We formulate a theory of expected returns in the context of a dynamic market microstructure model of trading between oligopolistic traders, who agree to disagree about precision of private information. Even though traders apply Bayes law consistently, there are no beliefs under which equilibrium prices follow a random walk and expected returns are constant; instead, equilibrium returns exhibit predictable patterns of momentum and mean-reversion in time series. Expected returns linearly depend on the history of dividend surprises and dividend-to-price ratios with coefficients related to precision of information flow, degree of disagreement between traders, risk aversion, and mean-reversion in fundamentals. The obtained predictions concerning the term structure of returns can be tested empirically against clearly defined alternatives.

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