# PRICE REVERSAL PRIMER

1. Introduction A price reversal occurs when a stock's price changes direction after a defined move. Reversals can occur intraday, over days or weeks, or over long horizons. They are influenced by news, liquidity, market microstructure, and behavioral biases. Understanding reversals helps traders identify mean reversion signals, avoid false signals, and place trades with better risk control.

2. Causes of Price Reversals - News and Information Events: Earnings announcements, guidance changes, macroeconomic data, and industry news can cause sharp moves followed by reversals when markets overreact or digest new data. - Liquidity and Order Flow Dynamics: Temporary imbalances in buying or selling create transient price pressure. As liquidity returns, prices often revert. - Market Microstructure Effects: Bid-ask bounce, quote changes, and transaction mechanics create artificial reversals at very short intervals. - Behavioral Overreaction and Underreaction: Traders may overreact to recent price changes, creating overshoots that reverse as sentiment normalizes. - Technical and Algorithmic Factors: Support/resistance levels, stop-loss clusters, and algorithmic execution behaviors often lead to short-lived moves that later unwind.

3. How Often Reversals Occur Reversal frequency depends on time horizon: - Intraday: Common, driven by overnight price drift and intraday liquidity. - Short-term (days–weeks): Reversals occur after extreme moves; however, momentum effects dominate at intermediate horizons. - Long-term (months–years): Markets exhibit mean reversion in valuations and index-level returns.

4. Measuring Reversals To study reversals, analysts should: - Select time horizons (minutes, daily, weekly). - Use clean data, preferably midquotes to avoid bid-ask bounce. - Identify extreme prior moves via return percentiles. - Compute subsequent returns and test for opposite-sign reactions. - Conduct event studies around news releases. - Use regressions to quantify the effects of liquidity, spreads, and order flow.

5. Practical Implications for Trading and Risk Management - Horizon selection is critical; reversal behavior differs sharply across timescales. - Transaction costs reduce short-horizon profitability; backtests must use realistic assumptions. - News-driven reversals offer opportunity but carry high tail-risk. - Signals improve when combined with liquidity, volatility, and news filters.

6. Suggested Additional Research When Predicting Reversals Analysts should examine: - Recent and upcoming news events. - Earnings history and surprise trends. - Liquidity conditions: spreads, depth, and order flow. - Short interest and positioning data. - Volatility regime shifts. - Macro conditions affecting the sector or index. - Relative strength vs peers or benchmarks. - Institutional ownership changes and insider activity.

7. Summary Price reversals reflect a mix of information flow, liquidity dynamics, behavioral biases, and structural market mechanics. Properly measuring and predicting reversals requires combining quantitative signals with qualitative research on news, fundamentals, and market conditions.