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A Longer Look at Dividend Yields

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A Longer Look at Dividend Yields*

There is by now a substantial body of work in finance which suggests that a variety of financial assets, in particular, a number of research studies (1984), Campbell and Shiller (1988), French (1988), Fuller and Hodrick (1992), consider the relationship between dividends and returns and find that dividend yields are correlated with future stock returns. The low power of statistical tests of the predictability in long-horizon returns are performance based on the financial data available.

The use of long-term dividend yields is a crucial issue. The ex post relationship between dividend yields and stock returns, conditioned on the survival of the firm, may be misleading. This conditioning may have led to the inferences about the behavior of dividend yields. For instance, when we look at the world's financial markets, we find that the dividend yields for stocks have been high for long uninterrupted periods, suggesting a mean reversion. As we show, the evidence of mean reversion in dividend yields is not a good turn forecastability.

* We thank Stephen Brown and Eugene Fama and Ross for useful comments. Eugene Fama provided particularly valuable insights.

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Abstract

This article reexamines the evidence on the ability of dividend yields to predict long-horizon stock returns. We use two new series beginning in 1871, a monthly series for the United States, and an annual series for the United Kingdom. Conditional on survival over the entire 122 years, dividend yields display only marginal ability to predict stock market returns in either country. We also argue that tests over long periods may be affected by survivorship. Simulations...

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