

Title: "Wealth, Return and Time-varying Cash Flow Correlations"

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Abstract

We develop a long-run risk model where the time-varying covariance of cash flow growths is modeled by Wishart process. Our model matches asset pricing moments in Fama-French Book-to-Market portfolios, especially the long-run correlation of cash flows. We estimate latent long-run risk component and Wishart part at each time, and thus conditional correlation of cash flows.

The correlation of financial market cash flow and consumption is cyclical and fluctuates around 17%. We found the latent variables forecast 1, 4 and 8-quarter ahead future market returns with adjusted R² 1.4%, 12.3% and 20.9%.

Overall, time-varying correlations of cross-sectional cash flows carry important information.