

Taking Stock. Financial economists wonder what is left of their favourite model.

- McKinsey : bubble in technology
 - media and telecom share price $\uparrow, \downarrow$ by more than market as a whole
 - $\beta_i = \frac{\sigma_{im}}{\sigma_m^2} \Rightarrow$ how the share price moves in relation with the market
“speed and volatility”, level of riskiness
 - $\beta_M = 1 = \sum_{i=1}^N w_i \beta_i$; w_i is the market share of asset i in the market portfolio.
 - $\beta_{\text{Media, Telecom}}$ are high. Betas for other old-economy shares fell.
 - investors should strip out the effects of the bubble.
- Fama and French
 - “value stock” (shares with low price-earning ratios) do much better over time than their betas would predict.
- Campbell and Tuomo Vuolteenaho propose a new way to measure the beta.

- the CAPM: $E(R_i) = R_f + (E(R_m) - R_f)\beta_i$
- Equity premium = Rate of return on investing in an equity share - R_f
- Equity premium is highly positive because
 - equity shares are less liquid
 - investing in equity share increases the volatility of people's income
- Mehra found all this unconvincing.
 - Bonds often do as poorly as equities in times of great distress.
 - In France, in the 1920s their prices fell by around 90%.
 - Holders of Mexican bonds suffered huge losses in 1980s.
- Unsatisfactory conclusion : there is no equity “premium” - in the sense of a fairly predictable excess over bond returns on which investors can rely.