Great Moments in Financial Economics: Iii. Short-Sales and Stock Prices

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Mark Rubinstein (https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=16123)
University of California, Berkeley - Haas School of Business

Abstract

This is the third in a series of articles on Great Moments in Financial Economics to appear in the Journal. For each, the purpose is to trace, as well as the author can, the history of the development of an important idea. In this case, the idea, usually associated with the work of Edward Miller, is that in the real-world of investors with (1) heterogeneous beliefs and of markets with (2) significant barriers to short-sales, stocks for which these barriers are binding will have prices at least temporarily too high relative to an alternative economy in which these two features are not both simultaneously present. In the early 21st century, this idea has experienced a sort of renaissance of research which has been used to explain a large number of phenomena which can otherwise appear anomalous, from the momentum factor in stock returns, to market crashes, to the recent Internet-based stock market "bubble", and to the growing popularity of certain hedge fund strategies.

Keywords: Short sales, heterogeneous beliefs

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