

Rietz (1988) and Barro (2006) subject consumption and dividends to rare disasters in the growth rate. We extend their framework and subject consumption and dividends to rare disasters in the growth persistence. We model growth persistence by means of two hidden types of economic slowdowns: recessions and lost decades. We estimate the model based on the postwar US data using maximum likelihood and find that it can simultaneously match a wide array of dynamic pricing phenomena in the equity and bond markets. The key intuition for our results stems from the inability to discriminate between the short and the long recessions ex ante.