Are Stocks Riskier over the Long Run? Taking Cues from Economic Theory

Abstract

We study the riskiness of stocks over long horizons from the perspectives of Bayesian investors who employ economic theory, specifically the long-run risk, habit formation, or prospect theory models, to form prior beliefs about return dynamics. We find that incorporating prior information from the habit formation or prospect theory models reinforces beliefs in mean reversion and inferences that stocks are safe over long horizons. In contrast, investors with long-run risk priors conclude that stocks display relatively little mean reversion and are actually riskier for long-horizon investors. Guidance from economic theory can be important because the sample evidence is relatively uninformative.

Venue: Faculty of Mathematics, Physics and Informatics of the Comenius University, room C, Mlynská dolina, Bratislava
Date: December 4, 2017
Program: 14:30 Registration
15:00 Katarína Lučivjanská: Are Stocks Riskier over the Long Run? Taking Cues from Economic Theory
17:00 Coffee