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ABSTRACT:

Despite their strong positive average returns across numerous asset classes, momentum strategies can experience infrequent and persistent strings of negative returns. These momentum crashes are partly forecastable. They occur in panic states, following market declines and when market volatility is high, and are contemporaneous with market rebounds. The low ex ante expected returns in panic states are consistent with a conditionally high premium attached to the option like payoffs of past losers. An implementable dynamic momentum strategy based on forecasts of momentum's mean and variance approximately doubles the alpha and Sharpe ratio of a static momentum strategy and is not explained by other factors. These results are robust across multiple time periods, international equity markets, and other asset classes.

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