Accepted Manuscript

Is Economic Uncertainty Priced in the Cross-Section of Stock Returns?

Turan G. Bali, Stephen J. Brown, Yi Tang

PII: S0304-405X(17)30237-4
DOI: 10.1016/j.jfineco.2017.09.005
Reference: FINEC 2815

To appear in: *Journal of Financial Economics*

Received date: 24 October 2016
Revised date: 4 November 2016
Accepted date: 2 December 2016

Please cite this article as: Turan G. Bali, Stephen J. Brown, Yi Tang, Is Economic Uncertainty Priced in the Cross-Section of Stock Returns?, *Journal of Financial Economics* (2017), doi: 10.1016/j.jfineco.2017.09.005

Is Economic Uncertainty Priced in the Cross-Section of Stock Returns?*

Turan G. Bali[a†], Stephen J. Brown[b,c], Yi Tang[d]

[a]*McDonough School of Business, Georgetown University, 37th and O Streets, N.W., Washington, D.C. 20057, USA*

[b]*Monash Business School, Monash University, 900 Dandenong Road, Caulfield East, Victoria 3145, Australia*

[c] *Stern School of Business, New York University, 44 West fourth Street, New York, NY 10012, USA*

[d]*Gabelli School of Business, Fordham University, 45 Columbus Avenue, New York, NY 10023, USA*

Abstract

We investigate the role of economic uncertainty in the cross-sectional pricing of individual stocks and equity portfolios. We estimate stock exposure to an economic uncertainty index and show that stocks in the lowest uncertainty beta decile generate 6% more annualized risk-adjusted return compared to stocks in the highest uncertainty beta decile. We find that the uncertainty premium is driven by the outperformance (underperformance) by stocks with negative (positive) uncertainty beta. Our results indicate that uncertainty-averse investors demand extra compensation to hold stocks with negative uncertainty beta and they are willing to pay high prices for stocks with positive uncertainty beta.

JEL Classification: G11; G12; C13; E20; E30

Keywords: Economic uncertainty; Uncertainty aversion; Cross-section of stock returns; ICAPM; Return predictability

*We are grateful to the editor, Bill Schwert, and an anonymous referee for their extremely helpful comments and suggestions. We thank Warren Bailey, Geert Bekaert, John Campbell, Cam Harvey, Murillo Campello, Bob Jarrow, Andrew Karolyi, Sydney Ludvigson, Maureen O'Hara, Lubos Pastor, Lasse Pedersen, and Qiusha Peng for their insightful and constructive comments. We also benefited from discussions with Senay Agca, Reena Aggarwal, Serdar Aldatmaz, Oya Altinkilic, Mike Anderson, Bill Baber, Jennie Bai, Matt Baron, Audra Boone, Linda Canina, Yong Chen, Jess Cornaggia, Ozgur Demirtas, Umut Gokcen, Michael Gordy, Derek Horstmeyer, Darien Huang, Byoung-Hyoun Hwang, Shane Johnson, Gergana Jostova, George Kapetanios, Hagen Kim, James Kolari, Juhani Linnainmaa, Yan Liu, Arvind Mahajan, Pamela Moulton, Michael Neumann, Han Ozsoylev, Paul Peyser, Alexander Philipov, Lee Pinkowitz, Christo Pirinsky, Marco Rossi, Kevin Sheppard, George Skiadopoulos, Wei Tang, Panayiotis Theodossiou, Ashley Wang, Sumudu Watugala, Rohan Williamson, Kamil Yilmaz, and seminar participants at the American Finance Association meetings, Multinational Finance Society meetings, Cornell University, Federal Reserve Board, George Mason University, George Washington University, Georgetown University, Koc University, the Office of Financial Research at the U.S. Department of the Treasury, the Recent Advances in Finance conference at Queen Mary University of London, Sabanci University, Texas A&M University, and the University of Georgia. All errors remain our responsibility.

†Corresponding author. Tel: +1 202 687 5388; Fax: +1 202 687 4031.
E-mail address: turan.bali@georgetown.edu (T.G. Bali).