R-squared and the Economy

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WORKING PAPER 19017

DOI 10.3386/w19017

ISSUE DATE May 2013

REVISION DATE June 2013

Many seemingly discordant results are reconciled if firm-specific return volatility is characterized as the intensity with which firm-specific events occur. A functionally efficient stock market allocates capital to its highest value uses, which often amounts to financing Schumpeterian creative destruction, wherein creative winner firms outpace destroyed losers, who can be last year's winners. This elevation in firm-specific fundamentals volatility elevates firm-specific return volatility in a sufficiently informationally efficient stock market. These linkages are interconnected feedback loops, rather than unidirectional chains of causality.

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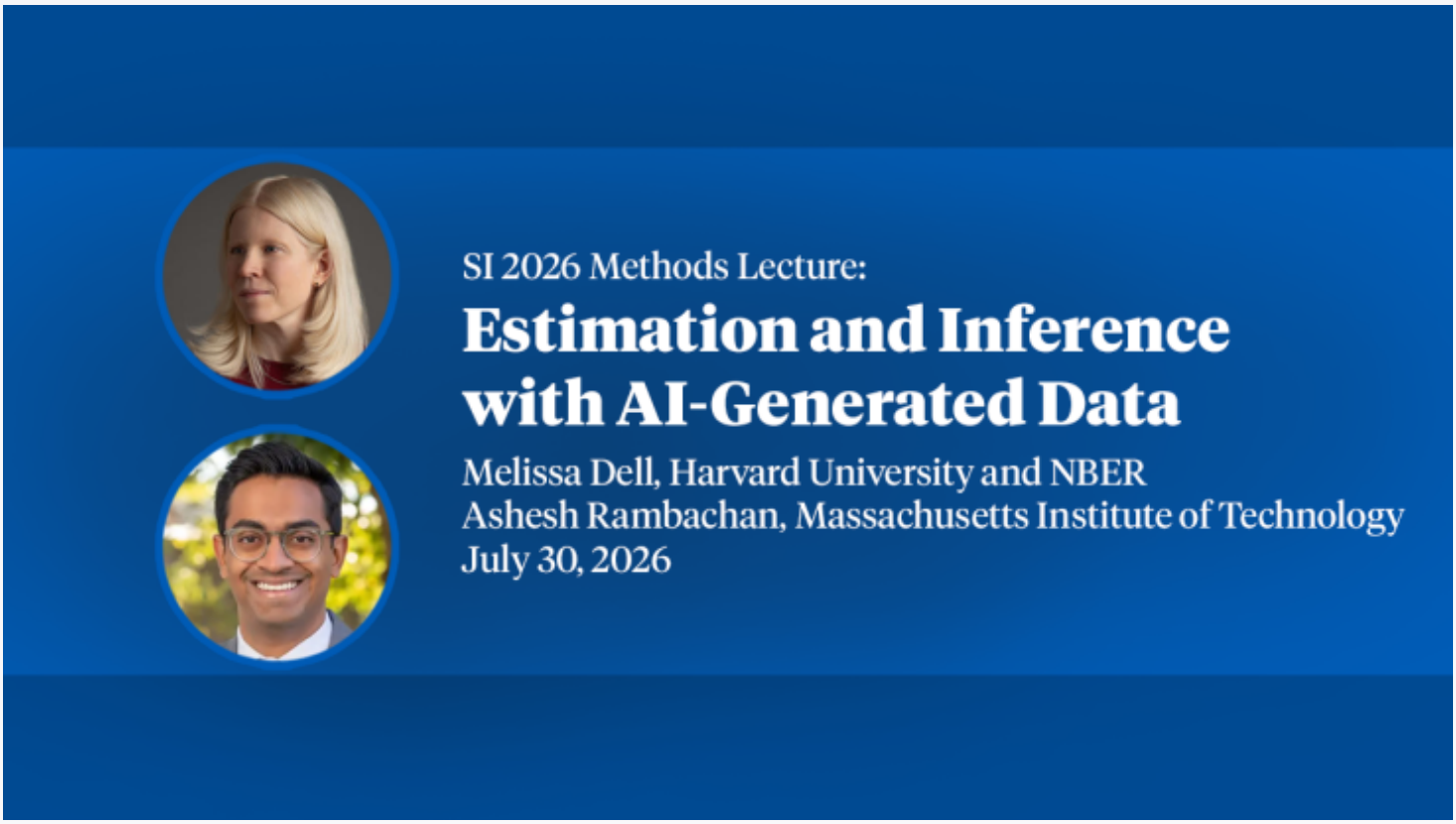


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