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An investment strategy based on gearing ratio

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Abstract

This study investigates the predictive ability of gearing in the long term for UK firms. Robustness tests are carried out to examine the returns in excess of that attainable using book to market, price earnings and size as risk factors. It is shown that by pursuing an investment strategy based on gearing ratios and a holding period of three years, returns of 9.9% in excess of market return are attainable. Excess returns, up to 21% are attainable when portfolios are constructed based on price earnings ratio and gearing ratio.

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