

# New Tests of Expectation Formation with Applications to Asset Pricing Models\*

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26 July, 2019

## Abstract

We show unit root econometrics can be fruitfully employed to analyze expectations data and test expectation formation in financial and macroeconomic models with various informational assumptions. Survey data suggests stock price forecasts are not cointegrated with consumption forecasts and rejects this aspect of the formation of stock price expectations in a wide range of asset pricing models. The evidence casts some doubt on the modeling of expectation formation in the asset pricing models which assume agents possess the knowledge of the equilibrium pricing function. Relaxing this knowledge appears necessary for models to reconcile the survey evidence and potential resolutions are discussed.

Keywords: Survey Expectation, Cointegration, Sentiment, Learning, Heterogeneous Beliefs

JEL classifications: D84, G12, G17.

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