

Executive Summary

In order to proof evidence of inefficiencies in capital markets, Shiller (1981) developed a variance-bound test that restricts theoretical rational asset prices to a certain variance. Time series of stock returns, however, show that the actual realized variance of stock prices is much bigger than the theoretically suggested variance. This thesis will disclose some weaknesses of Shiller's methodology and argument that the observed excess volatility could be explained within the framework of efficient markets by loosen the assumption of a constant expected dividend growth rate. It is argued that expectations of the development of dividends for a national capital market is a function of the economy's output. In the empirical part, six regression models are tested for their ability to explain stock returns in some function of GDP growth in a total of 38 emerging and developed countries. The calculations lead to mixed results. The volatility of stock markets can only partly be explained with GDP growth rates and hence also by the changes in expected dividend growth rates. The paper is concluded by the insight that the volatility in stock prices cannot be fully explained within the framework of the efficient market hypothesis, but that the share of excess volatility i.e. the irrational volatility of stock prices, in fact might be smaller than embraced by Shiller.