Q. Evidence of Ms. McShane, Equity risk premium tests, Pages 44-56: Given the discussion on pages 55-56 that based on a long run long Canada yield of 5.0% the market risk premium is 6.5% and based on current yields of 3.25-3.50% her market risk premium estimate is 8.0%, will she accept that her expected return on the market is 11.25%-11.50% regardless of the level of interest rates? Does this mean that Ms. McShane does not believe that the level of interest rates has a significant bearing on expected equity market returns?

A. Theoretically, it would be reasonable to expect that expected equity market returns are sensitive to the level of interest rates, as interest rates themselves are, in the long run a function of the required real rate of return on capital and inflation (see lines 1284-1285 of Ms. McShane's testimony). Ms. McShane's analysis of historical equity returns, interest rates and inflation indicates that there has not been any material upward or downward trend in the nominal historic equity market returns over the longer-term, that the experienced real equity returns generally have been higher when inflation was lower, and the experienced equity risk premium generally has been higher when interest rates were lower. Based on this analysis, set out at pages 49-52 of her testimony, her estimates of the expected equity market return are not materially different at the levels of long-term Canada bonds cited in the question.