

VALUE GROWTH RATE AND VALUE-TO-PRICE RATIO: FORECASTING RETURNS OF THE S&P 500 COMPOSITE INDEX

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ABSTRACT

We employ a modified Gordon model to estimate the intrinsic value of the S&P500 composite index. A unified framework is proposed to represent the relation between the expected future return and the inherent forecast variables (i.e., value growth and value relevance). Our results show both the value growth rate and the value-to-price ratio have significantly reliable predictive power for the future returns of the S&P500 index in one to eighteen months. In addition, fundamental variables, such as earnings yield, dividend yield, T-bill yield, and lagged index return, tend to have little predictive power for future returns of the S&P500 index when controlling for the value growth rate and/or the value-to-price ratio.

JEL Classification: G12

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