



Chapter 16 Are financial assets priced locally or globally?

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Abstract

We review the international finance literature to assess the extent to which international factors affect financial asset demands and prices. International asset-pricing models with mean-variance investors predict that an asset's risk premium depends on its covariance with the world market portfolio and, possibly, with exchange rate changes. The existing empirical evidence shows that a country's risk premium depends on its covariance with the world market portfolio and that there is some evidence that exchange rate risk affects expected returns. However, the theoretical asset-pricing literature relying on mean-variance optimizing investors fails in explaining the portfolio holdings of investors, equity flows, and the time-varying properties of correlations across countries. The home bias has the effect of increasing local influences on asset prices, while equity flows and cross-country correlations increase global influences on asset prices.

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Keywords

international capital asset-pricing model; home bias puzzle; segmented markets; integrated markets; equity flows

JEL classification

G12; G15; G11

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