JOURNAL ARTICLE

Trading Volume and Serial Correlation in Stock Returns

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Abstract

This paper investigates the relationship between aggregate stock market trading volume and the serial correlation of daily stock returns. For both stock indexes and individual large stocks, the first-order daily return autocorrelation tends to decline with volume. The paper explains this phenomenon using a model in which risk-averse "market makers" accommodate buying or selling pressure from "liquidity" or "noninformational" traders. Changing expected stock returns reward market makers for playing this role. The model implies that a stock price decline on a high-volume day is more likely than a stock price decline on a low-volume day to be associated with an increase in the expected stock return.

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