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THE VOLATILITY OF A FIRM'S ASSETS AND THE LEVERAGE EFFECT

By Jaewon Choi* and Matthew Richardson**

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Abstract:

We investigate the volatility of firms' assets in contrast to existing studies that focus on equity volatility. We estimate asset volatility using a comprehensive data set on the market values of corporate security returns. We find significant differences between the properties of equity and asset volatilities with implications for several important areas of finance. First, financial leverage has a large influence on equity volatility. Second, leverage and asset volatility have permanent and transitory effects, respectively, on equity volatility, helping explain the short- and long-run dynamics of equity volatility. Third, we analyze and compare the cross-section of asset versus equity returns.

JEL Classification: G12, G13, G32

Keywords: Asset volatility, asset returns, leverage effect, persistence in volatility, asset beta

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