The average return on the U.S. aggregate stock market is roughly 6% larger than the average return on government bills, reflecting “high risk, high return.” However, quantitatively explaining this gap has been a considerable challenge in the macro-finance literature over the last few decades. Holding a well-diversified stock portfolio does not seem so risky, considering that aggregate consumption and other economic fundamentals exhibit little volatility. This is one of many puzzles that suggest that there is more than meets the eye when it comes to understanding the connection between asset prices and macroeconomic fluctuations. One potential resolution is to consider the risk of rare but severe economic downturns like the Great Depression. While rare disaster models have received ample attention due to their success in explaining various puzzles, measuring disaster risk still remains as an issue. In this talk, Dr. Seo will discuss how derivative markets can help us overcome this issue.

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