Abstract
This paper analyzes mean reversion in international stock markets during the period 1900-2008, using annual data. Our panel of stock indexes in seventeen developed countries, covering a time span of more than a century, allows us to analyze in detail the dynamics of the mean-reversion process. In the period 1900-2008 it takes stock prices about 13.8 years, on average, to absorb half of a shock. However, using a rolling-window approach we establish large fluctuations in the speed of mean reversion over time. The highest mean reversion speed is found for the period including the Great Depression and the start of World War II. Furthermore, the early years of the Cold War and the period covering the Oil Crisis of 1973, the Energy Crisis of 1979 and Black Monday in 1987 are also characterized by relatively fast mean reversion. Overall, we document half-lives ranging from a minimum of 2.1 years to a maximum of 23.8 years. In a substantial number of time periods no significant mean reversion is found at all, which underlines the fact that the choice of data sample contributes substantially to the evidence in favor of mean reversion. Our results suggest that the speed at which stocks revert to their fundamental value is higher in periods of high economic uncertainty, caused by major economic and political events.