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Macro Roundup Article

Headline: The Price of Risk: With Equity Risk Premiums, Caveat Emptor!

Article Link: https://aswathdamodaran.substack.com/p/the-price-of-risk-with-equity-risk

Author(s)	Aswath Damodaran
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Tweet: .@AswathDamodaran argues his implied equity risk premium for the S&P; 500 of 4.44% is a better measure than alternatives for predicting future returns.

Summary: If you are using equity risk premiums or even earnings yield for market timing, recognize that having a high R-squared or correlation in past returns will not easily translate into market-timing profits, for two reasons. First, the past is not always prologue, and market and economic structures can shift, undercutting a key basis for using historical data to make predictions. Second, even if the correlations and regressions hold, you may still find it hard to profit from them, since you (and your clients, if you are a portfolio manager) may be bankrupt, before your predictions play out. Statistical noise (the standard errors on your regression predictions) can create havoc in your portfolios, even if it eventually gets averaged out.

Related Articles: The Benefit of Owning Stocks Over Bonds Keeps Shrinking and The Rasputin Effect: Global Resilience To Higher Rates and Most Global Economies Remain in Disequilibrium, Requiring Policy Action

Primary Topic: Financial Markets

Topics: Financial Markets, GDP, Op-Ed/Blog Post

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