Does Uncertainty Affect Stock Prices? [⋆]

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Abstract

I 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 Introduction

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 idiosyncratic investment risk (e.g., Dou (2017)), or investment sectors (e.g., Segal (2019)).

However, several recent studies question the role of macro uncertainty to induce recessions (see Ludvigson and coauthors). Macro uncertainty only deepens recessions, not causing them.

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

References

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