

Abstract: This study proposes an equilibrium model of term structures of bonds and equities. A major challenge for any equilibrium model is to describe the term structure of real interest rates that can be upward or downward sloping and the term structure of equity risk premiums that is on average downward sloping. We overcome this challenge by letting preference parameters of the recursive utility depend on state variables related to macro economy and financial markets. The parameters are calibrated by matching the model with a reduced-form model proposed by Lettau and Wachter (LW) (JFE, 2011) that has flexibility in generating various term structure shapes. Through this calibration, we provide an equilibrium foundation of the LW model and discuss what preference and consumption dynamics are consistent with observed term structures.