

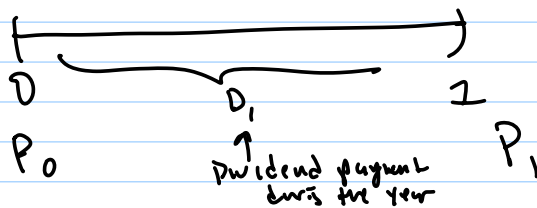
Econ 422 Lec 8

Note Title

8/2/2010

Holding period return.

Example: Hold stock for 1 year
1 year = holding period



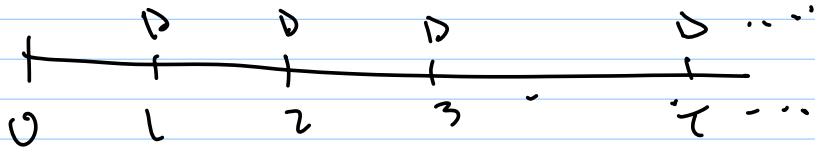
P_0 = purchase price today (time 0)

D_1 = dividend paid b/w periods 0 & 1

P_1 = sales price at year 1

Dividend Growth Models

(i) No growth in dividends



Stock is like perpetuity

$$P_0 = PV = D/r \Rightarrow r = D/P = \text{dividend}$$

$D =$ share of earnings from Firms

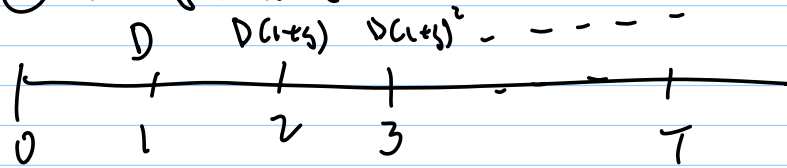
Assume all earnings are paid as dividends

$$D = E$$

$$\text{Then } P_0 = \frac{E}{r} \Rightarrow r = \frac{E}{P} = \text{No growth rate of return on stock}$$

$$\Rightarrow r = \frac{1}{P/E} = \frac{1}{\text{price earnings ratio}}$$

(2) growing dividend



growing perpetuity

$$P = \frac{D}{r-g} \Rightarrow \frac{P}{r}$$

$$r-g = \frac{D}{P} \Rightarrow r = \underbrace{\frac{D}{P}}_{\text{Dividend yield}} + \underbrace{g}_{\text{capital gain}}$$