

Abstract

This thesis focuses on the equity premium puzzle, risk-free rate puzzle and possible solutions of these two quantitative conundrums. Original formulation of both puzzles is introduced and comprehensive literature survey is presented to show the developments regarding this topic. These include risk-based explanations, non-risk based explanations and behavioral finance perspective. Main contribution of this study dwells in estimation of these two puzzles for the Czech Republic. Using consumption-based asset pricing model with time separable preferences, presence of the two puzzles is estimated employing annual Czech data from 1995 to 2011. The equity premium puzzle is not present in the Czech Republic, as the coefficient of risk aversion $\alpha = 5.57$. On the other hand, the risk-free rate puzzle is as severe as in developed economies. Furthermore, the individual time preference parameter β is estimated to be larger than one – a counterintuitive result suggesting consumers prefer unit of consumption tomorrow to unit of consumption today. Robustness of the results is confirmed when different proxy for a risk-free rate is used. Results do not change significantly and the risk-free rate puzzle persists. Direction for future research of the financial market puzzles in the Czech Republic is suggested.