Abstract

The relationship between liquidity and return predictability may be an important aspect to consider when investing in cryptoassets. We examine this relation using both cross-sectional as well as panel data. First, we calculate a set of predictability measures and aggregate the results into four variables. We then regress the predictability variables on a set of controls and two measures of liquidity, specifically the Amihud illiquidity ratio and the Corwin-Schultz spread estimate. The other independent variables include the logarithm of volume, turnover ratio and Garman-Klass volatility. Results from the cross-sectional analysis indicate that liquidity negatively impacts the degree of return predictability. Moreover, findings from a subset of panel data, including only 50 cryptoassets with the largest market capitalization, provide some evidence in favor of this relationship. Results from full panel data, however, present contradictory evidence. For these regressions, liquidity is found to be either insignificant or to possess a positive impact on the degree of return predictability. Altogether, we obtain mixed evidence about the effect of cryptoasset liquidity on return predictability.

JEL Classification C53, C58, G14

Keywords Cryptoassets, Predictability, Liquidity, Panel data

Title Liquidity and Predictability of Cryptoassets

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