[MOBI] The Equity Premium Puzzle A Review Foundations And Trendsr In Finance

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The Equity Premium Puzzle-Rajnish Mehra 2007-08-30 Over two decades ago, Mehra and Prescott (1985) challenged the finance profession with a poser: the historical US equity premium is an order of magnitude greater than can be rationalized in the context of the standard neoclassical paradigm of financial economics. This regularity, dubbed "the equity premium puzzle," has spawned a plethora of research efforts to explain it away. In this review, the author takes a retrospective look at the original paper and explains the conclusion that the equity premium is not a premium for bearing non-diversifiable risk.

The Equity Premium Puzzle- 2007

Behavioral Explanation of the Equity Premium Puzzle-Kevin Rink 2010-04 Bachelor Thesis from the year 2010 in the subject Business economics - Business Management, Corporate Governance, grade: 1,0, European Business School - International University Schloss Reichartshausen Oestrich-Winkel, language: English, abstract: Ever since the equity premium puzzle (EEP) was published by Mehra and Prescott (1985), it has become one of the most investigated problems in economics (Mehra, 2003, p. 54). The EEP describes the fact that we cannot link historic stock returns with the volatility of consumption growth (in a sense to be made precise below). Mehra and Prescott call this a puzzle as their consumption-based asset pricing model can not plausibly explain the S&P 500's annual risk premium of 6.2% over relatively risk-free governmental treasury bills between 1889 and 1978. This model reproduces an equity premium of 6.2% solely by adapting unreasonable estimates of agents' risk aversion (Mehra & Prescott, 1985, pp. 155-156). In this way, the model also predicts an extreme size of the risk-free rate (Cochrane, 2000, p. 416). Thus, the equity premium is not able to be explained exclusively by the risk of stock price fluctuations. (...) This thesis will examine the EPP from a behavioral perspective. The major research question to be pursued is this: How do behavioral approaches explain the equity premium puzzle? In order to answer this question, a variety of subtasks must be addressed. This includes the investigation of the initial model of Mehra and Prescott (1985) as well as its underlying assumptions. That is, in particular, needed because several well-established classical assumptions must be dropped to set up descriptive behavioral models. In addition, implications from psychology and behavioral economics must be introduced to answer the overall question of this thesis. Hence, the thesis will focus on the notions of loss aversion, narrow framing, and regret theory in an effort to explain the EPP. (...) The remainder of this thesis is organize
The Equity Premium Puzzle and the Riskfree Rate Puzzle - 1989

Bootstrap Applications in Finance - Matthias Böhm 2016

The Equity Premium Puzzle, Intrinsic Growth and Monetary Policy an Unexpected Solution - Robert Shuler 2013-11

The guy who discovered the equity premium does not invest in it. He is not the only one. High profile money managers routinely fail to measure up to the indexes they compare themselves to. That says a lot about why the equity "premium" is considered a puzzle. How would you get it if you wanted to? What is it? Stocks, also called equities, as a group not individually provide 7% to 8% higher returns than bonds or mortgages or most other kinds of investments whenever you look at periods 20 years or longer. How can the returns of a group of stocks be greater than the returns of individual stocks? It seems to violate arithmetic. The whole is greater than the sum of the parts because stock indexes are perpetual. They rotate in new companies which have achieved the requirements of the index (not flighty new issues) to replace older companies which are declining. You can do this. Change the lives of yourself and all your descendents. Might some of them live more than 20 years even if you don't? Learn how you can dramatically improve your investing style, why you should not worry about the FED, what you should have as long term goals instead of a career or retirement, why your career or small businesses is not diversified, the advantage of stocks over real estate or bonds, and how to rely more on being an investor. Learn the reasons behind market behavior, not simple prescriptions. Learn why stock picking is a bad idea, and what to do instead. Learn when and how to use credit, and why keeping your money in a bank may not be safe. Explore how your feelings about money and the origin of money influence you. Did you know the Roman Empire used almost no gold, and in the Bronze Age money was grain and you could eat it?

The Equity Premium Puzzle, Intrinsic Growth & Monetary Policy An Unexpected Solution Theory & Strategy for the Coming Jobless Age - Robert Shuler 2015-01-17

This book suggests we should adjust money supply to account for productivity if deflation is to be avoided. The central banker is not profit oriented and can create money at will, not be subject to rational investor constraints. Businesses leverage low interest rates enforced by the central bank to grow and increase employment, compensating for the reduced labor necessary for the former level of goods and services. This leveraged difference in returns is the equity premium. Even a one time productivity increase requires a corresponding permanent increase not in the money supply itself, but in the "rate of increase" of the money supply. Given the steady growth in productivity of the last 100 years, the world economy is now grossly under-stimulated and in danger of precipitous deflation. Both academic models and arguments based on historical events are presented, along with analysis of the meaning of money, investor behavior, and practical techniques for obtaining the equity premium in one's portfolio.

The Equity Premium Puzzle and the Riskfree Rate Puzzle - Philippe Weil 1989

The Equity Premium Puzzle and Decreasing Relative Risk Aversion - Maurice J. Roche 2005

The Equity Premium Puzzle - Robert Shuler 2015-08-11

The book presents a theory of a necessity to adjust money supply to account for productivity if deflation is to be avoided. The monetary agent (central banker) is a market participant who is not profit oriented and can create money at will, and thus not be subject to rational investor constraints. The monetary agent's power is similar to or greater than investor power in the market. Businesses leverage low interest rates enforced by the monetary agent to increase their activity, and growth rates, increasing employment to compensate for the reduced labor necessary to create the former level of goods and services. This leveraged difference in returns is the equity premium. Since productivity is a "rate" of production, even a one-time increase requires a
corresponding permanent increase not in the money supply itself, but in the "rate of increase" of the money supply. Given the steady growth in productivity of the last 100 years, the world economy is now grossly under-stimulated and in danger of precipitous deflation. Both academic models and arguments based on historical events are presented, along with analysis of the meaning of money, investor behavior, and practical techniques for obtaining the equity premium in one's portfolio.

On Asset Pricing and the Equity Premium Puzzle-Claudius Pythias Bart-Williams 2000

The Term Structure and the Equity Premium Puzzle-Marcello Esposito 1990

Transactions Costs and the Equity Premium Puzzle-Sanghyun Hong 2020

The Equity Risk Premium Puzzle Revisited- 2007

The Loss Aversion/narrow Framing Approach to the Equity Premium Puzzle-Nicholas Barberis 2006 We review a recent approach to understanding the equity premium puzzle. The key elements of this approach are loss aversion and narrow framing, two well-known features of decision-making under risk in experimental settings. In equilibrium, models that incorporate these ideas can generate a large equity premium and a low and stable risk-free rate, even when consumption growth is smooth and only weakly correlated with the stock market. Moreover, they can do so for parameter values that correspond to sensible attitudes to independent monetary gambles. We conclude by suggesting some possible directions for future research.

The Equity Premium Puzzle-James Pemberton 1993

The Equity Premium Puzzle-Isabel Gruber 2016

The Equity Premium Puzzle- 2006

Myopic Loss Aversion and the Equity Premium Puzzle-Line Isager-Nielsen 2006

Solutions to puzzles in finance-Kelly Maura Leahy 1992

The Equity Premium Puzzle and the Risk-free Rate Puzzle at Long Horizons-Kent Daniel 1996

Housing, House Prices, and the Equity Premium Puzzle-Morris A. Davis 2005 "Many recent papers have claimed that when housing services are treated separately from other forms of consumption in utility, a wide range of economic puzzles such as the equity premium puzzle can be explained. Our paper challenges these claims. The key assumption embedded in this literature is that households are not very willing to substitute housing services for consumption. We show that housing services and consumption must be much more substitutable than has been assumed for a neoclassical consumption model to be consistent with U.S. house price data. Further, when forced to match both historical house prices and stock returns, the lowest risk-free rate the model can generate is 11 percent"--Abstract.

Disappointment Aversion and the Equity Premium Puzzle-James Pemberton 1995
A Behavioural Approach to the Equity Premium Puzzle - Claire McDonald 2006

The Equity Premium Puzzle, Ambiguity Aversion, and Institutional Quality - S. Nuri Erbas 2007-09 With cross-section data from 53 emerging and mature markets, we provide evidence that equity premium puzzle is a global phenomenon. In addition to risk aversion, equity premium may reflect ambiguity aversion. We explore the sources of equity premium using some pertinent fundamental independent variables, as well as the World Bank institutional quality indexes and other proxies for the degree of ambiguity in the sample countries. Some World Bank and other indexes are statistically significant, which indicates that a large part of equity premium may reflect investor aversion to ambiguities resulting from institutional weaknesses.

'First Order' Risk Aversion and the Equity Premium Puzzle - Epstein, Larry G 1989

The Equity Premium Puzzle and the Resolution by 'myopic Loss Aversion' Revisited - Johan Sebastiaan Groot 1996

The Equity Premium Puzzle and the Resolution by 'myopic Loss Aversion' [i.e. Aversion] Revisited - J. S. De Groot 1996

The Equity Premium is No Puzzle - Mordecai Kurz 1996

Myopic Loss Aversion and the Equity Premium Puzzle - Shlomo Benartzi 1993 The equity premium puzzle, first documented by Mehra and Prescott, refers to the empirical fact that stocks have greatly outperformed bonds over the last century. As Mehra and Prescott point out, it appears difficult to explain the magnitude of the equity premium within the usual economics paradigm because the level of risk aversion necessary to justify such a large premium is implausibly large. We offer a new explanation based on Kahneman and Tversky's 'prospect theory'. The explanation has two components. First, investors are assumed to be 'loss averse' meaning they are distinctly more sensitive to losses than to gains. Second, investors are assumed to evaluate their portfolios frequently, even if they have long-term investment goals such as saving for retirement or managing a pension plan. We dub this combination 'myopic loss aversion'. Using simulations we find that the size of the equity premium is consistent with the previously estimated parameters of prospect theory if investors evaluate their portfolios annually. That is, investors appear to choose portfolios as if they were operating with a time horizon of about one year. The same approach is then used to study the size effect. Preliminary results suggest that myopic loss aversion may also have some explanatory power for this anomaly.

Agents’ Preferences, the Equity Premium, and the Consumption-Saving Trade-Off - Ms. Aude Pommeret 2001-08-01 This paper aims to measure the risk premium on French equities during 1960-92 and to evaluate how well theoretical models based on various representations of agents' preferences can explain it. Aside from the standard, time-additive utility function with constant relative risk aversion, three other utility functions are reviewed: a recursive utility function, a habit formation utility function, and a utility function that accounts for the interdependence of preferences. Both calibration and econometric estimations show that none of the studied marginal changes in the representation of agents' preferences are sufficient to solve both the equity premium puzzle and the risk-free rate puzzle.

The 6D Bias and the Equity Premium Puzzle - Xavier Gabaix 2001 If decision costs lead agents to update consumption every D periods, then econometricians will find an anomalously low correlation between equity returns and consumption growth (Lynch 1996). We analytically characterize the dynamic properties of an economy composed of consumers who have such delayed updating. In our setting, an econometrician using an Euler
equation procedure would infer a coefficient of relative risk aversion biased up by a factor of $6D$. Hence with quarterly data, if agents adjust their consumption every $D = 4$ quarters, the imputed coefficient of relative risk aversion will be 24 times greater than the true value. High levels of risk aversion implied by the equity premium and violations of the Hansen-Jagannathan bounds cease to be puzzles. The neoclassical model with delayed adjustment explains the consumption behavior of shareholders. Once limited participation is taken into account, the model matches most properties of aggregate consumption and equity returns, including new evidence that the covariance between $\ln(C(t+h)/\ln(C(t)$ and $R(t+1)$ slowly rises with $h$. Keywords: $6D$, bounded rationality, decision costs, delayed adjustment, equity premium puzzle. JEL Classification: E44, G1.

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<td>George M. Constantinides 1998 Ongoing questions on the historical mean and standard deviation of the return on equities and bonds and on the equilibrium demand for these securities are addressed in the context of a stationary, overlapping-generations economy in which consumers are subject to a borrowing constraint. The key feature captured by the OLG economy is that the bulk of the future income of the young agents is derived from their wages forthcoming in their middle age, while the bulk of the future income of the middle-aged agents is derived from their savings in equity and bonds. The young would like to borrow and invest in equity, but the borrowing constraint prevents them from doing so. The middle-aged choose to hold a diversified portfolio that includes positive holdings of bonds, and this explains the demand for bonds. Without the borrowing constraint, the young borrow and invest in equity, thereby decreasing the mean equity premium and increasing the rate of interest.</td>
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