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Behavioral Explanation of the Equity Premium Puzzle

By Kevin Rink

Grin Verlag Apr 2010, 2010. Taschenbuch. Book Condition: Neu. 216x151x13 mm. This item is printed on demand - Print on Demand Titel. - Bachelor Thesis from the year 2010 in the subject Business economics - Business Management, Corporate Governance, grade: 1,0, European Business School - International University Schloß Reichartshausen Oestrich-Winkel, language: English, abstract: Ever since the equity premium puzzle (EEP) was published by Mehra and Prescott (1985), it has become one of the most investigated problems in economics (Mehra, 2003, p. 54). The EEP describes the fact that we cannot link historic stock returns with the volatility of consumption growth (in a sense to be made precise below). Mehra and Prescott call this a puzzle as their consumption-based asset pricing model can not plausibly explain the S&P 500's annual risk premium of 6.2% over relatively risk-free governmental treasury bills between 1889 and 1978. This model reproduces an equity premium of 6.2% solely by adapting unreasonable estimates of agents' risk aversion (Mehra & Prescott, 1985, pp. 155-156). In this way, the model also predicts an extreme size of the risk-free rate (Cochrane, 2000, p. 416). Thus, the equity premium is not able to be explained exclusively by the risk of...



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