

Department of Actuarial Studies

Seminar Series

Wednesday, 15 March 2006

Speaker: Richard Fitzherbert

Title: The equity premium puzzle: the return on shareholders' equity (RoSe) hypothesis

Date & Time: Wednesday, 15 March 2006 at 4 p.m. to 6 p.m.

Location: E4A, Seminar Room 623

Abstract: This seminar will outline the return-on-shareholders'-equity explanation of the equity premium. According to this hypothesis, the level of the equity premium is determined (almost completely) by the return-on-shareholders'-equity achieved by company management rather than risk-averse behaviour by portfolio investors.

This explanation, by itself, does not solve the equity premium puzzle, however it does shift the focus from the behaviour of portfolio investors to the financial decision making of company boards and executives. Mehra and Prescott, in their well-known 1985 paper, challenged the traditional causal explanation for the existence of the equity premium as a risk premium. As a causal explanation of long-term equity returns, the RoSe hypothesis may provide an alternative and more reliable theoretical basis for setting asset allocations and discount rates.