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ABSTRACT

Consistent with Bayesian learning models, I find that two types of uncertainty—market uncertainty and firm-signal uncertainty—have opposite effects on investors' learning from new information. I provide novel evidence that investor learning increases with the level of prior market uncertainty and decreases with firm-signal uncertainty (i.e., signal precision). Specifically, I find that the stock price response to earnings announcements increases with market volatility and decreases with earnings volatility. The results indicate that investor learning increases linearly with market uncertainty and decreases nonlinearly with firm-signal uncertainty. The effect of market uncertainty is stronger for large firms, firms with more market information in their returns, and firms with more institutional ownership.

JEL classification codes: G10; G14; M40

Keywords: Market Uncertainty; Firm-signal uncertainty; Bayesian Learning; Earnings Announcements; Stock Price Responses

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