

# The Prize in Economic Sciences 2013

The Royal Swedish Academy of Sciences has decided to award the Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel for 2013 to

**Eugene F. Fama**

University of Chicago, IL, USA

**Lars Peter Hansen**

University of Chicago, IL, USA

**Robert J. Shiller**

Yale University, New Haven, CT, USA

*“for their empirical analysis of asset prices”*

## Trendspotting in asset markets

There is no way to predict the price of stocks and bonds over the next few days or weeks. But it is quite possible to foresee the broad course of these prices over longer periods, such as the next three to five years. These findings, which might seem both surprising and contradictory, were made and analyzed by this year's Laureates, **Eugene Fama, Lars Peter Hansen and Robert Shiller**.

Beginning in the 1960s, Eugene Fama and several collaborators demonstrated that stock prices are extremely difficult to predict in the short run, and that new information is very quickly incorporated into prices. These findings not only had a profound impact on subsequent research but also changed market practice. The emergence of so-called index funds in stock markets all over the world is a prominent example.

If prices are nearly impossible to predict over days or weeks, then shouldn't they be even harder to predict over several years? The answer is no, as Robert Shiller discovered in the early 1980s. He found that stock prices fluctuate much more than corporate dividends, and that the ratio of prices to dividends tends to fall when it is high, and to increase when it is low. This pattern holds not only for stocks, but also for bonds and other assets.

One approach interprets these findings in terms of the response by rational investors to uncertainty in prices. High future returns are then viewed as compensation for holding risky assets during unusually risky times.

**Prize amount:** SEK 8 million, to be shared equally between the Laureates.

**Further information:** <http://kva.se> and <http://nobelprize.org>

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The Royal Swedish Academy of Sciences, founded in 1739, is an independent organization whose overall objective is to promote the sciences and strengthen their influence in society. The Academy takes special responsibility for the natural sciences and mathematics, but endeavours to promote the exchange of ideas between various disciplines.

Lars Peter Hansen developed a statistical method that is particularly well suited to testing rational theories of asset pricing. Using this method, Hansen and other researchers have found that modifications of these theories go a long way toward explaining asset prices.

Another approach focuses on departures from rational investor behavior. So-called behavioral finance takes into account institutional restrictions, such as borrowing limits, which prevent smart investors from trading against any mispricing in the market.

The Laureates have laid the foundation for the current understanding of asset prices. It relies in part on fluctuations in risk and risk attitudes, and in part on behavioral biases and market frictions.

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