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[bhargava@umd.edu](mailto:bhargava@umd.edu)*Abstract*

This paper modeled the effects of firms' fundamentals such as total assets and long-term debt and of macroeconomic variables such as unemployment and interest rates on quarterly stock prices of over 3000 U.S. firms in the period 2000-07. The merged CRSP/Compustat database was augmented by macroeconomic variables and comprehensive dynamic models were estimated by maximum likelihood taking into account heterogeneity across firms. Likelihood ratio statistics were developed for sequentially testing hypotheses regarding the adequacy of macroeconomic variables in the models. The main findings were that the estimated coefficients of lagged stock prices in simple dynamic random effects models were in the interval 0.90-0.95. Second, comprehensive dynamic models for stock prices showed that the firms' earnings per share, total assets, long-term debt, dividends per share, and unemployment and interest rates were significant predictors; there were significant interactions between firms' long-term debt and interest rates. Finally, implications of the results for corporate policies are discussed.

Keywords: Compustat and CRSP databases; dynamic random effects models; endogeneity; maximum likelihood; macroeconomic variables; value investing.

JEL Classifications: C23, C33, G12, G17.

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