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# Answering Financial Anomalies: Sentiment-Based Stock Pricing

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## 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 the security should equal its net present value.

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# 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.

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