Excess Volatility: Beyond Discount Rates

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Evaluating prices and risk across time horizons or "along the term structure" forms an important aspect of any asset pricing model. It is important, for instance, to understanding the dynamics of prices through time, the existence of any arbitrage opportunities, and for comparing results between alternative models. The authors find that prices of long maturity claims of assets are dramatically and systematically more variable than justified by standard models. Their finding is pervasive, with excess volatility evident across a wide variety of markets including equity, currencies, commodities, sovereign and corporate bonds, and inflation. The authors find that trading against long maturity excess volatility is potentially profitable after accounting for standard risk factors.

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