

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