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Mustafa Onur Caglayan , Umut Celiker , Gokhan Sonaer

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Hedge Fund vs. Non-Hedge Fund Institutional Demand and the Book-to-Market Effect

Mustafa Onur Caglayan*, Umut Celiker†, and Gokhan Sonaer‡

* Associate Professor of Finance, College of Business, Florida International University, Miami, FL 33199. Phone: (305) 348-8430, E-mail: mustafa.caglayan@fiu.edu

† Corresponding Author: Assistant Professor of Finance, Department of Finance, Monte Ahuja College of Business, Cleveland, OH 44125 Phone: (216) 687-3683, E-mail: u.celiker@csuohio.edu

‡ Associate Professor of Finance, Department of Economics and Finance, Palumbo-Donahue School of Business, Duquesne University, Pittsburgh, PA 15282. Phone: (412) 396-4315, E-mail: sonaerg@duq.edu

Abstract

Recent studies have documented that institutional investors trade contrary to the predictions of the book-to market anomaly. We examine whether a prominent sub-group of institutional investors, namely hedge funds, differ from other institutions in terms of their trading behavior with respect to the book-to-market effect. We find that hedge funds significantly alter their trading preferences with respect to growth and value stocks, after book-to-market values become public information. More importantly, we show that hedge funds are better able to identify overpriced growth stocks compared to other institutions. Our results contribute to the literature on institutional investors' trading with respect to stock return anomalies.

Keywords: Book-to-market effect; institutional demand; hedge funds.

JEL Classifications: G10, G11, C13

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