



Journal of Behavioral Finance >

Volume 8, 2007 - [Issue 3](#)

1,158 25

Views | CrossRef citations to date | Altmetric

0

Original Articles

# Answering Financial Anomalies: Sentiment-Based Stock Pricing

Edward R. Lawrence, George McCabe & Arun J. Prakash

Pages 161-171 | Published online: 05 Dec 2007

🗨️ Cite this article   🔗 <https://doi.org/10.1080/15427560701547248>

Sample our  
Behavioral Sciences  
Journals



>> **Sign in here** to start your access  
to the latest two volumes for 14 days

📄 Full Article

🖼️ Figures & data

📖 References

🗨️ Citations

📊 Metrics

📄 Reprints & Permissions

Read this article

🔗 Share

## Abstract

The efficient market hypothesis (EMH) assumes that investors are rational and value securities rationally. A rational investor would value a security by its net present value; the price of a stock in this framework is based on the discounted cash flow or the present value model. Although the EMH-based model is partially successful in computing fundamental stock prices, other anomalies such as high trading volume, high volatility, and stock market bubbles remain unexplained. These models assume rational investors who are utility maximizers. But some investors behave irrationally or against the predictions, and in the aggregate they become irrelevant. In this paper, we relax the assumption of investor rationality, and attempt to explain high volatility, high trading volume, and stock market bubbles by incorporating investor sentiment into the already existing asset pricing model.

keywords:

# Notes

<sup>1</sup>We assume the dividends have extremely high growth  $g_s$ , where  $g_s > r$  until time  $T$ . Afterward, we assume dividends grow at a constant rate  $g_n$ , where  $g_n < r$ . The current price of the high-growth stock is then:

$$P_0 = \frac{DIV_1}{(r - g_s)} \left[ 1 - \left[ \frac{1 + g_s}{(1 + r)} \right]^T \right] + \frac{DIV_1(1 + g_s)^{T-1}(1 + g_n)}{(1 + r)^T * (r - g_n)}$$

<sup>2</sup>See Sharpe [1978, p. 315] for a fuller description of this method.

<sup>3</sup>Future dividends are computed from the current dividends and the growth rate. The discount rate is computed using CAPM. The growth rate is computed from the company-specific information (usually a multiple of ROE and the plowback ratio).

<sup>4</sup>For details about the formula and a description of each term, see Shleifer [[2000](#), pp. 134-143].

<sup>5</sup>For a firm with abnormally high growth, Equation ([3](#)) can be modified accordingly.

<sup>6</sup>The remaining three companies were added much later to the Dow Jones Index.

## Related research

People also read

Recommended articles

Cited by  
25

## Information for

[Authors](#)

[R&D professionals](#)

[Editors](#)

[Librarians](#)

[Societies](#)

## Opportunities

[Reprints and e-prints](#)

[Advertising solutions](#)

[Accelerated publication](#)

[Corporate access solutions](#)

## Open access

[Overview](#)

[Open journals](#)

[Open Select](#)

[Dove Medical Press](#)

[F1000Research](#)

## Help and information

[Help and contact](#)

[Newsroom](#)

[All journals](#)

[Books](#)

## Keep up to date

Register to receive personalised research and resources by email



Sign me up



Copyright © 2025 Informa UK Limited [Privacy policy](#) [Cookies](#) [Terms & conditions](#)

[Accessibility](#)

 Taylor and Francis Group

Registered in England & Wales No. 01072954  
5 Howick Place | London | SW1P 1WG