DETERMINANTS OF MOMENTUM IN STOCK PRICES

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Abstract

Financial market rigidities, slow information diffusion and behavioral biases reduce the suitability of asset prices as reliable guides to the allocation of real capital. To shed light on this issue, a vast amount of research has been devoted to the existence of market inefficiencies, with varying and often contradictory results.

An implication of complete market efficiency is that stock prices follow a random walk. Inefficiencies give rise to serial correlation in stock returns. Using Kalman filtering to fit an autoregressive dynamic linear model, this paper attempts to find predictable patterns in a comprehensive sample of U.S. stocks and indices. The findings suggest that serial correlation in stock returns has decreased significantly since the 1970s and occurs predominantly in companies with small market capitalization and low trading volume. Further results show that the expansive monetary policy in recent years has induced a temporary shift in stock returns to a reversal pattern.