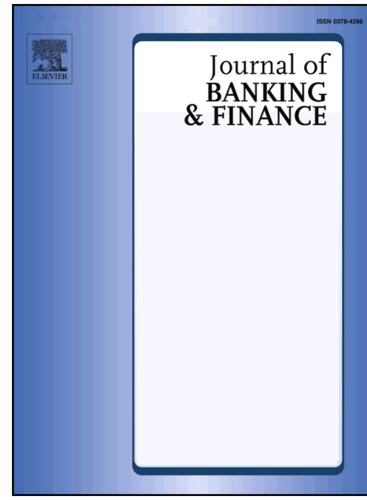
Accepted Manuscript



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PII: S0378-4266(15)00027-8
DOI: http://dx.doi.org/10.1016/j.jbankfin.2015.01.019
Reference: JBF 4656

To appear in: *Journal of Banking & Finance*

Received Date: 10 January 2014
Accepted Date: 29 January 2015

A Simple Asset Pricing Model with Heterogeneous Agents, Uninsurable Labor Income and Limited Stock Market Participation☆

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Abstract

In this paper we study a simple two-period asset pricing model to understand the implications of uninsurable labor income risk and/or borrowing constraints, limited stock market participation, heterogeneous labor income volatilities, and heterogeneous preferences. We appraise the performance of each of these in matching moments of asset returns to the data and show that limited stock market participation generates a significantly large equity premium. We also show that the distribution of wealth between stock market participants and non-participants plays an important role in asset pricing, and that the effect of borrowing constraints on asset returns are similar to that of limited participation. Finally, we discuss the practical implications of our investigation, providing an appraisal of ongoing changes in asset returns.

Keywords: asset pricing, general equilibrium, equity premium, uninsurable labor income, limited stock market participation, heterogeneous preference, borrowing constraint

JEL classification: G10; G11; G12

☆We are grateful to two anonymous referees for their valuable comments and constructive suggestions. This work was supported by the National Research Foundation of Korea Grant funded by the Korean Government (NRF-2014S1A3A2036037). The research in this paper was supported by the WCU(World Class University) program through the National Research Foundation of Korea, which is funded by the Ministry of Education, Science and Technology (R31-20007).

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