

# The long-run equity risk premium <sup>☆</sup>

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## Abstract

Based on a survey of US Chief Financial Officers (CFOs), we present expectations of the equity risk premium measured over a 10-year horizon relative to a 10-year US Treasury bond. This multi-year survey has been conducted each quarter from June 2000 to June 2005. Each quarter the survey also provides measures of cross-sectional disagreement about the risk premium, skewness, and a measure of individual uncertainty. The individual uncertainty is deduced from the 80% confidence interval that each respondent provides for his or her risk premium assessment. We also present evidence on the determinants of the long-run risk premium. Our analysis suggests there is a positive correlation between the ex ante risk premium and real interest rates as reflected in Treasury Inflation Indexed Notes.

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## 1. Introduction

We analyze the results of the June 2005 survey of Chief Financial Officers (CFOs) conducted by Duke University and CFO Magazine. In particular, we poll CFOs about their long-term expected return on the S&P 500. Given the current 10-year T-bond yield, we provide estimates

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<sup>☆</sup> An updated version of this paper will be posted each quarter to SSRN under a similar title, with wording that indicates the most recently conducted survey.

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of the equity risk premium and show how the premium changes through time. We also provide information on the disagreement over the risk premium as well as average confidence intervals.

## 2. Method

### 2.1. Design

The quarterly survey of CFOs was initiated in the third quarter of 1996.<sup>1</sup> Every quarter, Duke University polls financial officers with a short survey on important topical issues (Graham and Harvey, 2005). The usual response rate for the quarterly survey is 5–8%. Starting in June of 2000, a question on expected stock market returns was added to the survey. Figure 1 summarizes the results from the risk premium question.<sup>2</sup> While the survey asks for both the one-year and ten-year expected returns, we focus on the ten-year expected returns herein, as a proxy for the market risk premium.

The executives have the job title of CFO, Chief Accounting Officer, Treasurer, Assistant Treasurer, Controller, Assistant Controller, or Vice President (VP), Senior VP or Executive VP of Finance. Given that the overwhelming majority of survey respondents hold the CFO title, for simplicity we refer to the entire group as CFOs.

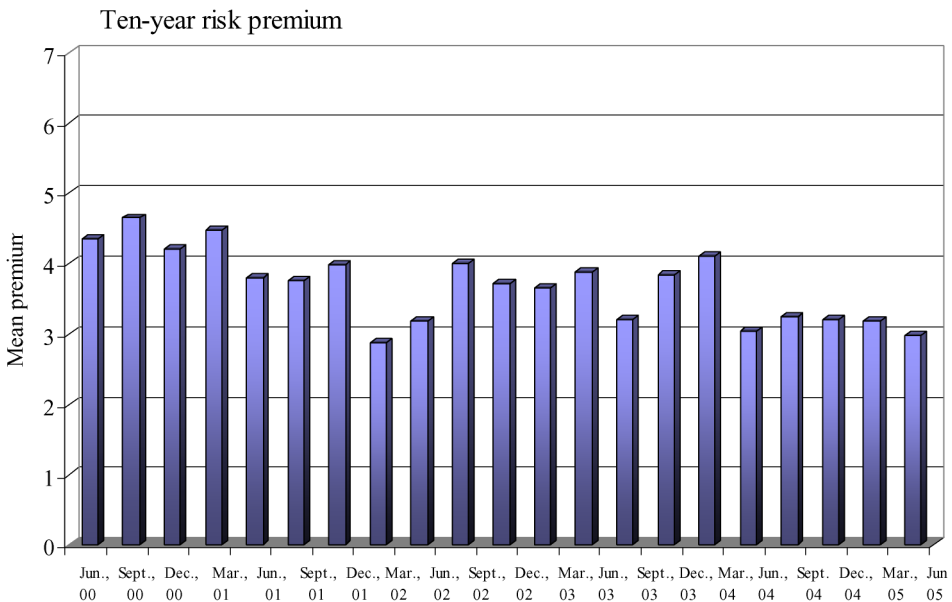


Fig. 1. Ten-year risk premium.

<sup>1</sup> The surveys from 1996Q3–2004Q2 were partnered with a well-known national organization of financial executives. The 2004Q3–2004Q4 surveys were solely Duke University surveys, which used Duke mailing lists (previous survey respondents who volunteered their email addresses) and purchased email lists. The surveys from 2005Q1 to present are partnered with CFO Magazine. The sample includes both the Duke mailing lists and the CFO Magazine subscribers that meet the criteria for policy-making positions.

<sup>2</sup> In the text and in Fig. 1, we refer to the most recent survey as June 2005. The table refers to the exact closing date of the survey, which was May 29, 2005.

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