

A Parsimonious Arbitrage-Free Model for Stocks and Bonds

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Abstract

We estimate a *relatively* simple asset pricing model that prices bonds and stocks simultaneously. We stretch the model by comparing its implications to those from the data, for a long list of established properties of bonds and stocks. We find that the model does surprisingly well in replicating the empirical findings in the data. For example, it matches the observed (a) equity premium, (b) stock volatility, (c) term structure of average yields and volatilities, (d) bond premia dynamics, (e) the predictability of stock returns by the dividend yield, (f) the predictability of the dividend-growth, and others.

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