

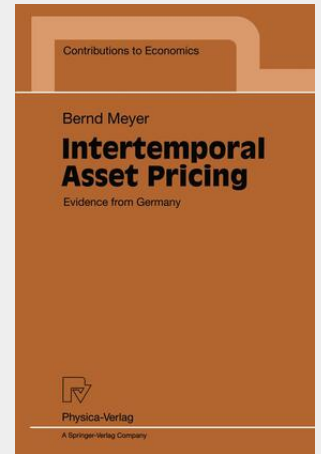
Meyer

Intertemporal Asset Pricing

Evidence from Germany

In the mid-eighties Mehra and Prescott showed that the risk premium earned by American stocks cannot reasonably be explained by conventional capital market models. Using time additive utility, the observed risk premium can only be explained by unrealistically high risk aversion parameters. This phenomenon is well known as the equity premium puzzle. Shortly afterwards it was also observed that the risk-free rate is too low relative to the observed risk premium. This essay is the first one to analyze these puzzles in the German capital market. It starts with a thorough discussion of the available theoretical models and then goes on to perform various empirical studies on the German capital market. After discussing natural properties of the pricing kernel by which future cash flows are translated into securities prices, various multi period equilibrium models are investigated for their implied pricing kernels. The starting point is a representative investor who optimizes his investment and consumption policy over time. One important implication of time additive utility is the identity of relative risk aversion and the inverse intertemporal elasticity of substitution. Since this identity is at odds with reality, the essay goes on to discuss recursive preferences which violate the expected utility principle but allow to separate relative risk aversion and intertemporal elasticity of substitution.

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