Q. Reference: Page 48, Lines 11-13

"My appendix E shows that inflation averaged not 2.0% but over 3.0% during this period, so her procedures may over estimate the market risk premium by at least 1.0%."

Please provide all empirical evidence to support the proposition that the expected nominal equity market return has tracked the expected rate of inflation.

A. Dr. Booth is not aware of any research that tracks expected nominal equity returns and expected inflation since this would require estimates of expected rates of return and such estimates are bogged down by inadequate asset pricing models. However, it is a basic proposition in finance that investors try to protect themselves from inflation by increasing nominal rates of return in line with expected inflation so that their real rate of return is constant. The evidence turns on the constancy of real equity rates of return over many decades. Note schedule 3 to Dr. Booth's testimony shows that LTC bond yields have generally tracked the expected inflation rate over the last 38 years.