Implied Cost of Capital Based Investment Strategies – Evidence From International Stock Markets[♦]

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Abstract

In the recent literature on estimating expected stock returns, one of the most appealing approaches is the concept of the so-called implied cost of capital. Calculated as the internal rate of return that equates stock price with discounted future cash-flows, this method has been applied to estimating the market risk premium as well as forecasting individual stock returns. In this paper we investigate several implied-cost-of-capital approaches in their intrinsic ability to predict stock returns. Using cross-sectional regression analysis and panel estimation, we confirm its hypothesized relation to stock returns across the largest equity markets, but detect qualitative differences among standard models employed.

JEL Classification: G11

Keywords: Implied cost of capital, implied return, portfolio management, expected stock returns, panel regressions, analysts' forecasts

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