valuation and return comovement benchmarks. However, Word2Vec and the BERT model significantly outperform the recommender systems on the managed portfolio benchmark. This result makes sense since we train Word2Vec and the BERT model to predict masked assets in managed portfolios. The BERT model has spectacularly high performance on the managed portfolio benchmark, which highlights the importance of contextualized embeddings for predicting institutional portfolio decisions.

Third, the text-based embeddings from Cohere and OpenAI perform poorly on our benchmarks. These embeddings represent not only the name of a firm (e.g., Apple as a fruit) but also its business (e.g., Apple as a technology firm). Future research could fine-tune the text-based embeddings to potentially improve performance on specific benchmarks. More broadly, future research could use a combination of portfolio holdings data, a large set of firm characteristics, and a collection of text data to estimate asset embeddings that most accurately represent firms. We show, both theoretically and empirically, that portfolio holdings data are essential for any attempt to represent firms, which is not the current practice at even the leading AI companies.

Although our main focus is asset embeddings, we can use the same models to estimate investor embeddings, which are vector representations of investors and their strategies. The investor embeddings provide a richer representation of investors than standard investor characteristics such as institutional type (e.g., mutual fund, hedge fund, or insurance company), size, and measures of activeness (e.g., turnover and active share). We use a BERT model to estimate the investor embeddings and show that it performs well on a masked investor benchmark. We propose several applications of investor embeddings for future research, including investor classification, performance evaluation, and detecting crowded trades.

In Section 7, we propose several applications of asset embeddings for future research. First, we could use the asset embeddings to construct replicating portfolios without historical

data on stock returns. For example, we could start with a strategy that is long United Airlines and short Zoom, which are exemplar stocks for exposure to COVID-19 risks. To construct a diversified COVID-19 factor, we could use the asset embeddings to find stocks that are most similar to United and Zoom. Second, financial institutions, regulators, and central banks could use asset and investor embeddings for risk management and stress testing. They could generate counterfactual changes in asset and investor embeddings, which imply counterfactual changes in asset prices in an asset demand system (Koijen and Yogo, 2019). Thus, we propose a novel methodology to generate stress scenarios, which could have broad application in risk management.

Asset embeddings are latent vectors that do not have a direct economic interpretation. In Section 8, our fifth contribution is to develop a framework that leverages recent advances in LLMs to interpret the asset embeddings. We feed the transcripts of earnings calls in the relevant quarter as context, limiting the risk of hallucinations. Then, for any set of firms that we identify as similar, we prompt an LLM to summarize common risk exposures, growth opportunities, or ESG characteristics. Thus, we have an economic narrative of why investors hold a given set of stocks. We could apply the same methodology to the investor embeddings, using the descriptions of the investment strategies in prospectuses, analyst reports, and investor letters.

### *1.1. Related Literature*

A large literature uses a large number of firm characteristics to model the stochastic discount factor or to predict stock returns (Kelly et al., 2019; DeMiguel et al., 2020; Feng et al., 2020; Freyberger et al., 2020; Kozak et al., 2020; Lettau and Pelger, 2020; Cong et al., 2022). We refer to Kelly and Xiu (2023) for a review of this literature. However, firm characteristics are only a subset of the investors' information set (Hansen and Richard, 1987). Since portfolio holdings contain all relevant information about firms, we can in theory recover the full information set by estimating asset embeddings from portfolio holdings data, while no such guarantees for other data sources like accounting and text data.

Another literature uses text data to represent firms and to define firm similarity, including 10-K filings (Hoberg and Phillips, 2016; Chen and Sarkar, 2020), earnings calls (Hassan et al., 2019), and news articles (Binsbergen et al., 2023; Bybee et al., 2023; Sarkar, 2025). Other sources of economic linkages between firms include customer-supplier relations (Cohen and Frazzini, 2008), production networks (Lee et al., 2024), and shared analyst coverage (Ali and Hirshleifer, 2020). We ultimately view the characteristics and text data as complementary to the portfolio holdings data. Moreover, we can estimate the asset embeddings with the portfolio holdings data and give them an economic interpretation with the text data, as we

demonstrate in Section 8.

We build on recent advances in AI that offer valuable tools to process unstructured data such as text, audio, and images. The most relevant tools for this paper are NLP models (Ducharme et al., 2003; Mikolov et al., 2013a,b; Pennington et al., 2014) and transformer models (Vaswani et al., 2017; Devlin et al., 2019). In an application to the stock market, Dolphin et al. (2022) estimate a neural network model to capture the covariance structure of daily stock returns. This paper is part of a growing literature that applies ML to economics and finance (Hassan et al., 2019; Gu et al., 2020; Nagel, 2021; Bybee et al., 2023; Chen et al., 2023; Hommel et al., 2023). A branch of this literature studies missing firm characteristics in asset pricing applications (Bryzgalova et al., 2022; Freyberger et al., 2022; Beckmeyer and Wiedemann, 2023; Chen and McCoy, 2024).

This paper contributes to the literature on demand system asset pricing (Koijen and Yogo, 2019). This literature develops theoretical and empirical frameworks to study asset prices, firm characteristics, and macro variables together with portfolio holdings. By substituting the equilibrium asset prices in asset demand, we derive reduced-form demand. We can estimate asset and investor embeddings from reduced-form demand without instruments or comprehensive holdings data that satisfy market clearing. Thus, we develop a recipe for prediction exercises using an asset demand system, which are possible under weaker identifying assumptions than those required for counterfactual exercises.

A recent literature estimates factor models on portfolio holdings data for various purposes (Madhavan et al., 2021; Gabaix and Koijen, 2022; Betermier et al., 2022; Balasubramaniam et al., 2023). Relative to this literature, we introduce benchmarks to establish clear metrics of progress and success, following a standard practice in the AI literature. We also explore a variety of modern AI methods to learn which methods work best on which benchmarks.

### *1.2. Notation*

We index the investors by $i = 1, \ldots, I$, the assets by $a = 1, \ldots, A$, and time by $t$. Time is at a quarterly frequency in our applications, which are based on quarterly portfolio holdings data. When we use monthly stock returns for the return comovement benchmark, we index time at a monthly frequency by $m$. Since our application is the stock market, we use the words "asset", "stock", and "firm" interchangeably throughout the paper. For concepts that involve only cross-sectional data, we omit the time subscript $t$ for simplicity.

We use calligraphic letters such as $\mathcal{A}$ and $\mathcal{B}$ to denote sets with the corresponding number of elements $|\mathcal{A}|$ and $|\mathcal{B}|$. We denote the set of assets in investor $i$'s portfolio as $\mathcal{A}_i$ with the corresponding number of assets $|\mathcal{A}_i|$. We order the assets in investor $i$'s portfolio in a decreasing order of portfolio weights, where $a_i(k)$ is the name of the $k$-th largest position.

Thus, investor $i$'s assets are $a_i(1), a_i(2), \ldots, a_i(|\mathcal{A}_i|)$. We denote the set of assets in investor $i$'s portfolio, excluding asset $a_i(k)$, as $\mathcal{A}_i(k) = \mathcal{A}_i \setminus \{a_i(k)\}$. We denote the set of investors that hold asset $a$ as $\mathcal{I}_a$ with the corresponding number of investors $|\mathcal{I}_a|$. We order the investors that hold asset $a$ in a decreasing order of ownership shares, where $i_a(k)$ is the name of the $k$-th largest investor. Thus, asset $a$'s investors are $i_a(1), i_a(2), \ldots, i_a(|\mathcal{I}_a|)$.

For each asset, we normalize its shares outstanding to one. We denote the price of asset $a$ at time $t$ as $P_{at}$, which is also its market capitalization (with the shares outstanding normalized to one). We denote the number shares of asset $a$ that investor $i$ holds at time $t$ as $Q_{iat}$. Thus, the dollar holding is $H_{iat} = P_{at}Q_{iat}$. We use a lowercase letter to denote the logarithm of the corresponding uppercase variable. For example, $h_{iat} = \ln(H_{iat})$. We use bold letters to denote column vectors and matrices. For example, we denote a vector of asset embeddings as $\boldsymbol{x}_a = [x_{ak}]_{k=1}^K \in \mathbb{R}^K$ and the corresponding matrix of asset embeddings as $[\boldsymbol{x}_a']_{a=1}^A \in \mathbb{R}^{A\times K}$. We denote the Frobenius norm of the matrix as $\|\boldsymbol{x}\| = \left(\sum_{a=1}^A \sum_{k=1}^K x_{akt}^2\right)^{\frac{1}{2}}$.

## 2. A Model of Portfolio Holdings as Embeddings Data

We present a simple asset pricing model, which shows that portfolio holdings data are ideal for estimating asset and investor embeddings. Investors use all relevant information for portfolio choice, including firm characteristics, text data (e.g., 10-K filings, earnings calls, news articles, and analyst reports), and other sources of information that are not readily available. Therefore, portfolio holdings data contain all relevant information, which are ultimately reflected in asset prices by market clearing. An econometrician can recover this information by estimating asset embeddings. We only present the main equations and leave all proofs for Appendix A.

We model investor $i$'s log dollar holding of asset $a$ as

$$h_{ia} = \kappa_i + (1 - \zeta_i)\, p_a + \nu_{ia}, \tag{1}$$

where $\kappa_i$ is a constant that scales with the investor's wealth and $\zeta_i$ is the price elasticity of demand for individual assets.[1] The demand shifter has a factor structure:

$$\nu_{ia} = \boldsymbol{\Lambda}_i' \boldsymbol{x}_a + \xi_{ia}. \tag{2}$$

The $K$-dimensional vector $\boldsymbol{x}_a$ is an asset embedding that contains all relevant information

[1] In the language of Gabaix and Koijen (2022), $\zeta_i$ is the micro elasticity (i.e., substitution across individual stocks) rather than the macro elasticity (i.e., substitution between the aggregate stock market and the aggregate bond market).

about asset $a$. This information includes firm characteristics, text data, and other sources of information that are not readily available. The $K$-dimensional vector $\boldsymbol{\Lambda}_i$ is the semi-elasticity of the portfolio holding to the asset embedding, conditional on the asset price. Investors respond heterogeneously to different elements of the asset embedding. For example, some investors use text data, but other investors do not. The scalar $\xi_{ia}$ represents the idiosyncratic component of investor $i$'s demand for asset $a$.

Koijen and Yogo (2019) derive equations (1) and (2) in a traditional model of portfolio choice when the returns have a factor structure, the factor loadings depend on firm characteristics, and investors have heterogeneous beliefs and agree to disagree. Koijen et al. (2024) extend this microfoundation to models of portfolio choice with hedging demand and non-pecuniary preferences for firm characteristics (e.g., ESG scores). Under this microfoundation, the asset embeddings capture differences in expected profitability or risk exposure across assets. Equation (1) is linear in log asset price, and equation (2) is linear in the asset embedding. These equations can be nonlinear in more general models of portfolio choice with constraints.

In Appendix A, we solve for equilibrium asset prices by market clearing. We then substitute the equilibrium asset prices in asset demand (1) to derive reduced-form demand:

$$h_{ia} = \boldsymbol{\lambda}_i' \boldsymbol{x}_a + \delta_i + \delta_a + \epsilon_{ia}. \tag{3}$$

The $K$-dimensional vector $\boldsymbol{\lambda}_i$ is an investor embedding, which is a linear transformation of $\boldsymbol{\Lambda}_i$ and $\zeta_i$. The investor embedding $\boldsymbol{\lambda}_i$ in reduced-form demand (3) represents the investor's preferences for asset embeddings, relative to the other investors' preferences. In contrast, the demand elasticities $\boldsymbol{\Lambda}_i$ in asset demand (2) represent the absolute preferences for asset embeddings, which require structural estimation by instrumental variables (Koijen and Yogo, 2019). The investor fixed effect $\delta_i$ controls for differences in wealth across investors. The asset fixed effect $\delta_a$ controls for differences in market capitalization across assets. Given these fixed effects, equation (3) models the active deviations of the portfolio weights from the market weights.

We can estimate the asset embeddings in reduced-form demand (3) by PCA. A necessary condition for identification is heterogeneity in $\boldsymbol{\lambda}_i$ (through either $\boldsymbol{\Lambda}_i$ or $\zeta_i$) across investors, which is the empirically relevant case with heterogeneity in the investment strategies. Investors with very different investment strategies (e.g., that disagree more) are especially informative for identifying the asset embeddings. Thus, an econometrician can asymptotically recover the same information set as investors, including firm characteristics, text data, and other sources of information that are not readily available. In finite samples, firm char-

acteristics and text data can augment the explanatory power of asset embeddings in actual applications due to estimation error in estimating the asset embeddings.

In Appendix A, we make an additional assumption that the asset embeddings are stable from time $t-1$ to $t$. Then the same asset pricing model implies that we can use returns, volume, or portfolio rebalancing (i.e., change in shares held) as alternative sources of embeddings data.

## 3. Applying AI Methods to Economics and Finance

Investors collectively use all relevant information about firms, including firm characteristics, text data, and other sources of information that are not readily available. Building on the insight that the portfolio holdings contain all relevant information, we explore various methods to extract this information from portfolio holdings data. Recent advances in processing text, audio, and images offer valuable AI tools for this purpose. In particular, NLP models represent words with high-dimensional latent vectors called embeddings. Embeddings capture similarities between words, sentences, and documents and can do math with words. In a classic example, the embeddings for "king", "man", and "woman" are used to compute "king − man + woman", which produces an embedding closest to "queen".

In economics and finance, we commonly use firm characteristics, based on accounting and financial market data, to model the similarity between firms. For example, we use firm characteristics to understand relative valuations, comovement of stock returns, and institutional portfolio decisions. The AI literature suggests a different approach. Since the portfolio holdings contain all relevant information about firms, we can extract this information directly from portfolio holdings data using modern AI methods. Our central insight is simple yet powerful. Just as documents structure words in NLP, songs structure notes in audio signal processing, and images structure pixels in computer vision, portfolios structure firms in economics and finance.

### *3.1. From Words and Sentences to Assets and Investors*

We summarize developments in NLP over the last three decades that are relevant for our application to economics and finance. Our high-level overview focuses on the conceptual issues and is not meant to be exhaustive. For textbook treatments of NLP, we refer to Prince (2023) and Jurafsky and Martin (2025).

We start with a simple yet powerful class of NLP models called recommender systems, which include PCA models and latent semantic analysis (Dumais et al., 1988). In a simple recommender system, we apply PCA to the document-word matrix to estimate word embed-

dings. Similarly, we apply PCA to the investor-asset matrix of portfolio holdings to estimate asset embeddings.

The next important step in the NLP literature was shallow neural network models such as Word2Vec (Mikolov et al., 2013a,b). In Word2Vec, we represent words as embeddings and train a shallow neural network to predict a target word, based on the surrounding words in a context window.[2] Thus, Word2Vec is a local nonlinear model in contrast to recommender systems, which are global bilinear models. To apply Word2Vec to portfolio holdings data, we order the assets in an investor's portfolio in a decreasing order of portfolio weights. According to the portfolio theory underlying equation (3), investors assign similar portfolio weights to assets with similar asset embeddings. We then train the model to predict a target asset (e.g., Apple), based on similarly-sized positions in the context window (e.g., Alphabet, Amazon, and Microsoft).

Word2Vec has two important limitations. First, the order of words in the context window does not matter. Second, the embeddings are context-invariant and have a one-to-one mapping to words. The second limitation is also relevant for our application. For example, Apple produces computer hardware (e.g., M4 chips), provides digital content and services (e.g., iCloud and Apple Music), and innovates in AI (e.g., Apple Intelligence). Thus, we should view Apple as a computer hardware company in a portfolio that includes Dell and Intel but as a digital content provider in a portfolio that includes Netflix and Spotify.

Finally, we consider transformer models such as BERT and GPT, which address the limitations of Word2Vec (Vaswani et al., 2017). A transformer model estimates a contextualized embedding as a weighted average of the word embeddings in a sentence. In our application, the transformer model estimates a contextualized embedding as a weighted average of the asset embeddings in a portfolio. The transformer model also uses information about the order of the assets in the entire portfolio through position embeddings.

### *3.2. Recommender Systems*

Starting with reduced-form demand (3), we apply PCA to log dollar holdings. We estimate the parameter vector $\boldsymbol{\theta} = (\boldsymbol{\lambda}_i', \boldsymbol{x}_a', \delta_i, \delta_a)'$ through the objective function:

$$\min_{\boldsymbol{\theta}} \sum_{i=1}^{I} \sum_{a=1}^{A} \left(h_{ia} - \boldsymbol{\lambda}_i' \boldsymbol{x}_a - \delta_i - \delta_a\right)^2 + \frac{\eta_\lambda}{IK} \sum_{i=1}^{I} \boldsymbol{\lambda}_i' \boldsymbol{\lambda}_i + \frac{\eta_x}{AK} \sum_{a=1}^{A} \boldsymbol{x}_a' \boldsymbol{x}_a. \tag{4}$$

[2]This method is the continuous bag of words. Alternatively, the continuous skip-gram method uses the target word to predict the surrounding words in a context window.

The first term is the mean squared error for log dollar holdings. The second and third terms regularize the investor and asset embeddings.

A recommender system won the Netflix Prize, which was a 2006 competition to predict whether a viewer $i$ would like a movie, given her past ratings $h_{ia}$ on a subset of movies. The embedding $\boldsymbol{x}_a$ represents the latent characteristics of movie $a$, and the embedding $\boldsymbol{\lambda}_i$ represents the viewer's preferences over the latent characteristics. Consider an alternative approach based on observed characteristics such as genre, length, and the parental guidance rating. Observed characteristics would have difficulty predicting preferences for niche categories like teenage vampire movies that are romantic. A recommender system automatically generates embeddings that represent "teenage", "vampire", and "romantic" and delivers an accurate recommendation.

Similarly, suppose that some investors like firms with a large number of GPUs for AI computing, high intangible capital, and generous work-from-home policies. This type of information is not readily available in accounting data and is difficult to systematically collect for all firms. However, a recommender system can recover this information from portfolio holdings data, as long as some investors collect and use this information in portfolio choice. Thus, asset embeddings could have broader economic application to represent firm characteristics that are difficult to measure, such as intangible capital or work-from-home policies.

#### 3.2.1. Variants

We consider several variants of the recommender system to learn which dimensions of the portfolio holdings data are most useful for the various benchmarks in Section 4. We take an exploratory approach in the absence of theoretical predictions on which variant performs best on which benchmark. The portfolio holdings data are sparse with many zero positions. In a variant labeled RS-Binary, we use only binary information for positive versus zero positions. In equation (4), we set $h_{ia} = 1$ for positive positions, $h_{ia} = 0$ for zero positions, and $\delta_i = 0$. We estimate this variant by PCA without regularization (i.e., $\eta_\lambda = \eta_x = 0$).

In a variant labeled RS-Ranks, we use only percentile ranks and replace zero positions with zeros. In equation (4), we set $h_{ia}$ to the percentile rank (i.e., ranking of the positive positions divided by $|\mathcal{N}_i|$) such that $h_{ia} = 1$ for the largest positive position, $h_{ia} = \frac{1}{|\mathcal{N}_i|}$ for the smallest positive position, and $h_{ia} = 0$ for the zero positions. We estimate this variant by PCA without regularization.

We next consider two variants that use log dollar holdings but make different economic assumptions about the zero positions. We first estimate the investor fixed effects as the mean of $h_{ia}$ by investor. We then estimate the asset fixed effects as the mean of $h_{ia} - \delta_i$

by asset. We then remove the investor and asset fixed effects as $\hat{h}_{ia} = h_{ia} - \delta_i - \delta_a$. In a variant labeled RS-L-0, we replace the zero positions with zeros (i.e., the average value conditional on investor and asset fixed effects). This variant assumes that the zero positions are uninformative, as if they were determined by investment mandates. In a variant labeled RS-L-Min, we replace the zero positions with the smallest value of $\hat{h}_{ia}$ for investor $i$. This variant assumes that the zero positions reflect a negative view, as if they were determined by binding short-sale constraints. We estimate both variants by PCA without regularization.

In a final variant labeled RS-L, we use only the intensive margin of positive positions. In equation (4), we use log dollar holdings but sum over only positive positions (i.e., $\sum_{a \in \mathcal{N}_i}$). We estimate the regularization parameters $(\eta_\lambda, \eta_x)$ by ten-fold cross-validation. We refer to Appendix B for further details on the estimation.

We discuss two potential extensions. First, we estimate high-dimensional unsupervised asset embeddings and train them on our benchmarks by ten-fold cross validation. Since we find good performance on all of our benchmarks, we did not pursue supervised estimation in this paper. However, supervised estimation is a straightforward extension that may be a powerful alternative, which produces lower-dimensional asset embeddings that are specialized to the benchmark (Bryzgalova et al., 2023). We could estimate the asset embeddings through a supervised objective function (B1), estimating the regularization parameters by ten-fold cross validation. Second, in Appendix C, we propose to use historical data, in addition to the current quarter, to sharpen the embedding estimates.

### *3.3. Shallow Neural Network Models*

Word2Vec exploits the fact that related words appear closely together in a sentence such as "salt" and "pepper". In analogy, investors assign similar portfolio weights to assets with similar asset embeddings, according to the portfolio theory underlying equation (3). Therefore, we order the assets in an investor's portfolio in a decreasing order of portfolio weights.[3] In the training data, we mask the $k$-th largest position in each investor's portfolio, which we denote as $b_i(k)$. We then train Word2Vec to predict the masked asset, based on the surrounding assets in a context window. We denote the set of assets in the context window as $\mathcal{C}_i(k) = \{a_i(l) \mid 0 < |k - l| \leq \chi\}$, where $\chi$ determines the size of the context window.

Let $\mathcal{B} = \{b_i(k) = [\text{MASK}]\}$ be the set of all masked assets in the validation data, where the true identity of the masked asset is $b_i(k) = a_i(k)$. Word2Vec exploits the fact that the masked asset should have an asset embedding that is similar to those of the assets in the context window. We define the average asset embedding in the context window as

[3]Alternatively, we could order the assets based on the difference between the portfolio weights and the market weights or a measure of portfolio rebalancing, which we describe in Appendix A.

$\boldsymbol{x}_i(k) = \frac{\sum_{a \in \mathcal{C}_i(k)} \boldsymbol{x}_a}{|\mathcal{C}_i(k)|}$. Word2Vec assigns a probability distribution over the masked asset, conditional on the average asset embedding in the context window:

$$\Pr\left(b_i(k) = a \mid \boldsymbol{x}_i(k)\right) = \frac{\exp\left(\boldsymbol{x}_a' \boldsymbol{x}_i(k)\right)}{\sum_{b \notin \mathcal{C}_i(k)} \exp\left(\boldsymbol{x}_b' \boldsymbol{x}_i(k)\right)}. \tag{5}$$

That is, the masked asset should have a high similarity with the average asset embedding in the context window. We train Word2Vec to minimize the cross-entropy loss function over the masked assets:

$$\ell = -\sum_{b_i(k) \in \mathcal{B}} \ln\left(\Pr\left(b_i(k) = a_i(k) \mid \boldsymbol{x}_i(k)\right)\right). \tag{6}$$

We can modify this methodology to estimate investor embeddings. Instead of ordering the assets for each investor based on its portfolio weights, we rank the investors for each asset based on its ownership shares. Word2Vec assigns a probability that the masked investor ranked $k$ is investor $i$, conditional on the average investor embedding in the context window. We implement this idea for the transformer model to test its ability to identify similar investors.

Global Vectors for Word Representation (GloVe) is a model that is related to Word2Vec, which is a matrix factorization method based on the co-occurrence matrix of words in a certain context window (Pennington et al., 2014). In Appendix C, we discuss how to use GloVe to estimate asset embeddings.

### *3.4. Transformer Models*

In recommender systems and Word2Vec, the embedding assigned to a word or an asset does not change, depending on the context. For example, the word "bank" has a different meaning in "bank deposit" versus "river bank". Similarly, Citigroup has a different context as part of a banking portfolio, large-cap portfolio or value portfolio. Following Vaswani et al. (2017), modern LLMs such as BERT and GPT are transformer models with an attention mechanism, which estimate contextualized embeddings. A transformer model can be an encoder that transforms an input sequence into contextualized embeddings or a decoder that transforms contextualized embeddings into an output sequence. We adopt the BERT model, which is a bidirectional encoder.[4]

[4]The BERT model is a bidirectional encoder, using surrounding words on both sides of the target word. In contrast, the GPT model is an unidirectional decoder, generating the next word based on the previous words. The BERT model is a better fit our application, by estimating contextualized embeddings from the entire portfolio. The GPT model may be suited for some applications such as generative portfolios that we discuss in Section 7.

#### 3.4.1. An Example of the Attention Mechanism

We start with a simple example of the attention mechanism to describe contextualized embeddings, specializing the textbook treatments of this subject to our context (Prince, 2023; Jurafsky and Martin, 2025). Investor $i$ holds a set of assets $\mathcal{A}_i$, and our goal is to estimate the contextualized embedding for asset $a \in \mathcal{A}_i$. We start with an input embedding $\boldsymbol{x}_a$ for asset $a$, called the query. We also have an input embedding for $\boldsymbol{x}_b$ for each asset $b \in \mathcal{A}_i$, called the key. We compute the similarity between the query and the key as $\sigma_{ab} = \boldsymbol{x}_a' \boldsymbol{x}_b$. We then compute the contextualized embedding for asset $a$ as a weighted average of input embeddings $\boldsymbol{x}_b$, called the values:

$$\boldsymbol{x}_a^i = \frac{\sum_{b \in \mathcal{A}_i} \exp(\sigma_{ab}) \boldsymbol{x}_b}{\sum_{b \in \mathcal{A}_i} \exp(\sigma_{ab})}. \tag{7}$$

The query $\boldsymbol{x}_a$ is a high-dimensional vector that captures many aspects of a firm, including its industry classification, reliance on external finance, and supply-chain risk. The contextualized embedding $\boldsymbol{x}_a^i$ focuses attention on external finance if the other assets in the portfolio have a high similarity through the elements that represent external finance. Clearly, the attention mechanism delivers a different contextualized embedding for asset $a$, depending on the other assets in the portfolio.

In this simple example, we used the same embeddings for the query, the keys, and the values. Generalizing this example, the transformer model uses $\boldsymbol{q}_a = \boldsymbol{W}_q \boldsymbol{x}_a$ as the query, $\boldsymbol{k}_b = \boldsymbol{W}_k \boldsymbol{x}_b$ as the keys, and $\boldsymbol{v}_b = \boldsymbol{W}_v \boldsymbol{x}_b$ as the values. We need to estimate these matrices $\boldsymbol{W}$ as part of the training. We compute the similarity between the query and the key as $\sigma_{ab} = \boldsymbol{q}_a' \boldsymbol{k}_b$. We then compute the contextualized embedding for asset $a$ as a weighted average of the values:

$$\boldsymbol{x}_a^i = \frac{\sum_{b \in \mathcal{A}_i} \exp(\sigma_{ab}) \boldsymbol{v}_b}{\sum_{b \in \mathcal{A}_i} \exp(\sigma_{ab})}. \tag{8}$$

The transformer model stacks multiple attention layers with a feed-forward layer in between. A transformer model is faster and has better performance with multiple attention heads per layer, by allowing the attention heads to focus on different aspects of the portfolio. Michel et al. (2019) provides an in-depth discussion of the benefits of multi-headed attention mechanisms.

What is still missing from the model so far is information about the location of words or, in our case, the position of assets in an investor's portfolio. Without such information, the model treats the inputs as a bag of words (or bag of stocks). To incorporate this important information, we rank all assets in an investor's portfolio based on the holdings (or, alternatively, active weights or rebalancing) to determine each asset's position. We then

take the sum of the position embeddings and the input asset embeddings $x_a$, and use the summed embeddings as inputs into the model. The position embeddings are estimated in modern BERT models alongside the input embeddings and the parameters of the attention layers.[5]

### 3.4.2. Training the BERT Model

To explain our application of the BERT model, we first summarize the training process for the original BERT model. Researchers train the BERT model on two tasks, masked language modeling and next-sentence prediction. In masked language modeling, we mask one (or multiple) words in a sentence. For example, the BERT model must predict the masked word in "The Fed decided to ____ the target rate to fight inflation." The BERT model generates a probability distribution over the masked word, based on the other words in the sentence. We estimate the BERT model to maximize the probability of picking the right word on a training sample. To pick the hyper-parameters, we evaluate the model on a validation sample to make sure that the model does not overfit.

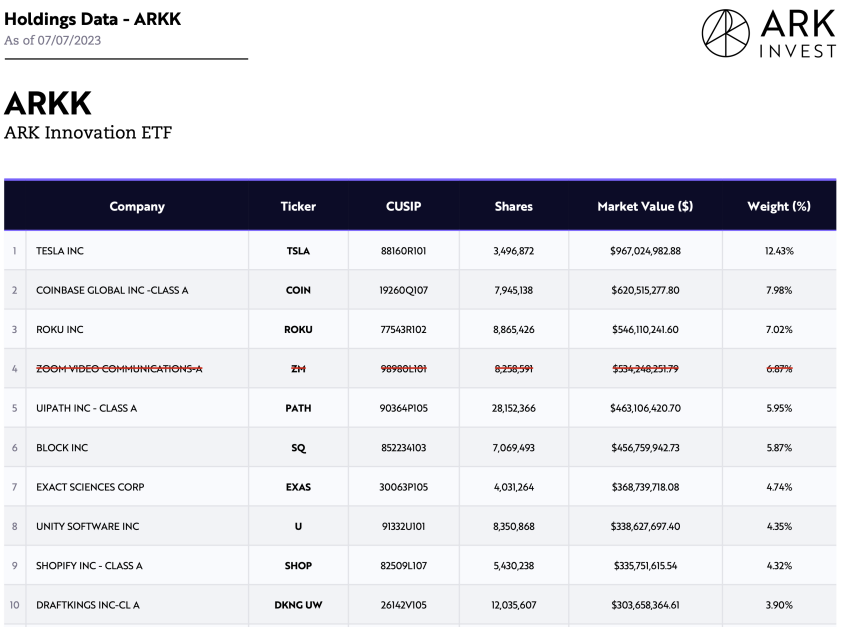
The trained BERT model assigns an input embedding $\boldsymbol{x}_a$ for each word $a$ and a contextualized embedding $\boldsymbol{x}_a^i$ (see (8)) for each word $a$ in sentence $i$, which depends on the other words in the sentence. In some applications such as sentence classification or sentiment analysis, we would like to summarize an entire sentence. For this purpose, Reimers and Gurevych (2019) fine-tune the pre-trained BERT model to predict whether two sentences belong together (i.e., two consecutive sentences) or not (i.e., randomly paired sentences). We commonly estimate a sentence embedding by averaging the contextualized embeddings for all words in a sentence as $\frac{1}{|\mathcal{A}_i|}\sum_{a\in\mathcal{A}_i}\boldsymbol{x}_a^i$, to which we will refer as the average contextualized embedding. Alternatively, we could use the [CLS] token, which is the first token of a sentence that represents the entire sentence.

We estimate two variants of the BERT model for our application: Portfolio-Shares BERT (PS-BERT) and Ownership-Shares BERT (OS-BERT). In PS-BERT, we use the investor's portfolio shares to estimate average contextualized investor embeddings, which capture investor similarity. In OS-BERT, we use the asset's ownership shares to average contextualized estimate asset embeddings, which capture asset similarity.

### 3.4.3. Portfolio-Shares BERT

To implement PS-BERT, we order the assets in an investor's portfolio in a decreasing order of portfolio weights. In practice, the input sequence may look like

[5]We also explored a BERT model with sinusoidal position embeddings, following Devlin et al. (2019). However, a BERT model with learned position embeddings performs better in our applications.



**Holdings Data - ARKK**
As of 07/07/2023

ARK INVEST

**ARKK**
ARK Innovation ETF

| | Company | Ticker | CUSIP | Shares | Market Value ($) | Weight (%) |
|---|---|---|---|---|---|---|
| 1 | TESLA INC | TSLA | 88160R101 | 3,496,872 | $967,024,982.88 | 12.43% |
| 2 | COINBASE GLOBAL INC -CLASS A | COIN | 19260Q107 | 7,945,138 | $620,515,277.80 | 7.98% |
| 3 | ROKU INC | ROKU | 77543R102 | 8,865,426 | $546,110,241.60 | 7.02% |
| 4 | ~~ZOOM VIDEO COMMUNICATIONS-A~~ | ~~ZM~~ | ~~98980L101~~ | ~~8,258,591~~ | ~~$534,248,251.79~~ | ~~6.87%~~ |
| 5 | UIPATH INC - CLASS A | PATH | 90364P105 | 28,152,366 | $463,106,420.70 | 5.95% |
| 6 | BLOCK INC | SQ | 852234103 | 7,069,493 | $456,759,942.73 | 5.87% |
| 7 | EXACT SCIENCES CORP | EXAS | 30063P105 | 4,031,264 | $368,739,718.08 | 4.74% |
| 8 | UNITY SOFTWARE INC | U | 91332U101 | 8,350,868 | $338,627,697.40 | 4.35% |
| 9 | SHOPIFY INC - CLASS A | SHOP | 82509L107 | 5,430,238 | $335,751,615.54 | 4.32% |
| 10 | DRAFTKINGS INC-CL A | DKNG UW | 26142V105 | 12,035,607 | $303,658,364.61 | 3.90% |

Figure 1. An Example of a Masked Portfolio. This figures shows the top ten holdings of the ARK Innovation ETF in July 2023. The fourth largest position, which is Zoom Video Communications, is masked by a red line.

Tesla, Coinbase Global,..., DraftKings.

We represent the name of each asset as a token, which results in $A$ tokens (i.e., the number of assets) plus a few special tokens.[6]

We estimate the investor embeddings in two steps. In the first step, we train a BERT model with four attention layers, two attention heads per layer, and a context window of 62 assets. We break up the portfolio into equal chunks if there are more than 62 assets in the portfolio. In analogy to masked language modeling, we mask one (or more) of the assets in an investor's portfolio. Following Devlin et al. (2019, Appendix A), we mask 15% of the assets in the training data, of which 80% are assigned the token [MASK], 10% are assigned the actual asset, and 10% are assigned a random asset. We then train the BERT model to predict the masked assets. For example, Figure 1 shows the top ten holdings of the ARK Innovation ETF in July 2023. The BERT model must predict the masked asset in the fourth largest position, which is Zoom Video Communications.

Let $\mathcal{B} = \{b_i(k) = [\text{MASK}]\}$ be the set of all masked assets in the validation data, where the true identity of the masked asset is $b_i(k) = a_i(k)$. The BERT model assigns a probability distribution $\Pr(b_i(k) = a \mid \mathcal{A}_i(k))$ over the masked asset, conditional on the set $\mathcal{A}_i(k)$ of

[6]The special tokens are [CLS] for the beginning of a sentence, [SEP] for the end of a sentence, [UNK] for unknown tokens (which does not apply in our case), [PAD] to complete the length of the sentence to a standard batch size of, in our case, 64, and [MASK] for the masked tokens.

all other assets in the investor's portfolio. We train the BERT model to minimize the cross-entropy loss function over the masked assets:

$$\ell = -\sum_{b_i(k)\in\mathcal{B}} \ln\left(\Pr\left(b_i\left(k\right) = a_i\left(k\right) \mid \mathcal{A}_i\left(k\right)\right)\right). \tag{9}$$

The trained model assigns an input embedding for each asset and a contextualized embedding for each investor-asset pair through the attention mechanism.

In the second step, we train a sentence transformer model by fine-tuning the pre-trained BERT model. We split the even and odd positions of a portfolio to construct portfolio pairs, where each half contains up to 62 assets. We train the sentence transformer model to predict the portfolio pairs, where the even and odd positions of the same investor are a match. In fine-tuning the sentence transformer, we use cosine similarity between investor embeddings as a distance measure to predict matching pairs. This step ensures that we can use cosine similarity as a distance measure to compare investor embeddings.

With the trained sentence transformer in hand, we compute the average contextualized embedding for a given investor for the largest 62 positions (due to the length of the context window), and refer to it as the investor embedding.

#### 3.4.4. Ownership-Shares BERT

To implement OS-BERT, we order an asset's investors in a decreasing order of ownership shares. In practice, the input sequence may look like

> Vanguard Growth Index Fund, Fidelity Magellan Fund,..., ARK Innovation ETF.

We represent the name of each investor as a token, which results in $I$ tokens (i.e., the number of investors) plus a few special tokens.

We estimate the asset embeddings for the OS-BERT model, following the same two steps as the PS-BERT model. We first train the BERT model to predict masked investors. The trained model assigns an input embedding to each investor and, for every asset, a contextualized embedding for each investor, which conditions on the other investors holding the asset, through the attention mechanism. In the second step, we train a sentence transformer model by fine-tuning this pre-trained BERT model. We train the sentence transformer model to predict the ownership pairs, where the even and odd positions of the same asset are a match.

We use the trained model to compute the contextualized embedding for each investor holding an asset and refer to the average contextualized embedding for a given asset as the asset embedding. We again average the embeddings of the largest 62 owners due to the

length of the context window. Through the fine-tuning step, we make sure that these asset embeddings can be compared using cosine similarity as a distance measure.

In the baseline specification, we train the OS-BERT model on each cross section. In Appendix C, we consider a generalized training procedure that uses a longer sample to pre-train the model and a more recent sample to fine-tune the model. This method uses more data and can provide more accurate estimates of embeddings. However, in our exploration, we found the performance gains to be too limited to add this additional complexity. In the same appendix, we also propose an integrated model of asset and investor embeddings, which we leave for future research.

## 4. Benchmarks to Evaluate Model Performance

The advancement of AI relies critically on benchmarks to evaluate new models and to compare them against existing models. For example, the image classification benchmarks in the ImageNet Large Scale Visual Recognition Challenge were instrumental in the advancement of deep learning and its application to computer vision. Benchmarks level the playing field for all research teams by establishing clear metrics of progress and success.

We introduce three benchmarks to evaluate the application of AI models to finance. They are predicting relative valuations, explaining the comovement of stock returns, and predicting institutional portfolio decisions. We choose these benchmarks because they satisfy three important criteria. First, the asset pricing model in Section 2 predicts that the portfolio holdings data are informative for these benchmarks. Second, these benchmarks are at the heart of asset pricing and portfolio theory, for which we have existing models (e.g., the Fama-French five-factor model) that establish a high hurdle. Third, these benchmarks require only a single quarter of data (i.e., a single cross section or a short panel of monthly data). This criterion facilitates a true out-of-sample test to measure progress in real time. For example, we could imagine an annual competition to evaluate new models on these benchmarks, just like the ImageNet Large Scale Visual Recognition Challenge.

### *4.1. Relative Valuation Benchmark*

Financial analysts assess the valuation of an existing firm or predict the valuation of a new firm through a comparison with similar firms matched on characteristics (Hommel et al., 2023; Ben-David and Chinco, 2024). The asset pricing model in Section 2 implies that we should define similar firms based on asset embeddings, instead of the usual practice of firm characteristics only. We focus on market-to-book equity as our measure of valuation, but other measures include the price-dividend ratio and the price-earnings ratio.

In Appendix A, we show that log market equity is a linear function of asset embeddings. In each quarter, we first estimate a cross-sectional regression of log market equity on log book equity $b_{at}$:

$$p_{at} = \gamma_t b_{at} + \alpha_t + p_{at}^{\perp}. \tag{10}$$

The residual $p_{at}^{\perp}$ is our valuation measure that is more general than market-to-book equity. Market-to-book equity is a special case when $\gamma_t = 1$.

We randomly split the sample of firms into 80% for training and 20% for out-of-sample testing, keeping the same split for all models. On the training data, we estimate a ridge regression of the valuation on the asset embeddings:

$$p_{at}^{\perp} = \boldsymbol{\beta}_t' \boldsymbol{x}_{at} + \delta_t + \epsilon_{at}. \tag{11}$$

In each quarter, we standardize the asset embeddings and estimate the ridge penalty by ten-fold cross validation.[7] We denote the estimated coefficients as $\hat{\boldsymbol{\beta}}_t$ and $\hat{\delta}_t$.

We evaluate the model performance in the testing data. The performance measure is the out-of-sample $R^2$, averaged over the entire sample period:

$$\text{RV} = 1 - \frac{1}{T}\sum_{t=1}^{T} \frac{\text{Var}\left(p_{at}^{\perp} - \hat{\boldsymbol{\beta}}_t' \boldsymbol{x}_{at} - \hat{\delta}_t\right)}{\text{Var}\left(p_{at}^{\perp}\right)}. \tag{12}$$

### *4.2. Return Comovement Benchmark*

A large literature in asset pricing finds variation in average stock returns and comovement of stock returns along firm characteristics. A test of average stock returns requires decades of data, but we could test comovement of stock returns on a single quarter of data. Thus, we test the performance of the asset embeddings against firm characteristics in explaining the comovement of stock returns. Firm characteristics are high hurdle because decades of research have selected those that have the highest explanatory power.

We use the asset embeddings in quarter $t-1$ to explain the monthly stock returns $r_{am}$

[7] One potential concern with using cross validation in cross-sectional models is cross-sectional dependance in the error terms, $\epsilon_{at}$. This is not of concern for our benchmarks for two reasons. First, given the micro foundation in Section 2, the cross-sectional dependance is precisely captured by the embeddings, $\boldsymbol{x}_{at}$. Indeed, the errors in (11) are size-weighted idiosyncratic demand shocks of investors that are cross-sectionally uncorrelated. Second, even if we use lower-dimensional embedding models and some residual correlation in the residuals remains, we are interested how well embeddings predict valuations (as opposed to causally identifying the impact of specific elements of the embeddings vector on valuations or, in case of the next benchmark, comovement; i.e., we are interested in the $R^2$ of regression (11), rather a structural interpretation of coefficient $\boldsymbol{\beta}_t$). By design, $\boldsymbol{\beta}_t$ then captures the projection of valuations (or comovement) on the embeddings space and the residuals are, by construction, uncorrelated. This validates our use of cross validation.

in quarter $t$. We randomly split the sample of firms into 80% for training and 20% for out-of-sample testing, keeping the same split for all models. On the training data, we estimate a ridge regression of monthly stock returns on the asset embeddings:

$$r_{am} = \boldsymbol{\beta}_m' \boldsymbol{x}_{a,t-1} + \delta_m + \epsilon_{am}, \tag{13}$$

where the slope $\boldsymbol{\beta}_m$ is a vector of monthly factor realizations. The constant $\delta_m$ removes the common factor with a unit factor loading across stocks. In each quarter, we standardize the asset embeddings and estimate the ridge penalty by ten-fold cross validation within the training sample. We denote the estimated coefficients as $\hat{\boldsymbol{\beta}}_m$ and $\hat{\delta}_m$.

We evaluate the model performance in the testing data. The performance measure is the out-of-sample $R^2$, averaged over the entire sample period:

$$\text{RC} = 1 - \frac{1}{M} \sum_{m=1}^{M} \frac{\text{Var}\left(r_{am} - \hat{\boldsymbol{\beta}}_m' \boldsymbol{x}_{a,t-1} - \hat{\delta}_m\right)}{\text{Var}\left(r_{am}\right)}. \tag{14}$$

### *4.3. Managed Portfolio Benchmark*

According to the portfolio theory underlying equation (3), investors assign similar portfolio weights to assets with similar asset embeddings. We test this core prediction using the managed portfolios of mutual funds, ETFs, and hedge funds.

We randomly split the sample of investors into 90% for training and 10% for out-of-sample testing, keeping the same split for all models. In the testing data, we mask the $k$-th largest position in each investor's portfolio, which we denote as $b_i(k)$. The model must predict the masked asset, based on the set $\mathcal{A}_i(k)$ of all other assets in the investor's portfolio. We set $k = 2$ in our implementation.[8]

In the training data, we estimate the recommender system, Word2Vec, and the PS-BERT model. To predict the masked asset, the model must assign a probability distribution over the masked asset. As we discussed in Section 3, Word2Vec and the PS-BERT model directly assign a probability distribution as part of the training process. For the recommender system, we start with equation (3) and make an additional assumption that $\epsilon_{ia}$ is drawn from a logistic distribution. Then the probability distribution over the masked asset is

$$\Pr\left(b_i(k) = a \mid \mathcal{A}_i(k)\right) = \frac{\exp\left(\boldsymbol{\lambda}_i' \boldsymbol{x}_a + \delta_a\right)}{\sum_{b \notin \mathcal{A}_i(k)} \exp\left(\boldsymbol{\lambda}_i' \boldsymbol{x}_b + \delta_b\right)}. \tag{15}$$

[8] We could increase the sample size by varying the position of the masked asset (i.e., $k = 2, 3, \ldots$). However, it is not necessary for our implementation because we already have a large sample of investors.

Intuitively, the masked asset should be the largest position among the set of assets that the investor does not hold, if the investor were to hold all assets.

We evaluate the model performance in the testing data. Let $\mathcal{B} = \{b_i(k) = [\text{MASK}]\}$ be the set of all masked assets in the testing data, where the true identity of the masked asset is $b_i(k) = a_i(k)$. The performance measure is the average log likelihood of correct predictions across investors, relative to the log likelihood of random guesses (i.e., $\frac{1}{|\mathcal{A}_i(k)|}$):

$$\text{MP} = \frac{\sum_{b_i(k)\in\mathcal{B}} \ln\left(\Pr\left(b_i(k) = a_i(k) \mid \mathcal{A}_i(k)\right)\right)}{-|\mathcal{B}| \ln\left(|\mathcal{A}_i(k)|\right)} - 1. \tag{16}$$

A higher measure implies better performance with an upper bound of one.

### *4.4. Proceeding Pragmatically without Statistical Guarantees*

Following much of the AI and ML literature, we proceed without statistical guarantees (i.e., unbiasedness, consistency, or optimality). Researchers have not yet developed the statistical tools to rigorously analyze the consistency and optimality of Word2Vec and the transformer models. Indeed, no one would claim that LLMs are optimal. Instead, researchers simply observe that these models perform well in many empirical applications. We proceed pragmatically by adopting models that have proven useful in other AI and ML applications and testing them on our benchmarks.

Researchers have developed asymptotic theory for the PCA model. In particular, Bai (2003) provides sufficient conditions for identification of factor models in the limit of large cross-sectional and time dimensions. These results apply to our setting in the limit of infinitely many investors and assets. The asymptotic theory also implies consistency in the relative valuation benchmark, as we have discussed above. We do not devote space to repeating the results that are valid only for the PCA model to keep a unified treatment of all models in Section 3. Instead, we refer interested readers to the relevant literature (Bai, 2009; Fortin et al., 2023).

## 5. Data and Measures of Asset Similarity

We provide a summary of the data construction with further details in Appendix D. We also describe competing models of firms, including firm characteristics and the text-based embeddings from Cohere and OpenAI.

### *5.1. Data Construction*

Our data construction essentially follows Koijen et al. (2024). We use the stock holdings of mutual funds, ETFs, closed-end funds, variable annuity funds, and hedge funds from the FactSet Ownership Data (FactSet, 2024). The data for hedge funds are from the Form 13F filings. For the other types of investors, we use data at the fund level instead of the 13F filer level (i.e., Vanguard funds instead of the Vanguard Group) for a more granular view of portfolios.[9] Future research may be able gain a more granular and complete view of institutional and households portfolios by bringing in additional data sources (e.g., Gabaix et al., 2023). Custodial data, which cover a large number of investors at a high frequency, would be ideal for this purpose.

We use the data on firm characteristics and stock returns from Jensen et al. (2023), which are based on the CRSP US Stock Database (Center for Research in Security Prices, 2024) and Compustat Fundamentals (S&P Global, 2024). We aggregate the stock-level data to the firm level by the CRSP permco. We remove micro and nano caps as defined by Jensen et al. (2023). We keep stocks that are held by at least 20 investors and investors who hold at least 20 stocks. In Section 8, we use cleaned transcripts of earnings calls from FactSet to interpret the asset embeddings. The quarterly sample period is 2005.Q1 to 2022.Q4.

Figure 2 shows the time series of the number of firms (left panel), investors (middle panel), and stock holdings (right panel). The number of funds and stock holdings increase substantially over time with the growing importance of institutional investors. In the context of LLMs, a larger and more diverse corpus enables researchers to estimate a larger transformer model for a fixed vocabulary (Kaplan et al., 2020). Thus, the growing number of stock holdings could enable researchers to estimate larger models of asset embeddings in the future.[10]

### *5.2. Competing Measures of Firm Similarity*

We use the benchmarks in Section 4 to evaluate the relative performance of three ways to represent firms and define firm similarity. They are holdings-based embeddings, firm characteristics, and the text-based embeddings from Cohere and OpenAI.

The first measure of firm similarity is the holdings-based embeddings. For each method in Section 3, we estimate embeddings whose dimension match the number of firm characteristics

[9] In an earlier version of this paper, we used only the institution-level data from the Form 13F filings. The asset embeddings performed well on our benchmarks, but not as well as using the fund-level data. We expect this result because more granular portfolio holdings lead to better estimates of the asset embeddings.

[10] An analysis of the scaling laws for transformer models based on portfolio holdings data is an interesting topic for future research.

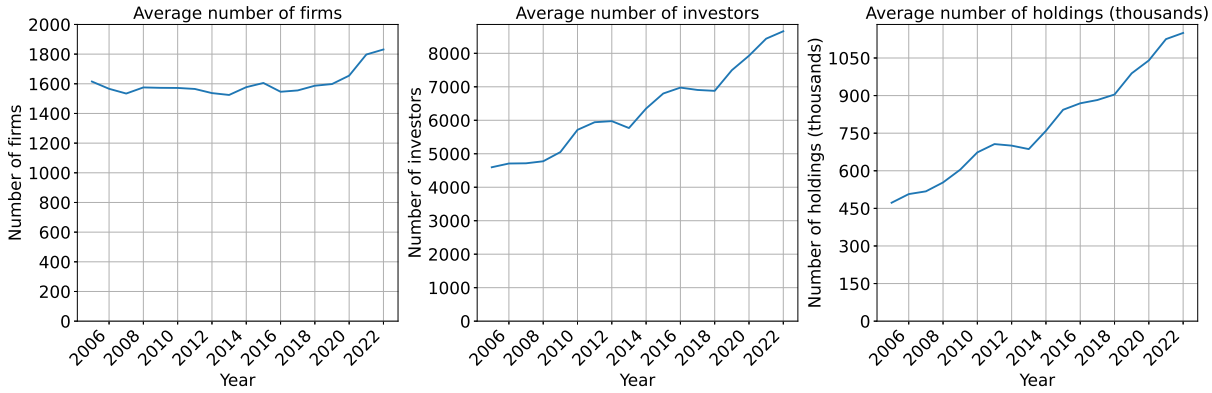



Figure 2. Number of Firms, Investors, and Stock Holdings. The quarterly observations for 2005.Q1 to 2022.Q4 are averaged by year.

that we describe below. We also estimate a larger model with ten dimensions, which is relatively small in the context of AI. Therefore, we also estimate larger models up to 128 dimensions for the recommender systems and the transformer models.

Observed firm characteristics are a natural competitor to measure asset similarity. For the relative valuation benchmark, we use four characteristics that include the market beta, asset growth, profitability, and the dividend-asset ratio. For this benchmark, we cannot use price-based characteristics such as book-to-market equity and momentum that have a mechanical correlation with the outcome variable. For the return comovement and managed portfolio benchmarks, we use six characteristics that include the market beta, log market equity, log book-to-market equity, asset growth, profitability, and momentum. We limit our sample to firms for which these characteristics are not missing.

The choice of firm characteristics always requires discretion. We choose the five characteristics in the Fama and French (2015) model and momentum as a high hurdle for the relative valuation and return comovement benchmarks. Decades of research have selected these characteristics for their high explanatory power. Consequently, these characteristics are among the most prominent in the asset pricing literature. Since our benchmark comparisons hold the dimension of the asset embeddings and the firm characteristics constant at six, we do not consider larger models of firm characteristics. However, a larger model of firm characteristics may be productive for some practical applications (Bryzgalova et al., 2022; Jensen et al., 2023).

The third measure of firm similarity is the text-based embeddings from two leading AI companies, Cohere and OpenAI. We use the most recent publicly available model as of March 2024. These embeddings represent not only the name of a firm (e.g., Apple as a fruit) but also its business (e.g., Apple as a technology firm). For example, OpenAI's ChatGPT model

Table 1. Competing Models of Firms and Investors

| Label | Description |
|---|---|
| Placebo | Random embeddings drawn from a standard normal distribution with the same dimension as the base model of asset embeddings. |
| Beta | Only the market beta as a characteristic. |
| Characteristics | Relative valuation benchmark: Market beta, asset growth, profitability, and dividend-asset ratio.<br>Return comovement and managed portfolio benchmarks: Market beta, log market equity, log market-to-book equity, asset growth, profitability, and momentum. |
| RS-Binary | Recommender system that uses only binary information for positive versus zero positions. |
| RS-Ranks | Recommender system that uses only percentile ranks and replaces the zero positions with zeros. |
| RS-L-0 | Recommender system that uses log dollar holdings, removes the investor and asset fixed effects, and replaces the zero positions with zeros. |
| RS-L-Min | Recommender system that uses log dollar holdings and replaces the zero positions with the investor's smallest positive position. |
| RS-L | Recommender system that uses log dollar holdings and ignores zero positions. |
| Word2Vec | Word2Vec estimated on stocks ordered by the investor's portfolio weights. |
| PS-BERT | Transformer model trained on the masked portfolio shares of investors. |
| OS-BERT | Transformer model trained on the masked ownership shares of stocks. |

For all models of asset embeddings, the dimension of the base model is the number of firm characteristics in the corresponding benchmark. The large model has ten dimensions.

gives a detailed description of a firm's business strategies and activities in response to a user prompt. As we describe in Appendix D, we reduce the dimension of the embeddings to four or ten for the relative valuation benchmark.

The text-based embeddings are current snapshots, which we cannot use for historical backtesting due to a look-ahead bias (Sarkar and Vafa, 2024). Therefore, we test the text-based embeddings on a single cross section at the end of our sample period. Cohere and OpenAI estimate the text-based embeddings on vast amounts of text data for use in a broad set of applications. We could fine-tune the text-based embeddings to improve performance on a specific benchmark (Sarkar, 2025). Similarly, we could fine-tune the holdings-based embeddings in Section 3, which we leave for future research.

For the remainder of the paper, we use the labels in Table 1 to refer to the competing models of firms and investors. We refer back to Section 3 for a detailed description of these models.

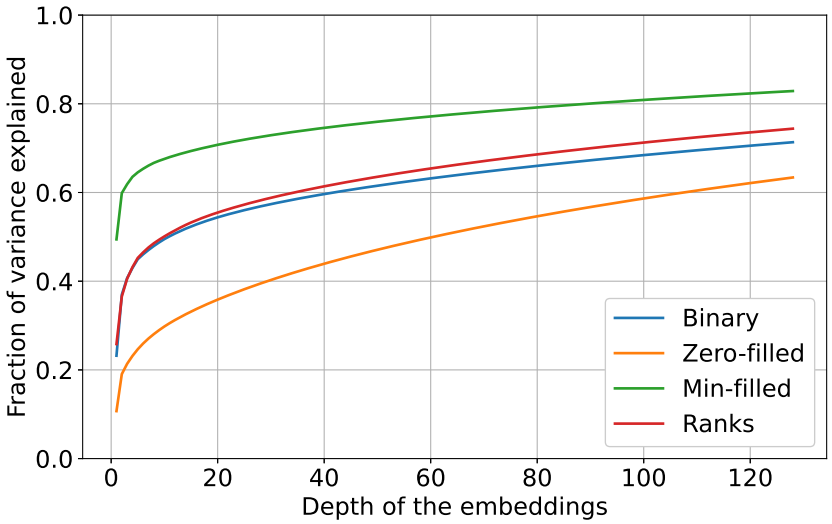



Figure 3. Variation in the Portfolio Holdings Explained by the Recommender Systems. The models are RS-Binary, RS-Ranks, RS-L-0, and RS-L-Min. See Table 1 for the model descriptions. The embedding dimension ranges from 4 to 128. The quarterly estimates for 2005.Q1 to 2022.Q4 are averaged over the entire sample period.

## 6. Main Empirical Results

We first examine how well the recommender systems in Section 3 explain the cross section of portfolio holdings. We then evaluate the performance of the asset embeddings, firm characteristics, and the text-based embeddings from Cohere and OpenAI on the benchmarks in Section 4. We also present an example of model output from the transformer models to illustrate how they define asset and investor similarity.

### *6.1. Explaining Portfolio Holdings through Recommender Systems*

For each recommender system that we estimate using PCA, we compute the share of the cross-sectional variance of the portfolio holdings that the asset embeddings explain. We then average this statistic over the entire sample period. Figure 3 reports the share of the cross-sectional variance of the portfolio holdings as a function of the embedding dimension from four to 128.

We have three main findings. First, all models explain most of the cross-sectional variance of the portfolio holdings when the embedding dimension is sufficiently high. When the embedding dimension is 128, the explained variation ranges from 63% for the RS-L-0 model to 83% for the RS-L-Min model. Second, the explained variation increases sharply for the first few dimensions, implying a strong factor structure in the portfolio holdings. Third, there are meaningful differences in explanatory power across the models. The RS-L-Min model has

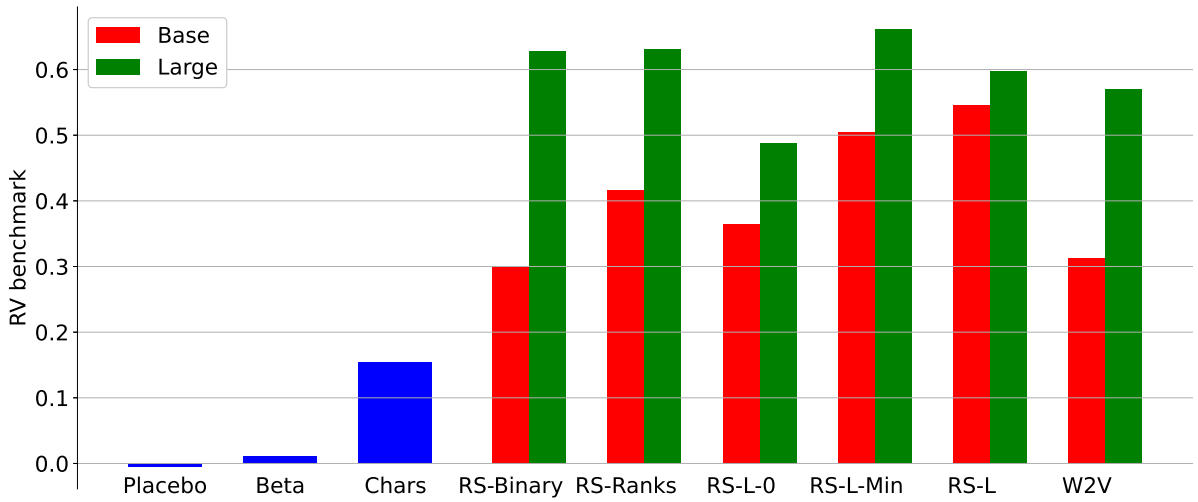



Figure 4. Relative Valuation Benchmark. From left to right, the models are placebo embeddings; the market beta as a characteristic; four characteristics (i.e., market beta, asset growth, profitability, and dividend-asset ratio); recommender systems RS-Binary, RS-Ranks, RS-L-0, RS-L-Min, and RS-L; and Word2Vec. See Table 1 for the model descriptions. The base model has four dimensions, and the large model has ten dimensions. The quarterly sample period is 2005.Q1 to 2022.Q4.

the highest explanatory power for a given embedding dimension, followed by the RS-Ranks model. These models ensure a smooth transition from the smallest positive position to the zero positions. The RS-Binary and RS-Ranks models have similar explanatory power with only small differences at higher dimensions.

### *6.2. Relative Valuation Benchmark*

Figure 4 reports the performance of the competing models in the relative valuation benchmark, which we described in Section 4. The firm characteristic are the market beta, asset growth, profitability, and the dividend-asset ratio. For each model of asset embeddings, we consider a base model with four dimensions to match the firm characteristics and a larger model with ten dimensions. We evaluate the models based on the performance measure (12), which is an out-of-sample $R^2$, over the entire sample period.

As we expect, the placebo embeddings have no explanatory power for relative valuations. The market beta has little explanatory power for relative valuations, but the four characteristics explain about 15% of relative valuations. The base models of asset embeddings with four dimensions significantly outperform the four characteristics, and the larger models with ten dimensions further improve the performance. Interestingly, both the RS-Binary model that uses only the extensive margin and the RS-L model that uses only the intensive margin

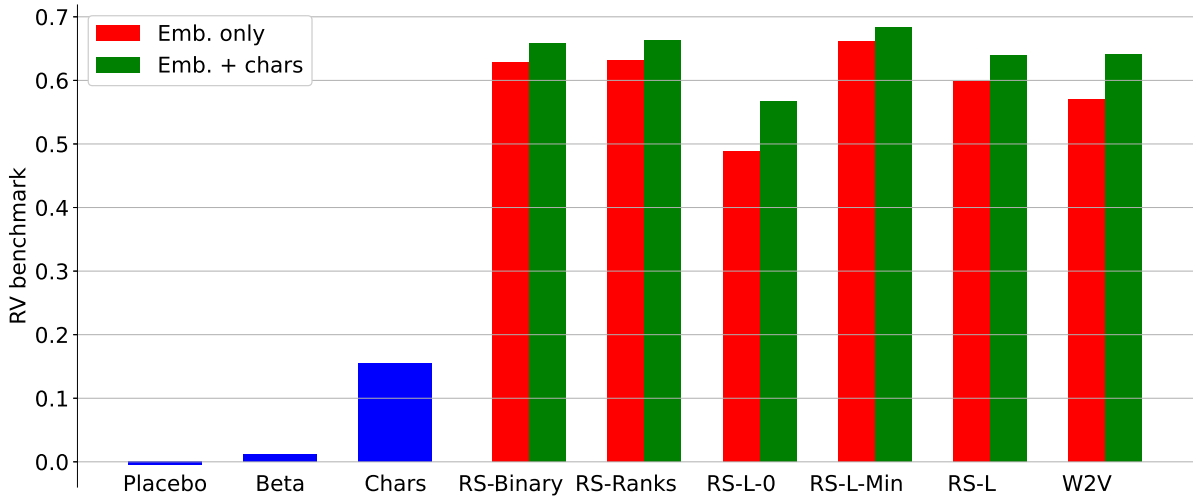



Figure 5. Combining Asset Embeddings and Firm Characteristics in the Relative Valuation Benchmark. The first bar repeats the performance of the large model of asset embeddings in Figure 4. The second bar reports the performance of a combined model of the asset embeddings and the four characteristics (i.e., market beta, asset growth, profitability, and dividend-asset ratio). The quarterly estimation sample covers 2005.Q1 to 2022.Q4.

benefit from a larger dimension. Among the models of asset embeddings, the RS-L-Min model has consistently high performance at both dimensions.

In Figure 5, the first bar repeats the performance of the large model of asset embeddings in Figure 4. The second bar reports the performance of a combined model of asset embeddings and the four characteristics. The performance gain from adding the four characteristics is small, implying that the asset embeddings already contain much of the information in these characteristics.

We compare the performance of holdings-based embeddings with that of text-based embeddings from Cohere and OpenAI. As we described in Section 5, we reduce the dimensions of the text-based embeddings to match the base (four-dimensional) and large (ten-dimensional) models of asset embeddings. Since the text-based embeddings are current snapshots, we limit the sample period to a single cross section in 2022.Q4. Figure 6 shows that the text-based embeddings have little explanatory power for relative valuations.

To understand the relatively poor performance of the text-based embeddings, Table 2 reports the ten closest firms to Apple, Citigroup, and Walmart, using the text-based embeddings from OpenAI. Although these embeddings identify firms with similar businesses, semantic similarity appears to also play an important role. For example, some of the firms that are closest to Citigroup are banks, but other firms like Cigna and Caci International simply start with "C" or "Ci". Similarly, the closest firm to Apple is Appian and to Walmart

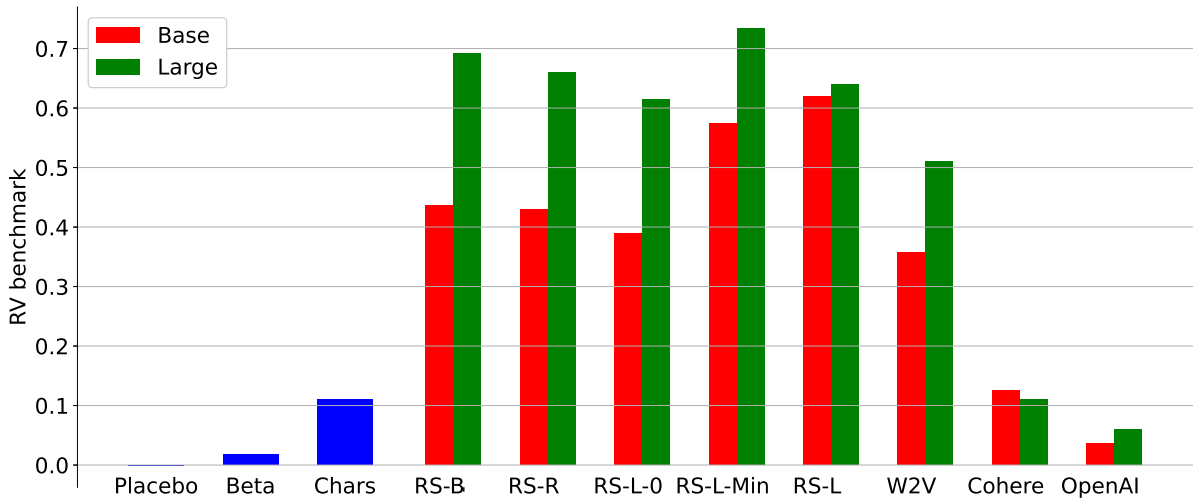



Figure 6. Text-Based Embeddings in the Relative Valuation Benchmark. The dimension of the text-based embeddings from Cohere and OpenAI are reduced to match the base (four-dimensional) and large (ten-dimensional) models of asset embeddings. The sample period is 2022.Q4.

is Walgreens. As we discussed in Section 5, we could fine-tune the text-based embeddings to potentially improve performance, which we leave for future research.

Figure 7 compares the performance of the RS-L-Min model and the OS-BERT model at high dimensions up to 128. We choose the RS-L-Min model as the best performing model at ten dimensions. Although the OS-BERT model has high explanatory power for relative valuations, the RS-L-Min model outperforms at all dimensions. The performance of the OS-BERT model is more sensitive to the embedding dimension than that of the RS-L-Min model. The performance of the RS-L-Min model starts to flatten at 16 dimensions, but the performance of the OS-BERT model keeps increasing beyond 16 dimensions.

These results suggest that the OS-BERT model may benefit from fine-tuning on the relative valuation benchmark. Indeed, we typically train LLMs on masked language modeling and subsequently fine-tune them on a specific task. We leave fine-tuning for future research, given the already solid performance of the OS-BERT model across the benchmarks in Section 4.

### *6.3. Return Comovement Benchmark*

Figure 8 reports the performance of the competing models in the return comovement benchmark, which we described in Section 4. The firm characteristics are the market beta, log market equity, log book-to-market equity, asset growth, profitability, and momentum. For each model of asset embeddings, we consider a base model of six dimensions to match the

Table 2. Text-Based Embeddings from OpenAI

| Rank | Apple Inc | Citigroup Inc | Walmart Inc |
|---|---|---|---|
| 1 | Appian Corp | Citizens Financial Group Inc | Walgreens Boots Alliance Inc |
| 2 | Adobe Inc | Goldman Sachs Group Inc | Home Depot Inc |
| 3 | Interdigital Inc | American International Group Inc | Murphy USA Inc |
| 4 | Microsoft Corp | Comerica Inc | Amazon Com Inc |
| 5 | Gopro Inc | Cigna Corp New | Qurate Retail Inc |
| 6 | Netapp Inc | Capital One Financial Corp | Big Lots Inc |
| 7 | Intel Corp | Caci International Inc | Burlington Stores Inc |
| 8 | Alphabet Inc | Capital City Bank Group | Dollar Tree Inc |
| 9 | Autodesk Inc | C N O Financial Group Inc | Nordstrom Inc |
| 10 | Appfolio Inc | JP Morgan Chase & Co | Kohls Corp |

This table reports the ten closest firms to Apple, Citigroup, and Walmart, according to the text-based embeddings from OpenAI.

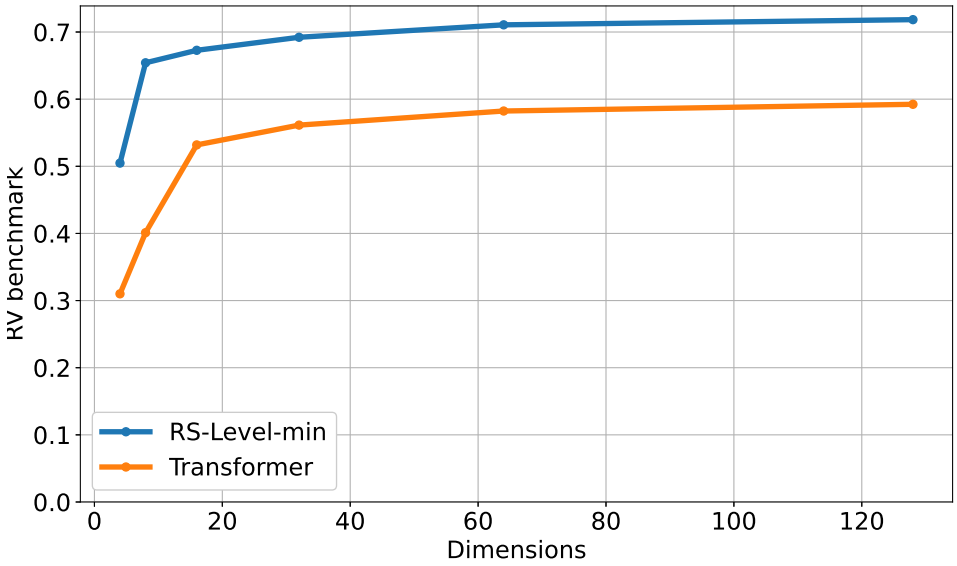



Figure 7. High-Dimensional Models in the Relative Valuation Benchmark. This figure reports the performance of the RS-L-Min model and the OS-BERT model at dimensions four to 128. The quarterly sample period is 2005.Q1 to 2022.Q4.

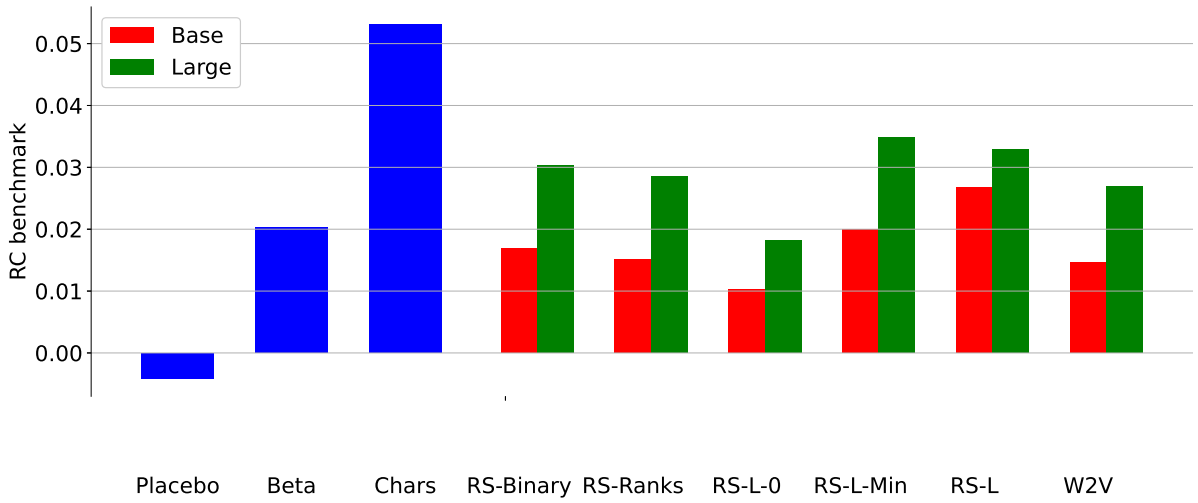



Figure 8. Return Comovement Benchmark. From left to right, the models are placebo embeddings; the market beta as a characteristic; six characteristics (i.e., market beta, log market equity, log market-to-book equity, asset growth, profitability, and momentum); recommender systems RS-Ranks, RS-L-0, RS-L-Min, and RS-L; and Word2Vec. See Table 1 for the model descriptions. The base model has six dimensions, and the large model has ten dimensions. The asset embeddings or firm characteristics in quarter $t-1$ are used to explain the monthly stock returns in quarter $t$. The quarterly sample period is 2005.Q1 to 2022.Q4.

firm characteristics and a larger model with ten dimensions. We evaluate the models based on the performance measure (14), which is an out-of-sample $R^2$, over the entire sample period.

As we expect, the placebo embeddings have no explanatory power for stock returns. The market beta explains 2% of the variation in stock returns, and the six characteristics explain 5.3%. These characteristics are a high hurdle because decades of research have selected them to explain the comovement of stock returns. The large models of asset embeddings with ten dimensions outperform the market beta but fall short of the high hurdle of six characteristics. Among the large models of asset embeddings, the RS-L-Min model has the highest performance.

In Figure 9, the first bar repeats the performance of the large model of asset embeddings in Figure 8. The second bar reports the performance of a combined model of asset embeddings and the six characteristics. All models outperform a baseline of the six characteristics only, implying that the asset embeddings contain independent information that helps to explain the comovement of stock returns.

Figure 10 compares the performance of the RS-L-Min model and the OS-BERT model at high dimensions up to 128. We choose the RS-L-Min model as the best performing model at ten dimensions. The performance of the RS-L-Min model peaks with an out-of-sample

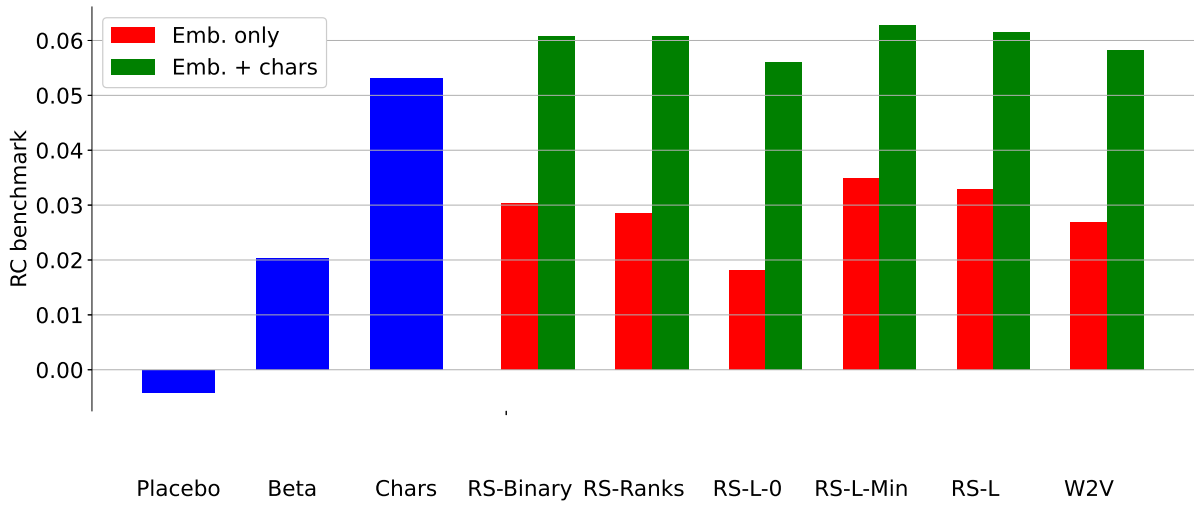



Figure 9. Combining Asset Embeddings and Firm Characteristics in the Return Comovement Benchmark. The first bar repeats the performance of the large model of asset embeddings in Figure 8. The second bar reports the performance of a combined model of the asset embeddings and the six characteristics (i.e., market beta, log market equity, log book-to-market equity, asset growth, profitability, and momentum). The asset embeddings or firm characteristics in quarter $t-1$ are used to explain the monthly stock returns in quarter $t$. The quarterly sample period is 2005.Q1 to 2022.Q4.

$R^2$ of 7.2%, exceeding 5.3% for the six characteristics. Thus, the higher dimensions of asset embeddings contain information that helps to explain the comovement of stock returns. The OS-BERT model does not perform as well as the RS-L-Min model, but its performance continues to improve at high dimensions. These results suggest that the OS-BERT model may benefit from fine-tuning on the return comovement benchmark, which we leave for future research.

### *6.4. Managed Portfolio Benchmark*

Figure 11 reports the performance of the competing models in the managed portfolio benchmark, which we described in Section 4. The firm characteristics are the market beta, log market equity, log book-to-market equity, asset growth, profitability, and momentum. For each model of asset embeddings, we consider a base model with six dimensions to match the firm characteristics and a larger model with ten dimensions. We evaluate the models based on the performance measure (16) over the entire sample period.

In contrast to the previous two benchmarks, holdings-based embeddings estimated using the Word2Vec model significantly outperform firm characteristics and holdings-based embeddings estimated using recommender systems. Word2Vec has a performance measure of 26% for the base model and 29% for the large model. The firm characteristics and the

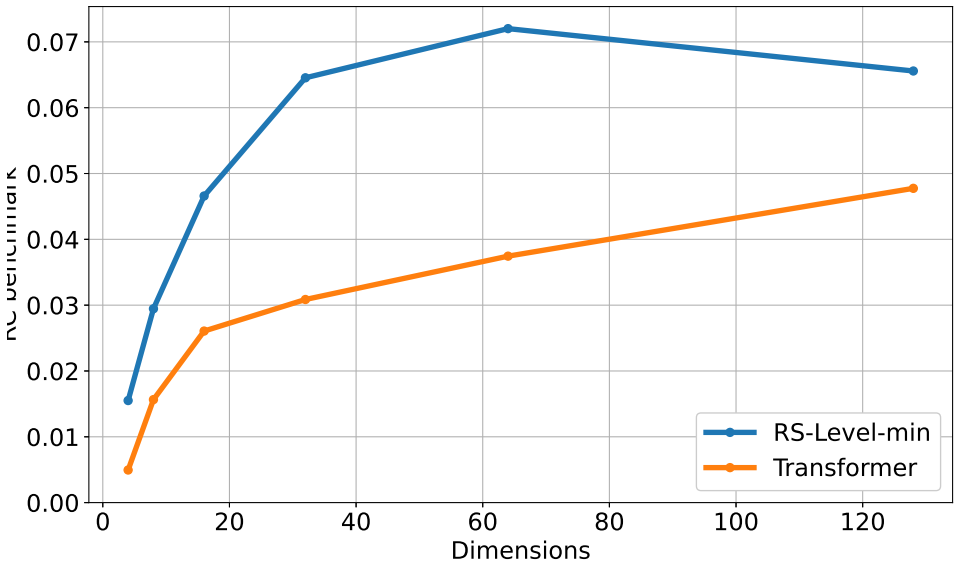



Figure 10. High-Dimensional Models in the Return Comovement Benchmark. This figure reports the performance of RS-L-Min recommender system and the OS-BERT model at dimensions four through 128. The asset embeddings in quarter $t-1$ are used to explain the monthly stock returns in quarter $t$. The quarterly sample period is 2005.Q1 to 2022.Q4.

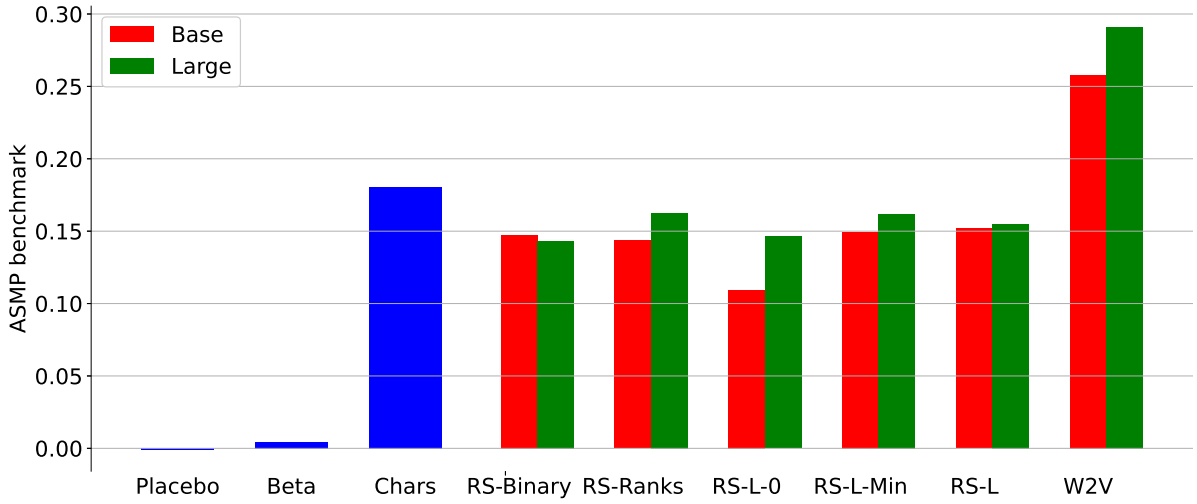



Figure 11. Managed Portfolio Benchmark. From left to right, the models are placebo embeddings; the market beta as a characteristic; six characteristics (i.e., market beta, log market equity, log market-to-book equity, asset growth, profitability, and momentum); recommender systems RS-Ranks, RS-L-0, RS-L-Min, and RS-L; and Word2Vec. See Table 1 for the model descriptions. The base model has six dimensions, and the large model has ten dimensions. The sample period is 2022.Q4.

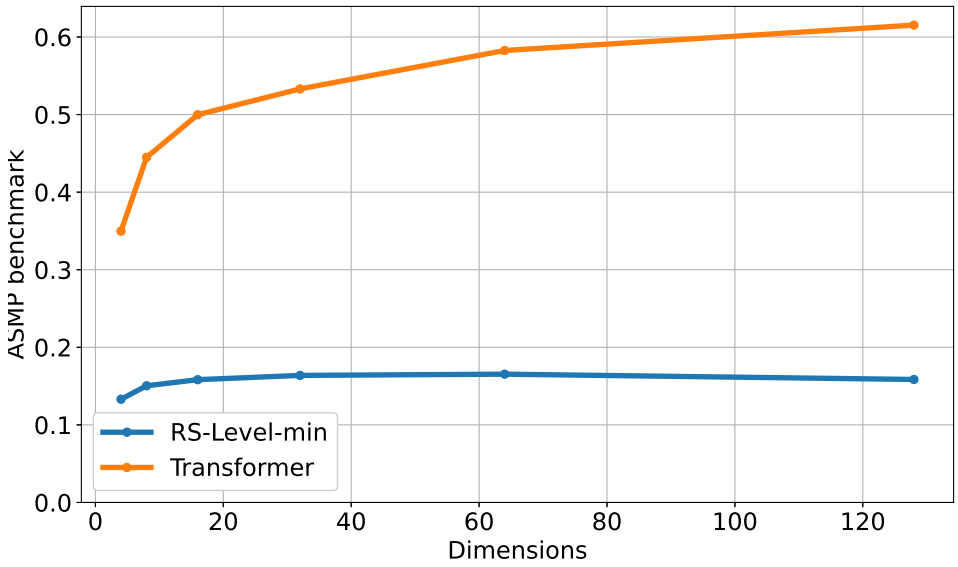



Figure 12. High-Dimensional Models in the Managed Portfolio Benchmark. This figure reports the performance of RS-L-Min recommender system and the PS-BERT model at dimensions four to 128. The sample period is 2022.Q4.

recommender systems have a performance measure below 20%.

Figure 12 compares the performance of the RS-L-Min model and the PS-BERT model at high dimensions up to 128. We train the PS-BERT model on masked assets in managed portfolios, which is precisely the objective of this benchmark. Even at low dimensions, the PS-BERT model outperforms Word2Vec and all other models. The performance measure for the PS-BERT model increases from 35% at four dimensions to over 60% at higher dimensions. The performance of the RS-L-Min model does not increase much at higher dimensions.

We offer three possible explanations for the large performance gap between the RS-L-Min model and the PS-BERT model. First, the RS-L-Min model is bilinear in asset and investor embeddings, while the PS-BERT model is nonlinear. The PS-BERT model may capture nonlinearities that are important for the managed portfolio benchmark. Second, the RS-L-Min model requires an auxiliary assumption that the probability distribution over the masked asset is a logit function (15), so an alternative specification may improve its performance. Third, the PS-BERT model minimizes a cross-entropy loss function over the masked assets, while the RS-L-Min model minimizes a least-squares loss function for log dollar holdings. The RS-L-Min model may outperform because the loss function directly aligns with the managed portfolio benchmark.

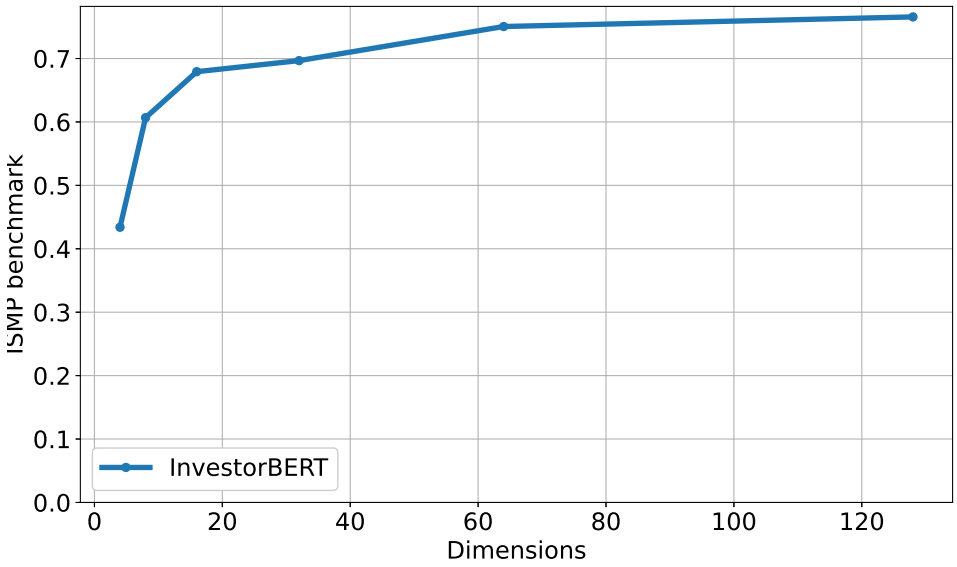



Figure 13. Masked Investor Benchmark. This figure reports the performance of the OS-BERT model at dimensions four through 128. The sample period is 2022.Q4.

### *6.5. Masked Investor Benchmark*

In analogy to the managed portfolio benchmark, we define a masked investor benchmark to test the performance of the OS-BERT model. Instead of predicting the second largest asset in a given portfolio, we predict the second largest investor for a given asset. The investor embeddings could identify similar investors beyond standard investor characteristics such as institutional type (e.g., mutual fund, hedge fund, or insurance company), size, benchmark portfolio, and measures of activeness (e.g., turnover and active share).

Figure 13 reports the performance of the OS-BERT model at high dimensions up to 128. The OS-BERT performs well in the masked investor benchmark, just as the PS-BERT model performs well on the managed portfolio benchmark in Figure 12. The performance measure for the OS-BERT model increases from 43% at four dimensions to over 70% at higher dimensions.

### *6.6. Identifying Similar Assets and Investors*

We present an example of model output from the transformer models to illustrate how they define asset and investor similarity. Table 3 reports the nine closest firms to Apple and Citigroup in 2022.Q4, based on the average contextualized embeddings from the OS-BERT model. Much of the model output conforms to our intuition for asset similarity. For example, Tesla, Amazon, Microsoft, Alphabet (Google), and Nvidia are technology firms that seem close to Apple. Likewise, American International Group, Wells Fargo, Goldman Sachs,

and Bank of America are financial firms that seem close to Citigroup. However, industry is only one of many characteristics that investors consider in portfolio choice. Investors could consider other characteristics such as profitability, riskiness, or ESG score. The multi-dimensional nature of asset similarity could easily explain why the model output does not always align along industry characteristics.

Table 3 also reports the nine closest investors to the Dimensional US Small Cap Value ETF and AQR Arbitrage in 2022.Q4, based on the average contextualized embeddings from the PS-BERT model. Most of the model output conforms to our intuition for investor similarity. These funds have very different investment strategies. The Dimensional US Small Cap Value ETF follows a more traditional strategy that is familiar from the asset pricing literature (Fama and French, 1992) and Morningstar's classification system for funds. Eight of the nine closest investors have "small cap value" in their name. The lone exception of Undiscovered Managers Behavioral Value is actually a small-cap value fund, marketed as "Designed to provide long-term capital appreciation primarily through a portfolio of small-cap value stocks." We emphasize that the input into the PS-BERT model is portfolio holdings data and not the investor names.

AQR Arbitrage follows a less traditional strategy. According their Form ADV filing (Part 2A, Item 8: Methods of Analysis, Investment Strategies, and Risk of Loss), their investment strategy includes convertible arbitrage, convertible bonds, merger arbitrage, corporate events, and distressed investments. Thus, the names of the closest investors may not directly reveal similarity, except for a few cases with "arbitrage strategy" or "merger arbitrage" in the name. When we look up the descriptions of the closest investors, BCK Capital Management follows a "special situations investment strategy", and Water Island Capital is a "specialist in event-driven investing." Thus, the PS-BERT model correctly identifies investors with similar investment strategies.

## 7. Additional Applications of Embeddings

We discuss additional applications of asset embeddings, including generative portfolios, risk management and stress testing, and firm valuation. We also discuss additional applications of investor embeddings, including investor classification, performance evaluation, and detecting crowded trades. Finally, we discuss alternative data sources to maximize explanatory power.

### *7.1. Generative Portfolios*

We could use asset embeddings to construct replicating portfolios without historical data on stock returns, which is especially useful for new opportunities and risks not reflected in

Table 3. Asset and Investor Similarity in the Transformer Models

| Apple Inc | Citigroup Inc | Dimensional US Small Cap Value ETF | AQR Arbitrage LLC |
|---|---|---|---|
| Tesla Inc | Altria Group Inc | Acclivity Small Cap Value | BCK Capital Management LP |
| Costco Wholesale Corp | Exxon Mobil Corp | Undiscovered Managers Behavioral Value | Water Island Capital LLC |
| Amazon Com Inc | American International Group Inc | SEI Inst. Managed Trust - Small Cap Value | VIA AM SICAV - Alternative-Liquid |
| Microsoft Corp | Wells Fargo & Co New | SBL Series Q (Small Cap Value) | GAMCO International SICAV - Merger Arbitrage |
| Nike Inc | General Motors Co | Guggenheim Small Cap Value | Yakira Capital Management, Inc. |
| Alphabet Inc | Valero Energy Corp New | MassMutual Small Company Value | GDL |
| Nvidia Corp | Gilead Sciences Inc | MML Small Company Value | Pentwater Capital Management LP |
| Adobe Inc | Goldman Sachs Group Inc | PF Small Cap Value | Lyxor Newcits IRL - Tiedemann Arbitrage Strategy |
| Disney Walt Co | Bank Of America Corp | MML Small/Mid Cap Value | Gabelli & Co. Investment Advisers, Inc. |

We use the average contextualized embeddings from the OS-BERT model to identify the nine closest firms to Apple and Citigroup. We use the average contextualized embeddings from the PS-BERT to identify the nine closest investors to the Dimensional US Small Cap Value ETF and AQR Arbitrage. We define the closest firms and investors based on cosine similarity of the 128-dimensional contextualized embeddings. The sample period is 2022.Q4.

historical returns. For example, suppose that we would like to construct a COVID-19 factor that has low returns when COVID-19 infections increase. A starting point for this strategy could be long United Airlines and short Zoom, which are exemplar stocks for exposure to COVID-19 risks. To construct a diversified COVID-19 factor, we could use the asset embeddings to find stocks that are most similar to United Airlines and Zoom. We could use the same logic to construct an AI factor, starting from large players such as Alphabet, Amazon, Apple, Meta, Microsoft, and Nvidia.

### *7.2. Risk Management and Stress Testing*

Financial institutions, regulators, and central banks could use asset and investor embeddings for risk management and stress testing. For example, stable diffusion is a generative AI model that creates new images from text descriptions (Rombach et al., 2022). Similarly, regulators and central banks would like to generate stress scenarios that are possible but never realized in the past, which satisfy realistic substitution patterns across assets and investors. They could generate counterfactual changes in asset and investor embeddings, which imply counterfactual changes in asset prices in an asset demand system (Koijen and Yogo, 2019). Thus, we propose a novel methodology to generate stress scenarios, which could have broad application in risk management.

### *7.3. Firm Valuation*

Security analysts have long used the cost of capital implied by the CAPM to value a firm, given a firm's expected cash flows. Although faculty teach this basic approach to undergraduates and MBA students, they are aware that the CAPM is a simplified model that does not explain actual valuations (Chicago Booth, 2023). Even multi-factor models have poor predictions for actual valuations (Hommel et al., 2023).

An alternative approach is to estimate the cost of capital based on similar firms. However, a systematic definition of firm similarity is elusive. For example, is Apple more similar to technology or consumer-product firms? The asset pricing model in Section 2 implies that the asset embeddings directly reveal how investors perceive similarity. Confirming this theory, asset embeddings predict relative valuations better than firm characteristics in Section 4.

We could estimate the cost of capital based on asset embeddings in two ways. First, we could use the present-value identity to infer the cost of capital, based on the firm's expected cash flows and the valuation predicted by the asset embedding. Second, we could estimate of the cost of capital as the predicted value from a predictive regression of stock returns on the asset embeddings.

### *7.4. Applications of Investor Embeddings*

We do not fully explore investor embeddings in this paper, except for its performance in the masked investor benchmark in Section 6. We briefly discuss three applications of investor embeddings, which we leave for future research.

First, investor embeddings identify investors who implement similar investment strategies. Therefore, we could use the investor embeddings to systematically classify investors based on their investment strategies. Standard investor characteristics include institutional type (e.g., mutual fund, hedge fund, or insurance company), size, and measures of activeness (e.g., turnover and active share). However, these investor characteristics do not explain much of the variation in the investment strategies (Koijen et al., 2024).

Second, we could use the investor embeddings for performance evaluation. Daniel et al. (1997) develop characteristics-based benchmarks, based on market equity, book-to-market equity, and momentum. We could extend their insight to higher dimensions, which is important in light of the more recent literature cited in the introduction. We define a set of investors that are similar to investor $i$, based on cosine similarity of the investor embeddings, as $\mathcal{I}_i = \left\{ j \mid \frac{\boldsymbol{\lambda}_i' \boldsymbol{\lambda}_j}{\|\boldsymbol{\lambda}_i\| \|\boldsymbol{\lambda}_j\|} \geq \chi \right\}$. We then define investor $i$'s abnormal return as its return minus the average return of similar investors:

$$\alpha_{it} = r_{it} - \frac{1}{|\mathcal{I}_i|} \sum_{j \in \mathcal{I}_i} r_{jt}. \tag{17}$$

Third, the investor embeddings identify common factors in investment strategies, which is a natural measure of crowded trades. Examples of crowded trades that caused market dislocations include quantitative equity strategies in August 2007 and the Japanese carry trade in August 2024. Early detection of crowded trades, based on the investor embeddings, is valuable to investors and regulators.

### *7.5. Alternative Data Sources*

The literature has explored many sources of text data, including 10-K filings (Hoberg and Phillips, 2016; Chen and Sarkar, 2020), earnings calls (Hassan et al., 2019), and news articles (Binsbergen et al., 2023; Bybee et al., 2023; Sarkar, 2025). These text data could supplement the portfolio holdings data. An obvious extension of our research is to estimate high-dimensional embeddings based on portfolio holdings data, a large set of firm characteristics, and a collection of the text data to maximize explanatory power. We could also estimate lower-dimensional embeddings through fine-tuning or supervised estimation on a target task.

## 8. Interpreting Embeddings

Asset and investor embeddings are latent vector representations that perform well on the new benchmarks that we introduce. This raises the questions whether we can interpret the embeddings, also to connect them to economic models and theories. This is particularly challenging for individual elements of the embedding vectors as those are invariant to rotation. This feature is naturally shared with text embeddings.

In an attempt to interpret the asset embeddings, we could project them on firm characteristics. However, the benchmarks in Section 6 show that the asset embeddings contain important information that the firm characteristics do not. We explore an alternative approach that applies modern LLMs to cleaned transcripts of earnings calls. For any set of firms that are similar based on the asset embeddings, the LLM could provide interpretations of why investors hold firms together in their portfolios, for instance due to similar risk exposure, growth opportunities, and ESG characteristics.

### *8.1. Interpreting Asset Embeddings*

As an illustration, we start with ten firms in our sample that had the largest drawdowns during the first quarter of 2020. The firms are Occidental Petroleum Corporation (−70%), Marathon Petroleum Corporation (−60%), Discover Financial Services (−58%), EOG Resources Inc. (−57%), Boeing Company (−54%), Pioneer Natural Resources Company (−53%), ConocoPhillips (−52%), American International Group (−52%), Phillips 66 (−51%), and Valero Energy Corporation (−51%). We choose this example as a salient set of firms that were most exposed to the COVID-19 shock. However, our procedure applies to any set of similar firms, based on their stock returns or asset embeddings.

We feed the earnings calls for the ten firms in a given quarter as context into OpenAI's gpt-4o-2024-08-06 model. We then prompt the LLM:

---

You are a sophisticated financial analyst. The above context includes transcripts of earnings calls for the following companies:

{company_list}

that took place during the following year quarters: {year_quarter_list}. Carefully analyze these transcripts and then identify up to three of the common, most important risks shared by these companies. Please provide specific examples and details for each risk and discuss all companies in this context.

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By feeding the earnings calls in a specific quarter, the LLM summarizes the risks mentioned in earnings calls, limiting the risk of hallucinations. Figure 14 reports the summaries of the earnings calls in 2019.Q4 (top panel) and 2020.Q2 (bottom panel). The risks in 2019.Q4 are general, but the risks in 2020.Q2 are specific to COVID-19 and its impact on demand and operations, financial liquidity and capital management, and supply chain and operational disruptions.

We could extend this methodology in at least three ways. First, risk exposure is only one of many reasons why investors hold a group of stocks. We could adjust the prompt to summarize other reasons such as growth opportunities and ESG characteristics. Second, we could ask the LLM to summarize not only the similarities of the ten firms of interest but also the differences from other sets of firms across various industries. These other sets of firms serve as control groups to filter general risks that are not unique to the ten firms of interest. From a technical perspective, we may need to use LLMs with larger context windows (e.g., Google's Gemini) or use retrieval-augmented generation methods to handle the larger dataset. Third, we could feed additional context into the LLM, including 10-K filings, news articles, and analyst reports.

### *8.2. Interpreting Investor Embeddings*

We could use the same methodology to interpret the investor embeddings. As context, we could use the descriptions of the investment strategies in prospectuses (Abis et al., 2022), analyst reports (e.g., from Morningstar), and investor letters.

## 9. Conclusion

We introduce the concept of asset embeddings to represent firms and investor embeddings to represent investors and their strategies. We argue theoretically that portfolio holdings contain all relevant information about firms and investors and are ideal for estimating asset and investor embeddings. Just as documents structure words in ways that allow us estimate word embeddings, portfolios structure assets in ways that allow us to estimate asset embeddings. Thus, this paper is a bridge from recent advances in AI and ML to economics and finance.

We confirm empirically that asset and investor embeddings make powerful predictions in economics and finance applications. Asset embeddings predict relative valuations, explain the comovement of stock returns, and predict the portfolio choice of institutional investors. For example, a base model of four-dimensional asset embeddings explains over 50% of the variation in relative valuations, whereas a set of four leading firm characteristics explains

Based on the analysis of the earnings call transcripts for the companies listed, three common, significant risks shared by these companies are:

1. **Commodity Price Volatility:**
   - **Occidental Petroleum Corp., Marathon Petroleum Corp., EOG Resources, Inc., Pioneer Natural Resources Co., ConocoPhillips, Phillips 66, and Valero Energy Corp.**: These companies are heavily exposed to fluctuations in oil and gas prices, which can significantly impact their revenues and profitability. For instance, Occidental Petroleum and ConocoPhillips discussed the impact of oil price volatility on their financial performance and strategic decisions. Similarly, Valero Energy and Phillips 66 highlighted how refining margins and crude differentials, which are influenced by global oil prices, affect their earnings. The uncertainty in commodity prices can lead to unpredictable cash flows and necessitate adjustments in capital expenditure and operational strategies.
2. **Regulatory and Environmental Risks:**
   - **The Boeing Co., American International Group, Inc., and Valero Energy Corp.**: These companies face significant regulatory and environmental risks that can affect their operations and financial performance. Boeing, for example, is dealing with regulatory scrutiny and safety concerns related to the 737 MAX, which has led to production halts and reputational damage. American International Group (AIG) is subject to regulatory changes in the insurance industry, which can impact its product offerings and profitability. Valero Energy and other energy companies are also navigating environmental regulations, such as those related to emissions and renewable fuels, which can lead to increased compliance costs and operational adjustments.
3. **Market and Economic Uncertainty:**
   - **Discover Financial Services, The Boeing Co., and American International Group, Inc.**: These companies are exposed to broader market and economic uncertainties that can affect consumer demand, investment decisions, and financial stability. Discover Financial Services, for instance, is sensitive to changes in consumer credit behavior and economic conditions that influence loan growth and credit quality. Boeing's performance is tied to global air travel demand, which can be impacted by economic downturns and geopolitical tensions. AIG's insurance business is also influenced by economic cycles, which affect underwriting results and investment income. These uncertainties require companies to be agile in their strategic planning and risk management practices.

Overall, these risks highlight the importance of strategic flexibility, robust risk management, and proactive regulatory compliance for these companies to navigate the challenges in their respective industries.

The earnings call transcripts for the companies listed above reveal several common risks that these companies faced during the second quarter of 2020. Here are three of the most important shared risks:

1. **Impact of COVID-19 on Demand and Operations:**
   - **Occidental Petroleum Corp., Marathon Petroleum Corp., and Valero Energy Corp.:** These companies highlighted the significant decline in demand for oil and refined products due to the COVID-19 pandemic. Occidental Petroleum noted the unprecedented drop in oil prices and demand, which led to operational adjustments and financial measures to preserve liquidity. Marathon Petroleum and Valero Energy also discussed the impact of reduced travel and economic activity on gasoline and jet fuel demand, leading to lower refinery utilization rates.
   - **The Boeing Co.:** Boeing faced a sharp decline in demand for commercial aircraft as airlines reduced operations due to travel restrictions and decreased passenger traffic. The company had to adjust production rates and manage supply chain disruptions.
   - **Discover Financial Services and American International Group, Inc.:** These financial companies experienced challenges related to the economic downturn caused by the pandemic. Discover Financial Services noted increased credit risk and the need for higher loan loss provisions, while AIG faced potential claims related to business interruption and other insurance lines.
2. **Financial Liquidity and Capital Management:**
   - **ConocoPhillips and EOG Resources, Inc.:** Both companies emphasized the importance of maintaining strong liquidity and financial flexibility in response to the volatile oil market. ConocoPhillips highlighted its strong balance sheet and liquidity position, while EOG Resources focused on cost reductions and capital discipline to preserve cash flow.
   - **Phillips 66 and Pioneer Natural Resources Co.:** These companies took measures to conserve cash and maintain liquidity, such as reducing capital expenditures and suspending share repurchases. Phillips 66 secured additional credit facilities to enhance its financial position, while Pioneer Natural Resources emphasized its strong balance sheet and cost-cutting efforts.
   - **American International Group, Inc.:** AIG discussed its focus on liquidity and capital strength, highlighting its actions to manage financial resources prudently during the crisis.
3. **Supply Chain and Operational Disruptions:**
   - **The Boeing Co.:** Boeing faced significant supply chain disruptions due to the pandemic, affecting its production schedules and delivery timelines. The company had to work closely with suppliers to manage these challenges and ensure business continuity.
   - **Valero Energy Corp. and Marathon Petroleum Corp.:** These companies experienced operational disruptions as they adjusted refinery operations to match reduced demand. Valero Energy discussed the need to balance supply with demand to avoid inventory build-up, while Marathon Petroleum highlighted the impact of lower utilization rates on its operations.
   - **Occidental Petroleum Corp. and ConocoPhillips:** Both companies had to navigate supply chain challenges related to oilfield services and equipment availability, as well as manage production curtailments in response to market conditions.

Overall, these companies faced significant risks related to the COVID-19 pandemic's impact on demand, financial liquidity, and supply chain disruptions. Each company took specific actions to mitigate these risks and adapt to the rapidly changing environment.

Figure 14. Interpreting Asset Embeddings. We use OpenAI's gpt-4o-2024-08-06 model to summarize earnings calls for Occidental Petroleum Corporation, Marathon Petroleum Corporation, Discover Financial Services, EOG Resources Inc., Boeing Company, Pioneer Natural Resources Company, ConocoPhillips, American International Group, Phillips 66, and Valero Energy Corporation. The top panel reports summaries of the earnings calls in 2019.Q4. The bottom panel reports summaries of the earnings calls in 2020.Q2.

only 15%. Across all benchmarks, we find success training high-dimensional asset embeddings by ridge regression with cross validation. Thus, an obvious extension is to estimate high-dimensional asset embeddings on a combination of portfolio holdings data, a large set of firm characteristics, and a collection of text data to maximize explanatory power. Alternatively, fine-tuning or supervised estimation may achieve similar (or greater) explanatory power with a lower-dimensional model.

We focused on the US equity market as the application in this paper. We suspect that our methodology would be useful in other countries and asset classes such as fixed income, currencies, commodities, and derivatives. The key input is security-level portfolio holdings data for institutional investors or households (Koijen et al., 2021; Gabaix et al., 2023). In an application to fixed income markets, Gabaix et al. (2025) find that firm embeddings explain credit spreads and the volatility of credit spreads better than credit ratings and the distance to default.

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## Appendix

## A. Proofs for the Model of Portfolio Holdings as Embeddings Data

We derive all results for the asset pricing model in Section 2.

### *A.1. Equilibrium Asset Prices*

Since we normalized the shares outstanding to one, market clearing for asset $a$ is

$$P_a = \sum_{i=1}^{I} H_{ia}. \tag{A1}$$

We solve for the equilibrium asset prices by linearizing the market clearing equation (A1) and substituting asset demand (1) and (2). We approximate investor $i$'s log dollar holding of asset $a$ around $\bar{h}_{ia} = \ln(V_i w_a)$, where $V_i$ is investor $i$'s wealth and $w_a$ are portfolio weights (e.g., market weights) that sum to one (i.e., $\sum_{a=1}^{A} w_a = 1$). We define the corresponding log market capitalization that satisfies market clearing as $\bar{p}_a = \ln\left(\sum_{i=1}^{I} V_i w_a\right)$. A first-order approximation of the logarithm of the market clearing equation (1) is

$$\exp(\bar{p}_a)(1 + p_a - \bar{p}_a) = \sum_{i=1}^{I} \exp\left(\bar{h}_{ia}\right)\left(1 + h_{ia} - \bar{h}_{ia}\right). \tag{A2}$$

Let $S_i = \frac{V_i}{\sum_{j=1}^{I} V_j}$ be investor $i$'s wealth as a share of total wealth. We substitute asset demand (1) and (2) in equation (A2) and solve for the equilibrium asset prices:

$$p_a = \left(\frac{\mathbf{\Lambda}_S}{\zeta_S}\right)' \boldsymbol{x}_a + \alpha + \frac{\xi_{Sa}}{\zeta_S}, \tag{A3}$$

where $\zeta_S = \sum_{i=1}^{I} S_i \zeta_i$, $\mathbf{\Lambda}_S = \sum_{i=1}^{I} S_i \mathbf{\Lambda}_i$, $\xi_{Sa} = \sum_{i=1}^{I} S_i \xi_{ia}$, and

$$\alpha = \frac{1}{\zeta_S}\left(\sum_{i=1}^{I} S_i(\kappa_i - v_i) + \ln\left(\sum_{i=1}^{I} V_i\right)\right). \tag{A4}$$

*A.2. Reduced-Form Demand*

We substitute the equilibrium asset price (A3) in asset demand (1) to obtain reduced-form demand (3), where

$$\begin{aligned} \boldsymbol{\lambda}_i &= \boldsymbol{\Lambda}_i - \frac{\zeta_i}{\zeta_S}\boldsymbol{\Lambda}_S, && \text{(A5)} \\ \delta_i &= \kappa_i + (1-\zeta_i)\,\alpha, && \text{(A6)} \\ \delta_a &= \frac{\boldsymbol{\Lambda}_S'\boldsymbol{x}_a + \xi_{Sa}}{\zeta_S}, && \text{(A7)} \\ \epsilon_{ia} &= \xi_{ia} - \frac{\zeta_i}{\zeta_S}\xi_{Sa}. && \text{(A8)} \end{aligned}$$

The investor embedding (A5) is investor $i$'s semi-elasticity of the portfolio holding to the asset embedding, relative to the average semi-elasticity of the other investors. This relative semi-elasticity includes an adjustment $\frac{\zeta_i}{\zeta_S}$ for the relative price elasticity. Heterogeneity in either $\boldsymbol{\Lambda}_i$ or $\zeta_i$ implies heterogeneity in $\boldsymbol{\lambda}_i$ across investors.

The residual (A8) has a factor structure through the term $\frac{\zeta_i}{\zeta_S}\xi_{Sa}$, which represents investors trading against the idiosyncratic demand shocks of other investors. There are two assumptions under which we have identification of the asset embeddings in reduced-form demand (3). First, reduced-form demand is a pure factor model when the price elasticities $\zeta_i$ are constant across investors. In this case, the investor fixed effect $\delta_a$ absorbs the size-weighted idiosyncratic demand shifter $\xi_{Sa}$. Second, we have identification if the asset embeddings are uncorrelated with the size-weighted idiosyncratic demand shifters. A special case of this assumption is the limit of infinitely many atomistic investors such that the size-weighted idiosyncratic demand shifter converges to zero.

*A.3. Asset Embeddings through Returns, Volume, and Portfolio Rebalancing*

If an asset does not pay dividends, its log return from time $t-1$ to $t$ is $r_{at} = \Delta p_{at}$. Furthermore, we assume that the asset embeddings are stable from time $t-1$ to $t$, so that $\boldsymbol{x}_{at} \approx \boldsymbol{x}_{a,t-1}$. We then write equation (A3) in first differences as

$$r_{at} = \left(\frac{\Delta\boldsymbol{\Lambda}_{St}}{\zeta_S}\right)' \boldsymbol{x}_{a,t-1} + \frac{\Delta\xi_{Sat}}{\zeta_S}. \qquad \text{(A9)}$$

We could use this equation to estimate the asset embeddings as the factor loadings in a factor model of returns. We could use returns at any frequency (e.g., daily, monthly, or quarterly) or even volume to estimate the asset embeddings, as long as they are stable.

If the asset embeddings are stable from time $t-1$ to $t$, we write reduced-form demand

(3) in first differences as

$$\Delta h_{iat} = \Delta \boldsymbol{\lambda}_{it}' \boldsymbol{x}_{a,t-1} + \Delta \delta_{it} + \Delta \delta_{at} + \Delta \epsilon_{iat}. \tag{A10}$$

Equations (A9) and (A10) imply that we could estimate asset embeddings based on portfolio rebalancing, defined as $\Delta q_{iat} = \Delta h_{iat} - r_{at}$. Portfolio rebalancing could be more informative than portfolio holdings in the presence of inertia, capital gains taxes, or portfolio constraints.

## B. Estimating the Recommender System by Alternating Least Squares

We describe the estimation of the RS-L model by alternating least squares.[11] We generalize our description to supervised estimation of the asset embeddings. The estimation sample consists of only the positive positions. For log dollar holdings, we denote the sample size as $N_h = \sum_{i=1}^{I} |\mathcal{N}_i|$ and the variance as $\sigma_h^2 = \text{Var}\left(h_{ia}\right)$. For the target variable, we denote the sample size as $N_y = MA$ and the variance as $\sigma_y^2 = \text{Var}\left(y_{am}\right)$. We define $\phi_h = \frac{1-\phi}{N_h \sigma_h^2}$ and $\phi_y = \frac{\phi}{N_y \sigma_y^2}$, where $\phi \in [0, 1)$ is the relative weight on the target task.

We estimate the parameter vector $\boldsymbol{\theta} = (\boldsymbol{\lambda}_i', \boldsymbol{x}_a', \delta_i, \delta_a, \boldsymbol{\beta}_m', \delta_m)'$ through the objective function:

$$\begin{aligned} \min_{\boldsymbol{\theta}} \phi_h \sum_{i=1}^{I} \sum_{a \in \mathcal{N}_i} \left(h_{ia} - \boldsymbol{\lambda}_i' \boldsymbol{x}_a - \delta_i - \delta_a\right)^2 + \phi_y \sum_{m=1}^{M} \sum_{a=1}^{A} \left(y_{am} - \boldsymbol{\beta}_m' \boldsymbol{x}_a - \delta_m\right)^2 \\ + \frac{\eta_\lambda}{IK} \sum_{i=1}^{I} \boldsymbol{\lambda}_i' \boldsymbol{\lambda}_i + \frac{\eta_x}{AK} \sum_{a=1}^{A} \boldsymbol{x}_a' \boldsymbol{x}_a + \eta_\beta \sum_{m=1}^{M} \boldsymbol{\beta}_m' \boldsymbol{\beta}_m. \end{aligned} \tag{B1}$$

The first term is the mean squared error for log dollar holdings. The second term is the mean squared error for the target variable. The remaining terms regularize the investor embeddings, asset embeddings, and the parameters in the target task. We could generalize the objective function to also regularize the fixed effects $(\delta_i, \delta_a, \delta_m)$. We estimate the regularization parameters $(\phi, \eta_\lambda, \eta_x, \eta_\beta)$ by ten-fold cross-validation.

Let $\boldsymbol{\lambda}_i^\delta = (\boldsymbol{\lambda}_i', \delta_i)'$, $\bar{\boldsymbol{x}}_a = (\boldsymbol{x}_a', 1)'$, $\bar{\boldsymbol{\lambda}}_i = (\boldsymbol{\lambda}_i', 1)'$, $\boldsymbol{x}_a^\delta = (\boldsymbol{x}_a', \delta_a)'$, $\bar{\boldsymbol{\beta}}_m = (\boldsymbol{\beta}_m', 0)'$, and

[11] We have also considered the Adam algorithm in the JAX machine learning library as an alternative estimation methodology.

$\boldsymbol{\beta}_m^{\delta} = (\boldsymbol{\beta}'_m, \delta_m)'$. We rewrite the objective function (B1) as

$$\min_{\boldsymbol{\theta}} \phi_h \sum_{i=1}^{I} \sum_{a \in \mathcal{N}_i} \left(h_{ia} - \delta_a - \boldsymbol{\lambda}_i^{\delta\prime} \bar{\boldsymbol{x}}_a\right)^2 + \phi_y \sum_{m=1}^{M} \sum_{a=1}^{A} \left(y_{am} - \boldsymbol{\beta}_m^{\delta\prime} \bar{\boldsymbol{x}}_a\right)^2 \tag{B2}$$
$$+ \frac{\eta_\lambda}{IK} \sum_{i=1}^{I} \boldsymbol{\lambda}_i' \boldsymbol{\lambda}_i + \frac{\eta_x}{AK} \sum_{a=1}^{A} \boldsymbol{x}_a' \boldsymbol{x}_a + \eta_\beta \sum_{m=1}^{M} \boldsymbol{\beta}_m' \boldsymbol{\beta}_m.$$

Let $\mathbb{1}(a \in \mathcal{N}_i)$ be an indicator function that is equal to one if $a \in \mathcal{N}_i$. We define the vectors $\bar{\boldsymbol{h}}_i = [h_{ia} - \delta_a]_{a \in \mathcal{N}_i}$, $\bar{\boldsymbol{h}}_a = [\mathbb{1}(a \in \mathcal{N}_i)(h_{ia} - \delta_i)]_{i=1}^{I}$, $\bar{\boldsymbol{y}}_a = [y_{am} - \delta_m]_{m=1}^{M}$, and $\boldsymbol{y}_m = [y_{am}]_{a=1}^{A}$. We define the matrices $\bar{\boldsymbol{x}} = [\bar{\boldsymbol{x}}_a']_{a=1}^{A}$, $\bar{\boldsymbol{x}}_i = [\bar{\boldsymbol{x}}_a']_{a \in \mathcal{N}_i}$, $\bar{\boldsymbol{\lambda}} = \left[\bar{\boldsymbol{\lambda}}_i'\right]_{i=1}^{I}$, and $\bar{\boldsymbol{\beta}} = \left[\bar{\boldsymbol{\beta}}_m'\right]_{m=1}^{M}$. Let $\boldsymbol{D}(\eta)$ be a diagonal matrix with the elements $\eta$, except that the last diagonal element is zero.

We initialize the parameters at the estimated values for the RS-L-0 model. We then iterate on the following steps until convergence.

1. The first-order condition for $\boldsymbol{\lambda}_i^{\delta}$ is

$$-\phi_h \sum_{a \in \mathcal{N}_i} \left(h_{ia} - \delta_a - \boldsymbol{\lambda}_i^{\delta\prime} \bar{\boldsymbol{x}}_a\right) \bar{\boldsymbol{x}}_a + \boldsymbol{D}\left(\frac{\eta_\lambda}{IK}\right) \boldsymbol{\lambda}_i^{\delta} = \mathbf{0}, \tag{B3}$$

   which implies that

$$\boldsymbol{\lambda}_i^{\delta} = \left(\phi_h \bar{\boldsymbol{x}}_i' \bar{\boldsymbol{x}}_i + \boldsymbol{D}\left(\frac{\eta_\lambda}{IK}\right)\right)^{-1} \phi_h \bar{\boldsymbol{x}}_i' \bar{\boldsymbol{h}}_i. \tag{B4}$$

2. The first-order condition for $\boldsymbol{\beta}_m^{\delta}$ is

$$-\phi_y \sum_{a=1}^{A} \left(y_{am} - \boldsymbol{\beta}_m^{\delta\prime} \bar{\boldsymbol{x}}_a\right) \bar{\boldsymbol{x}}_a + \boldsymbol{D}(\eta_\beta) \boldsymbol{\beta}_m^{\delta} = \mathbf{0}, \tag{B5}$$

   which implies that

$$\boldsymbol{\beta}_m^{\delta} = \left(\phi_y \bar{\boldsymbol{x}}' \bar{\boldsymbol{x}} + \boldsymbol{D}(\eta_\beta)\right)^{-1} \phi_y \bar{\boldsymbol{x}}' \boldsymbol{y}_m. \tag{B6}$$

3. The first-order condition for $\boldsymbol{x}_a^{\delta}$ is

$$-\phi_h \sum_{i=1}^{I} \mathbb{1}(a \in \mathcal{N}_i) \left(h_{ia} - \delta_i - \bar{\boldsymbol{\lambda}}_i' \boldsymbol{x}_a^{\delta}\right) \bar{\boldsymbol{\lambda}}_i - \phi_y \sum_{m=1}^{M} \left(y_{am} - \delta_m - \bar{\boldsymbol{\beta}}_m' \boldsymbol{x}_a^{\delta}\right) \bar{\boldsymbol{\beta}}_m \tag{B7}$$
$$+ \boldsymbol{D}\left(\frac{\eta_x}{AK}\right) \boldsymbol{x}_a^{\delta} = \mathbf{0},$$

which implies that

$$\boldsymbol{x}_a^{\delta} = \left(\phi_h \bar{\boldsymbol{\lambda}}'\bar{\boldsymbol{\lambda}} + \phi_y \bar{\boldsymbol{\beta}}'\bar{\boldsymbol{\beta}} + \boldsymbol{D}\left(\frac{\eta_x}{AK}\right)\right)^{-1}\left(\phi_h \bar{\boldsymbol{\lambda}}'\bar{\boldsymbol{h}}_a + \phi_y \bar{\boldsymbol{\beta}}'\bar{\boldsymbol{y}}_a\right). \tag{B8}$$

4. The embeddings are identified only up to scaling and rotation. As an optional step, we scale and rotate the asset embeddings to satisfy

$$\frac{1}{A}\boldsymbol{x}'\boldsymbol{x} = \boldsymbol{I}. \tag{B9}$$

Thus, $\frac{1}{A}\sum_{a=1}^{A} x_{ak}^2 = 1$ for each component $k$, so that the scaling does not depend on the number of assets.

### *B.1. Out-of-Sample Testing*

In supervised estimation, we are often interested in how well the asset embeddings perform out of sample. In this case, we split the sample of the target variable into training and testing data. We then use only the training data to estimate the asset embeddings.

## C. Extensions of the AI Methods

### *C.1. Recommender Systems Using Historical Data*

We estimate the recommender system on each cross section. We could connect the asset embeddings across quarters by adding another regularization term $\|\boldsymbol{x}_t - \boldsymbol{x}_{t-1}\|^2$ to the objective function (4). This term stabilizes the unidentified rotation across quarters and limits the time variation in the asset embeddings. The intuition is that the asset embeddings in the previous quarter serve as a prior for the current asset embeddings. We could of course add more lags and parameters to enrich the time-series dynamics of the asset embeddings. An advantage of using historical data is that we can sharpen the estimates of asset and investor embeddings. Moreover, by estimating asset embeddings that can be compared across periods, we can use them for return predictability.

### *C.2. Estimating Asset Embeddings by GloVe*

GloVe takes the co-occurrence matrix of words across documents as an input, based on how frequently pairs of words appear in a context window. GloVe estimates the embeddings by minimizing a weighted least squares objective, which captures the difference between the dot product of the embeddings and the logarithm of the frequency of co-occurrences. We could

adopt this method by constructing a co-occurrence matrix of assets across portfolios, based on how frequently pairs of assets appear in a context window.

### *C.3. Transformer Models Using Historical Data*

Unlike word embeddings in NLP, asset and investor embeddings change at a higher frequency. Some characteristics like industry classification are highly persistent over time, while other characteristics like profitability and risk exposure change at a higher frequency. In the baseline specification, we train the BERT model on each cross section, which is simple but potentially inefficient. Therefore, we consider using historical data to estimate the asset embeddings. When using historical data on holdings beyond the current quarter, we restrict attention to the list of stocks in the current quarter as the vocabulary.

To explore this issue, we consider a generalized training procedure that proceeds in two steps. First, we use a longer sample up to five years to train the BERT model. Second, we fine-tune the model on one to four quarters of the most recent data. The first step captures the persistent component of asset embeddings, and the second step captures the higher frequency variation. For the managed portfolio benchmark, we found a performance gain of up to 5% in the out-of-sample $R^2$. Because of the limited performance gain, we present the baseline specification in the paper to avoid the additional complexity.

There are other approaches to introduce the historical data, which we leave for future research. First, we currently mask 15% of the sample to construct the training data. We could use the historical data but decrease the masking share to put less weight on the older data. Second, we could examine the estimated parameters in the BERT model to find out which ones vary significantly over time. We could then use the historical data but allow only a subset of the parameters to vary over time. This procedure is similar to the low rank approximation (LoRa) approach to fine-tuning LLMs.

### *C.4. Integrated Model of Asset and Investor Embeddings*

We separately estimate the PS-BERT model for the investor embeddings and the OS-BERT model for the asset embeddings. We could combine them into a single model and also incorporate log dollar holdings in the objective function, instead of the ranked positions as we currently do. We start with the input embeddings for investors $\boldsymbol{\lambda}_i$ and assets $\boldsymbol{x}_a$. For each asset $a$, we estimate the contextualized investor embedding $\boldsymbol{\lambda}_i^a$ as a weighted average of the input embeddings for the other investors holding asset $a$. For each investor $i$, we estimate the contextualized asset embedding $\boldsymbol{x}_a^i$ as a weighted average of the input embeddings for the other assets in investor $i$'s portfolio. We then train the BERT model to minimize the

objective function:

$$\sum_{i=1}^{I}\sum_{a=1}^{A}\left(h_{ia}-\boldsymbol{\lambda}_i^{a\prime}\boldsymbol{x}_a^i-\delta_i-\delta_a\right)^2, \tag{C1}$$

subject to the same regularization methods as the traditional BERT model.

## D. Data Construction

### *D.1. Stock Market and Portfolio Holdings Data*

We provide a detailed description of how we construct the stock market and portfolio holdings data.

#### D.1.1. FactSet Ownership Data

We construct the quarterly stock holdings of mutual funds, ETFs, closed-end funds, variable annuity funds, and hedge funds using the FactSet Ownership Data (FactSet, 2024). In the 13F Ownership Data, FactSet provides the quarter-end reported dollar holding (adj_mv) by 13F filer, CUSIP, and report date. We aggregate the dollar holding up to the rollup entity level. We keep only hedge funds, based on the entity sub-type in the own_ent_institutions file.

In the Fund Ownership Data, FactSet provides the reported dollar holding (adj_mv) by fund identifier, CUSIP, and report date. Funds often report at a frequency higher than quarterly. We construct the quarter-end dollar holding by keeping the last report in each quarter when sorted by report date, filing date, transfer date, and form type. We keep observations where the report date is within five days of the quarter-end date. Based on the fund type, we keep only mutual funds, ETFs, closed-end funds, and variable annuity funds.

We construct market equity as the product of unadjusted price and unadjusted shares outstanding. We merge the dollar holdings and market equity by date and CUSIP and keep observations where both variables are positive.

#### D.1.2. Firm Characteristics and Stock Returns

We use the data on firm characteristics and stock returns from Jensen et al. (2023), which are based on the CRSP US Stock Database (Center for Research in Security Prices, 2024) and Compustat Fundamentals (S&P Global, 2024). We use book equity (be), market equity (me), the market beta (beta_60m), book-to-market equity (be_me), asset growth (at_gr1), profitability (gp_at), momentum (ret_12_1), and the dividend-asset ratio (div_at).

The data on firm characteristics and stock returns are at the security (CRSP permno) level. We aggregate them to the firm (CRSP permco) level, using market equity weights. Jensen et al. (2023) group stocks into five size categories. We keep firms for which at least one of its stocks is a small cap or above (i.e., above the 20th percentile for market equity). We drop any firms with missing characteristics or non-positive book equity. We winsorize log book-to-market equity, asset growth, profitability, and momentum at the 1st and 99th percentiles in each cross section. We winsorize the dividend-asset ratio at the 99th percentile in each cross section.

#### D.1.3. Merging and Cleaning

We first merge the FactSet stock holdings data with the CRSP-Compustat link file by date and historical CUSIP. We use the historical CUSIP from the FactSet sym_cusip_hist file. We then merge the data on firm characteristics and stock returns from Jensen et al. (2023) by date and CRSP permco.

Our sample starts in 2005.Q1, which is dictated by a limited coverage of funds in the FactSet Fund Ownership Data before that date. We drop investors with a highly concentrated portfolio, defined as a single holding that exceeds 75% of the portfolio. In each cross section, we keep investors who hold at least 20 stocks and stocks that are held by at least 20 investors, which we impose by iterating on these two criteria until convergence.

We winsorize log dollar holdings. In each cross section, we first remove investor fixed effects by subtracting the median by investor. We then remove stock fixed effects by removing the median by stock. We then winsorize these centered log dollar holdings at the 2.5th and 97.5th percentiles. Finally, we recenter the winsorized log dollar holdings by removing the investor and stock fixed effects, using the mean instead of the median.

### *D.2. Text-Based Embeddings*

We use the text-based asset embeddings from Cohere and OpenAI, based on the most recent publicly available models as of March 2024. We use the list of CRSP company names to download the embeddings as of 2022.Q4. Following the recommendations of Cohere and OpenAI, we use cosine similarity to measure firm similarity.

We use the embed-english-v3.0 model from Cohere. Cohere provides task-specific embeddings for search query, search document, classification, and clustering. We use the clustering embeddings since our application is to identify similar firms. The embeddings have 1024 dimensions. For the relative valuation benchmark, we reduce the embeddings to four and ten dimensions by Uniform Manifold Approximation and Projection (McInnes et al., 2020).

We use the text-embedding-3-large model from OpenAI. OpenAI allows us to download their embeddings at any desired dimension up to 3,072. Thus, we download the embeddings at four and ten dimensions for the relative valuation benchmark.