



# Market Expectations in the Cross Section of Present Values

## 2012 FIRST PRIZE

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Returns and cash flow growth for the aggregate U.S. stock market are highly and robustly predictable. Using a single factor extracted from the cross-section of book-to-market ratios, we find an *out-of-sample* return forecasting  $R^2$  of 13% at the annual frequency (0.9% monthly). We document similar out-of-sample predictability for returns on value, size, momentum, and industry portfolios. We present a model linking aggregate market expectations to disaggregated valuation ratios in a latent factor system. Spreads in value portfolios' exposures to economic shocks are key to identifying predictability and are consistent with duration-based theories of the value premium.

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