Does Forecasting Price Efficiency (FPE) Affect Revelatory Price Efficiency (RPE)?

Bharat Raj Parajuli
University of Utah

Abstract

This paper offers evidence that forecasting price inefficiencies signaled by corporate events affect stocks’ revelatory price efficiency (RPE). RPE decreases after over-valuation signals, more in firms with worse investment opportunities, poor corporate governance, more entrenched managers, and higher short sale constraints. Whereas, RPE increases after under-valuation signals, more in firms with better investment opportunities and managers who listen to prices and during boom times. Results are stronger when Q and Price-to-Value and corporate events suggest mis-valuation in same direction. The results imply that market over-valuations are corrected slower and hence are stickier and more prevalent in the economy than under-valuations.

Findings Summary

- Short Answer: YES

- RPE decreases after FP inefficiency (over-valuation)
- RPE decreases more in firms with
  - Worse investment opportunities
  - Poor corporate governance, more entrenched managers
  - Higher short-sale constraints
- RPE increases after FP inefficiency (under-valuation)
- RPE increases more in firms with
  - Better investment opportunities
  - Managers who listen to prices more

Author Contacts

Email: raj.Parajuli@utah.edu
Ph no: 801 706 1597
Thank you for your questions/comments!