Asset Pricing with Long-Run Durable Expenditure Risk:

Evidence from the U.S. and Japan

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Abstract

Applying the model of Parker and Julliard (2005) to durable goods, this study investigates the relationship between long-run durable expenditure risk and cross-sectional variation of stock returns across two highly developed capital markets: the U.S. and Japan. A new finding is that the long-run durable expenditure model can obtain a reasonable risk-aversion parameter and estimate a smaller value than those obtained with the many novel models proposed in recent years. The U.S. and Japan share a common relationship between the pattern of business cycles and durable expenditure risk in the future horizon following return; that is, durable expenditure risk over the long-run is countercyclical. The ability to use data on consumption, for which households have true latitude in making choices, could help to resolve equity premium puzzles.

JEL classification: G11; G12; E21

Keywords: Durable goods; Equity premium puzzle; CCPAM; GMM; Long-run consumption risk