The Working Group on Risk, with the support of the group BFA (SFdS) & Institut des Actuaires (IA), has the pleasure to invite you to the Seminar by:

Prof. Tolga CENESIZOGLU
HEC Montreal, *Canada*

Wednesday, January 22, 2014 at 12:30 pm
EEE - ESSEC La Défense – room 103

Return Decomposition over the Business Cycle

Campbell and Shiller (1988) have suggested decomposing unexpected stock returns into unexpected changes in investors' beliefs about future cash flows (cash flow news) and discount rates (discount rate news) to analyze the relative importance of each component in determining the observed variation in stock prices. Based on a generalization of this approach to a framework with regime-switching parameters and variances, we analyze the decomposition of the unconditional and conditional variances of returns on the S&P 500 index over the business cycle. In expansions, the conditional variance of cash flow news is almost always higher than that of discount rate news, and thus, contributes more to the conditional variance of returns. In recessions, the conditional variances of both cash flow and discount rate news (as well as their conditional covariance) increase but the conditional variance of discount rate news increases more than that of cash flow news, and thus, contributes more to the conditional variance of returns. Given that the economy is often in a expansion period, this implies that cash flow news is more important than discount rate news in determining the unconditional variance of returns in contrast to the standard Campbell and Shiller approach. We show that these results are broadly consistent with the implications of a stylized asset pricing model in which the growth rates of dividends and consumption take on different values depending on the underlying state of the economy.

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http://crear.essec.edu/working-group-on-risk/meeting-schedule-2013-2014

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