Bond Risk Premia by Cochrane and Piazzesi

This paper studies time-varying risk premia in U.S. government bonds. The regressions of one-year excess returns are based on five forward rates available at the beginning of the period, that is, a single tent-shaped linear combination of forward rate. It predicts one-year excess returns on one to fine-year maturity bonds with R2 up to 44 percent. The return forecasting factor has a clear business cycle correlation:Expected returns are high in bad times, and low in good times, and the return-forecasting factor forecasts long-run output growth.And the return-forecasting factor is poorly related to level, slope, and curvature movements in bond yields. Therefore, it represents a source of yield curve movement not captured by most term structure models.

**Estimates of the return-forecasting factor,**

= log price of *n*-year discount bond at time *t*.

. the log forward rate at time t for loans between time t+n-1 and t+n

. the log holding period return from buying an n-year bond at time t and selling it as an n-1-year bond at time t+1

. the log holding period return from buying an n-year bond at time t and selling it as an n-1-year bond at time t+1

. excess log returns



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