

# Information in the Idiosyncratic Volatility of Small Firms\*

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## Abstract

Non-systematic volatilities of small firms are special as predictors of stock returns. They are positively related with future returns on all age and size portfolios. They dominate systematic volatility, big-firm volatility and other volatilities. And there is strong evidence that idiosyncratic risk is priced in small-firm returns. Small-firm volatility as a predictor of big-firm returns is in part a proxy for systematic volatility and consumption-wealth ratio. We rule out several hypotheses, including a liquidity premium, as potential explanations of our results, but not the idea that small-firm idiosyncratic volatility is correlated with the risk of the total investor portfolio, which includes non-equity assets.

**JEL classification:** G10, G12

**Keywords:** Idiosyncratic Risk, Systematic Risk, Small Firms

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