Survey on Uncertainty and Valuation *

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Abstract

This report provides a survey of how uncertainty affects stock returns. In general, the literature documents a negative relation. A few papers present the opposite evidence, although the negative effects dominates in most studies.

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1 Overview

In relation to asset prices, in endowment economies uncertainty increases equity risk premium[1]. This is consistent with Epstein and Zin (1991) preferences, and early resolution of uncertainty. Uncertainty decreases stock prices, and contributes positively to risk premia. Discount rate shocks suppress investment and raise equity premium, in many papers involving endogenous growth (e.g., Kung and Schmid (2015)), idiosyncratic investment risk (e.g., Dou (2017)), or investment sectors (e.g., Segal (2019)).

[1] See, e.g., Bansal and Yaron, 2004

References

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