

Seminar series

## Securities markets: trends, risks and policies

# Hedging labor income risk over the life-cycle

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### Abstract:

Using the restrictions implied by a mainstream labor income process, our method reconstructs the life-cycle dynamics of Permanent Income (PI) Shocks. This delivers precise estimates of both initial and updated individual correlations between PI shocks and stock returns, even with a short time-series dimension of the data. Consistent with life-cycle theory, risk taking by each household is highly sensitive to such correlation and predicted participation is in line with actual participation choices, also over time.

**Keywords:** household wealth risk, stock market participation, permanent income shocks.

**JEL Classification:** G10, G11, D14, C15

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