Four centuries of return predictability

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Abstract
We combine annual stock market data for the most important equity markets of the last four centuries: the Netherlands and UK (1629–1812), UK (1813–1870), and US (1871–2015). We show that dividend yields are stationary and consistently forecast returns. The documented predictability holds for annual and multi-annual horizons and works both in- and out-of-sample, providing strong evidence that expected returns in stock markets are time-varying. In part, this variation is related to the business cycle, with expected returns increasing in recessions. We also find that, except for the period after 1945, dividend yields predict dividend growth rates.

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