

Report Type

Mid Term Award Report

Full Name

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Faculty/Department

Judge Business School&CERF

Project Title

The 52-week high, q theory and the cross-section of stock returns

Project Start Date

Jan 01, 2015

Project End Date

Jan 16, 2017

Amount Awarded

0

Project Abstract

Hou, Xue and Zhang's (2015) q-factor model outperforms other factor models in capturing the PTH (the ratio of current price to 52-week high price) anomaly: High-PTH stocks earn high future returns. PTH's relations with future profitability and future investment growth are both significantly positive, and they mirror PTH's relation with future returns in the cross-section and by time horizons. Incorporating the information about future investment growth contained in price level variables (e.g., PTH) helps the q factors to better capture those anomalies rooted in future investment growth. Together, these results suggest that the PTH anomaly is consistent with the investment CAPM.

Activities and Achievement

The finance literature has documented numerous anomalies, that is, stock return is predicted by various firm characteristics instead of risk. These anomalies defy the traditional asset pricing theory, such as CAPM. Understanding these anomalies is one of the most important challenges for researchers in field of asset pricing. Behavioural finance borrows findings in psychological studies to explain these anomalies. The underlying theme of behavioural finance is that investors make irrational decisions due to various psychological biases, which gives rise to various anomalies. The commonality between traditional asset pricing theory and behavioural finance is that they both focus on investors' behaviours. Recently, a new path, which focuses on firms' behaviours, has emerged to explain these anomalies. The q-theory of investment suggests that a firm keeps investing until its stock return equals its investment return, defined as marginal benefit of investment divided by marginal cost of investment. As investment return is associated with firm characteristics, stock return should be associated with firm characteristics as well. Thus, the q-theory of investment offers an alternative explanation for the anomalies, which does not rely on investor irrationality. My current research focuses on differentiating the behavioural explanation and q-theory explanation for these anomalies. This project examines one particular anomaly (the 52-week high anomaly) in which stocks whose prices closer to their 52 week highs earn higher returns. We find that the 52-week high anomaly, which is commonly interpreted as a result of investors' behavioural bias, is consistent with the q-theory explanation.

Dissemination

This paper was accepted for publication at Journal of Financial Economics in January 2017.

Outputs

Major Difficulties and Any Other Issues

The referee report was very clear and helpful, so we were able to address the referee's concerns.

Web Links

<https://sites.google.com/site/ylemcam/>

Additional Information

Declaration

Details of relevant outputs of this award have been submitted to the CERF Database and details of any ensuing outputs will be submitted in due course.

Signature - Main Award Holder

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