Hedge Fund Ownership and Stock Market Efficiency

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ABSTRACT

We examine the relation between changes in hedge fund stock holdings and the informational efficiency of equity prices, and find that, on average, increased hedge fund ownership leads to significant improvements in the informational efficiency of equity prices. The contribution of hedge funds to price efficiency is greater than the contributions of other types of institutional investors, such as mutual funds or banks. However, stocks held by hedge funds experienced extreme declines in price efficiency during liquidity crises, most notably in the last quarter of 2008, and the declines were most severe in stocks held by hedge funds connected to Lehman Brothers and hedge funds using leverage.

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