

An Empirical Study of Liquidity and Return Autocorrelations on Chinese Stock Market

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Abstract

This paper investigates the cross-sectional relation between liquidity and stock returns with the period from Jan 2001 to Dec 2012 on Chinese stock market. Departing from prior studies using turnover ratio as liquidity measures, we employ a revised illiquidity measure of Amihud (2002), which consider the changes of information asymmetry before and after Non-Tradable Share Reform(Hencefore NTS Reform). We find that winner portfolios preform return reversals and loser portfolios preform return continuations before NTS Reform, while winner portfolios exhibit return continuations and loser portfolios exhibit return reversals after NTS Reform. Additionally, all of these return autocorrelations are stronger for high illiquidity portfolios. Furthermore, we use market capitalization as proxy for the extent of speculative trading and suppose that return reversal accompanied by high illiquidity occur in large stocks, while return continuation accompanied by high illiquidity occur in small stocks. Our empirical results are remarkably consistent with our hypothesis both before and after NTS Reform.

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