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Stock Return Anomalies and Individual Investors in the Korean Stock Market

Jeewon Jang^{*}

Abstract

I find a negative cross-sectional relation between the probability of future price crashes and subsequent returns in the Korean stock market, substantially due to the overpricing of stocks with a high probability of crashes. Using precise information on retail trading in the Korean stock market, I also find that stocks with a high crash probability have a relatively high proportion of retail trading. Moreover, the negative relation between the probability of crashes and stock returns is much stronger in stocks traded more heavily by retail investors. However, I cannot find a negative relation between the probability of jackpot payoffs and subsequent returns in Korea, unlike in the United States, even among stocks with a high proportion of retail trading. Both portfolio- and firm-level evidence on the crash effect suggests that stocks with a higher retail trading proportion are more likely to be overpriced, as expected from the limits to arbitrage literature.

JEL classification: G11; G12; G14

Keywords: Anomalies; crash; overpricing; retail investors; limits to arbitrage

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