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Limit hits and informationally-related stocks

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ABSTRACT

We propose a method of propensity score matching to study limit hits on connected TWSE-listed stocks across industries between 1/1/2004 and 12/31/2013. The findings show significant liquidity and price impacts on connected stocks. We demonstrate that informed traders may trade connected stocks as a substitution for the hitting stock, and connected stocks seem to provide alternatives for uninformed traders to reverse their suboptimal trades even prior to the hit. In addition, our results indicate that liquidity impacts of limit hits with less information asymmetry are weaker and there is a common liquidity response of connected stocks to firm-specific limit hits.

JEL classification: G14, G18, G19

Keywords: Price limit; Liquidity impact; Price impact; Propensity score match; Order imbalance reversal

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