VALUING STOCKS

• CF associated with holding stocks
  – dividend stream and sales price

• Short Run Equilibrium
  – Central role of future price expectations ("beauty contest")

• Explaining future price expectations:
  – fundamental valuation
  – Fundamental price

• Fundamental valuation with growth
  – constant: Gordon growth model (growing perpetuity)
  – in phases
    * need formula for growing annuity
Fundamental Value based on Earnings

• Why not $FV = PV$ of future earnings?

Four scenarios

1. Full distribution of earnings
2. Reinvestment of earnings at $r$ (opportunity cost of capital)
   • Growth equation
3. Reinvestment of earnings above opportunity cost of capital
4. Reinvestment of earnings below opportunity cost of capital