

## Accepted Manuscript

Equity premium predictions with many predictors: A risk-based explanation of the size and value factors

Adam Stivers

PII: S0927-5398(17)30093-2

DOI: <https://doi.org/10.1016/j.jempfin.2017.10.004>

Reference: EMPFIN 1009

To appear in: *Journal of Empirical Finance*

Received date: 9 November 2016

Revised date: 11 August 2017

Accepted date: 23 October 2017

Please cite this article as: Stivers A., Equity premium predictions with many predictors: A risk-based explanation of the size and value factors. *Journal of Empirical Finance* (2017), <https://doi.org/10.1016/j.jempfin.2017.10.004>

This is a PDF file of an unedited manuscript that has been accepted for publication. As a service to our customers we are providing this early version of the manuscript. The manuscript will undergo copyediting, typesetting, and review of the resulting proof before it is published in its final form. Please note that during the production process errors may be discovered which could affect the content, and all legal disclaimers that apply to the journal pertain.



## Equity Premium Predictions with Many Predictors: A Risk-Based Explanation of the Size and Value Factors

**Adam Stivers**

University of Wisconsin-La Crosse

1725 State Street

La Crosse, WI

[astivers@uwlax.edu](mailto:astivers@uwlax.edu)

Phone: 608.785.6677

### Abstract

This paper investigates whether a direct mechanism can be found that demonstrates that the size and value factors of Fama and French (1993) are indeed ICAPM factors, as some have suggested. The results endorse this hypothesis: small-size and value portfolios reflect changes in future investment opportunities. To test the hypothesis, the paper forecasts the equity premium using disaggregated portfolio returns with a partial least squares (PLS) regression approach. PLS is chosen as it is particularly suited to condense a large set of portfolios into a single index. The “index” portfolio obtained from the forecast performs well out-of-sample and hedges against future market risk, in addition to explaining future market returns in sample. Thus, the index portfolio may be viewed as an additional risk factor in the form of a Merton (1973) state variable. The index places larger weights on small-size and -value portfolios. This also provides a possible explanation for why equal-weighted portfolios typically perform better out-of-sample compared to factors implied by traditional mean-variance approaches and asset pricing models.

*This version: August 10, 2017*

**JEL Classification:** G12, G17, G11

**Keywords:** asset pricing, factor models, equity premium, forecasting, risk hedging

Download English Version:

<https://daneshyari.com/en/article/7360615>

Download Persian Version:

<https://daneshyari.com/article/7360615>

[Daneshyari.com](https://daneshyari.com)