



IMPLIED RISK PREMIUM TESTS



Forward Looking Premiums: A Repeat

- Assume that you were looking at an investment, where you were guaranteed a cash flow of \$ 1 (with certainty) every year in perpetuity. How much would you pay for this investment right now?

- Now assume that you were looking at an investment, where you expect to generate a cash flow of \$ 1, with about the same uncertainty as you would face on an average risk stock, in perpetuity. How much would you pay for this investment?

Age and Risk Aversion

- Studies of risk aversion find that as people age, they become more risk averse. If that is true, would someone older than you pay more or less for this investment?
- There are some parts of the world that are aging (Japan, Europe, even China). As investors age, what should happen to risk premiums in these markets?

Crisis and Risk Premiums

- Now assume that an unexpected crisis (economic, political, pandemic) hits the economy. As an investor, would you pay less or more for the same investment (that I offered you)?

- What does that imply for risk premiums?