

# Equilibrium Portfolios and Equity Premium with Wealth Heterogeneity and Uncertainty Aversion (D. Makarov, A. Schornick)

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- Stylized facts:
  - Limited participation in the stock market
  - Participation increases in wealth
  - Share of wealth invested in stocks decreases in wealth
- Implications for Equity Premium Puzzle
- Makarov & Schornick
  - Endogenous participation
  - Uncertainty aversion
  - Wealth heterogeneity

- Done so far:
  - Basak & Cuoco (1998): limited participation leads to higher risk premium
  - Cao, Wang & Zhang (2005): limited participation (endogenous) leads to lower risk premium
  - Ui (2010): conditions
  
- Makarov & Schornick
  - Cao, Wang & Zhang (2005) + wealth effects
  - risk aversion and model uncertainty decrease in wealth
  - limited participation leads to higher risk premium

- Cao, Wang & Zhang (2005)
  - dispersion  $\uparrow \Rightarrow$  participation  $\downarrow \Rightarrow$  risk premium  $\uparrow$ , uncertainty premium  $\downarrow \Rightarrow$  equity premium  $\downarrow$
  
- Makarov & Schornick:
  - wealth  $\downarrow$  (dispersion  $\uparrow$ , risk aversion  $\uparrow$ )  $\Rightarrow$  participation  $\downarrow \Rightarrow$  equity premium  $\downarrow$

## COMMENTS:

- Role of wealth effects, risk premium vs. uncertainty premium
- Intuition
- Disentangling wealth and model uncertainty
- Theoretical role of the power law distribution
- Extensions in line with Cao, Wang & Zhang (2005)