

Do Equity Returns Provide a Hedge Against Inflation? An Analysis of High Frequency, Cross-Country, and Sector Level Data, 1975-2009

By

Isil Erol
Assistant Professor of Economics
The Middle East Technical University
Department of Economics
06531 Ankara, Turkey
Tel: +90-312-2103048 Email: isile@metu.edu.tr

Dogan Tirtiroglu*
Professor of Finance and Chair in Banking
The University of Adelaide
Business School
10 Pulteney Street, Room 12.42
Adelaide, SA 5005, Australia
Tel: +1-61-8-8303-8007 Email: dogan.tirtiroglu@adelaide.edu.au

Kasirga Yildirak
Assistant Professor of Economics
The Trakya University
Department of Economics
Edirne, Turkey
Tel: +90-312-2105614 E-mail: kasirga@metu.edu.tr

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The authors are alphabetically listed and contributed equally to this article. This is a preliminary version. Please do not quote without the full permission of the authors.

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Abstract

This paper introduces the Brownian bridge as a means of constructing reliable simulated high frequency inflation rates from low frequency inflation rates and tests, by providing a distribution of parameter estimates rather than their point estimates, whether high frequency equity returns have offered a hedge against high frequency inflation rates - total, expected and unexpected - across five different sectors in USA, Japan, UK, Canada, and South Africa between January 1, 1975 and May 31, 2009. A Kalman filter constructs the expected and unexpected inflation rates. A literature review demonstrates that research on this topic in the top academic journals has fallen silent since the early 1980s and that the literature uses only low frequency and only country-level data. Hence, our paper extends the evidence, disaggregated at the sector-level, to five countries with different inflationary experiences from the early 1980s until the present time and also provides a decade-by-decade comparative examination. Some of our findings differ substantially from those of monthly data for the same time period.