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Working Paper

Term Structure(s) of Equity Risk Premium (with L. Gomes), under revision

ABSTRACT: Using dividend and variance swap data simultaneously, we provide a series of novel facts on the term structure of equity risk premium. We also show the importance of another dimension of the term structure related to investment horizon and how the term structure changes over time. Moreover, we uncover new information on the level and variation of the term structure of the (physical) expectation of dividend growth. Among many facts, we show that: risk premium is increasing and concave on maturity; risk premium is also increasing and concave on investment horizon, but increases much faster than maturity; independently of maturity, most of the risk premium is associated with short-horizon risk premium; dividends are highly predictable once we account for time variation in the horizon term structure; and liquidity explains the high returns of dividend contracts and the term structure puzzle. Using both dimensions jointly highlights additional challenges to asset pricing models, but, unlike previous literature, we show that all these facts are consistent, for instance, with a long-run risk model with jump risks.