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# Ranked Market Information as a Stock Return Indicator

During the last two decades the academiccommunity has frequently reconsidered the issue of stock market efficiency and predictability of stock returns. The empirical evidence suggests that prices do not reflect all publicly available information, hence indicating that future stock returns are at least to some extent predictable. Consequently, there seem to be anomalies present on the stock markets that are not consistent with the concept of market efficiency.

Although the use of financial ratios in predictability studies has been extensive in the past, the use of the filtered information contained in their rankings has received little attention. Rankings of stocks according to some financial indicator may predict future stock returns. One reason for this could be that it is easier for a portfolio manager to use the ranked market indicators in order to make his investment decisions for the proportion of the portfolio to be invested in the stock market. Another reason could be that if there are less active participants or laggards on the market it is more likely that this group of investors will build up their portfolio according to the ranked value of a specific market indicator rather than according to the actual level of that indicator.

The present study extends the literature in mainly two ways. Firstly, the paper provides further evidence on the predictability of stock returns and the impact of financial indicators measured not only as levels/ratios but also as rankings. Secondly, we examine the impact of the financial indicators under different market conditions.

We use the information in a number of market oriented financial measures in order to predict returns on the individual stocks contained in the S&P500 index. Specifically, these financial measures are the projected dividend yield, the price-to-book ratio, the market capitalization, the cashflow-to-price ratio, the price-to-earnings ratio and the volatility. The applied financial measures are widely used to evaluate the stock market performance of a company.

Firstly, our results confirm predictability of stock returns based on financial market indicators. Furthermore, the empirical results support the assumption that the rankings of stocks according to financial indicators contain additional information about future stock returns within a linear regression framework. Monthly regressions of 6-months future returns on our information set of financial indicators, levels/ratios as well as rankings, result in an average adjusted R-square of about 11%. Using ranked indicators only we obtain an average explanatory power of 10%.

Secondly, the results indicate a weak relationship between market conditions and the impact of the financial indicators. Our conclu