Retail Short Selling and Stock Prices

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ABSTRACT
This study uses a unique database to paint a rich picture of the role of retail short selling in stock pricing. We find that retail short selling negatively predicts firm-specific stock returns at monthly horizons, even after controlling for known predictors of returns. Return predictability is strongest in small stocks and those with low analyst and media coverage; but it is not confined to stocks with short-sale constraints. Retail shorting also robustly predicts market reactions to news and the linguistic tone of news stories. Moreover, it conveys information beyond that from other retail trades, short selling by institutional investors, and trading by corporate insiders. These and other results suggest retail short selling informs market prices, but they are inconsistent with alternative theories in which retail short selling is a proxy for investor sentiment or attention.

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