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What do stock price levels tell us about the firms?

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Abstract

We hypothesize that high stock price levels impede informed trading on the stocks and reduce price informativeness. This is because uninformed trading is needed to facilitate informed trading, and high stock prices may impose budget constraints on uninformed investors. Indeed, we find, for high-price firms, (i) options to stock trading volume (O/S), an informed trading measure in options market, is higher, (ii) price informativeness about future earnings is lower, and (iii) investment sensitivity to price is lower. We also find these patterns reverse after stock splits, suggesting that firms can use splits to improve informed trading and enhance price informativeness.

JEL classification: G30, G12, G14, G17

Keywords: Stock price level, price informativeness, O/S, future earnings, stock splits

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