Market Expectations in the Cross Section of Present Values

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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.

described herein, and is only current as of the date indicated. There is no assurance that such events or targets will be achieved, and may be significantly different from that shown here. The information in this document, including statements concerning financial market trends, is based on current market conditions, which will fluctuate and may be superseded by subsequent market events or for other reasons.