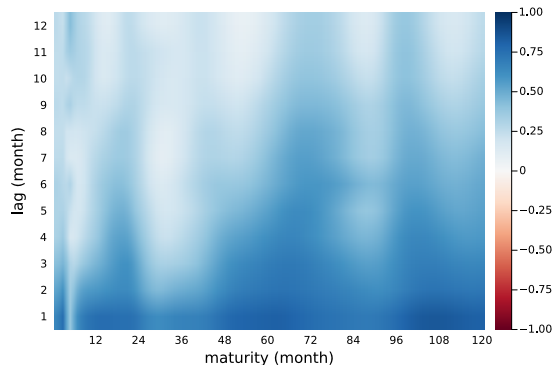


**Figure 3: Autocorrelation in the residuals.** The figure illustrates the autocorrelation of the residuals from the regression of bond yields. Panel (a) shows the results when using the first three principal components of bond yields  $\mathcal{P}_t$  as regressors, while panel (b) presents the results when both the principal components  $\mathcal{P}_t$  and the residual factors  $f_{t-1}$  are used as regressors.

(a) without the residual factors



(b) with the residual factors

