

Credit Ratings and Stock Liquidity

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ABSTRACT

We analyze contemporaneous and predictive relations between debt ratings and measures of equity market liquidity, and find that common measures of adverse selection, which reflect a portion of the uncertainty about future firm value, are larger when debt ratings are poorer. This relation holds even after controlling for many other observable factors. We also show that ratings changes can be predicted using current levels of adverse selection, which suggests that credit rating agencies sometimes react slowly to new information. Collectively, our results offer new insights into the value of debt ratings, the specific nature of the information they contain, and the speed with which they reflect changes in uncertainty.