Forecasting Stock Prices Based on the Residual Income Valuation Model: Evidence from a Time-Series Approach

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Abstract : Previous studies applying residual income valuation (RIV) model generally use panel data and single-equation model to forecast stock prices. Unlike these, this paper uses Taiwan longitudinal data to estimate multi-equation time-series models such as Vector Autoregressive (VAR), Vector Error Correction Model (VECM), and conduct out-of-sample forecasting. Further, this work assesses their forecasting performance by two instruments. In favor of extant research, the major finding shows that VECM outperforms other three models in forecasting for three stock sectors over entire horizons. It implies that an error correction term containing long-run information contributes to improve forecasting accuracy. Moreover, the pattern of composite shows that at longer horizon, VECM produces the greater reduction in errors, and performs substantially better than VAR.