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MBS (Finance) Thesis

Cross-sectional analysis of pricing efficiency, liquidity, and information asymmetry

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Abstract

This paper tests the relation between pricing efficiency and liquidity, with and without, the effects of asymmetric information. First, we show that informed trading is negatively related to liquidity. This result is consistent with previous researches, which find that informed trading reduces liquidity. Second, this report explores the direct relation between price efficiency and liquidity by applying a cross-sectional regression. The result indicates that liquidity associated with asymmetric information effects enhances pricing efficiency. The cross-sectional relation between relative informational efficiency and liquidity combed with informed trading is significantly positive. Third, we find that pure liquidity trading also contributes to price informativeness. The positive relation between relative informational efficiency and liquidity unrelated to asymmetric information cannot be rejected.