

EXAMINING THE IMPACT OF ETF INVESTMENTS ON DIFFERENT CHARACTERISTICS OF THE UNDERLYING STOCKS IN THE US

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ABSTRACT

Exchange Traded Funds (ETFs) have been one of the most important innovations in the financial industry over last the three decades. Their popularity stems from the diversification benefits offered similar to that of mutual funds, while exhibiting higher liquidity and flexibility of trading like that of a stock. However, these advantage comes at a cost, as ETFs are also marred with controversies of exhibiting significant risk of increasing volatility and mis-pricing in the underlying stocks. With the total assets of ETFs surpassing that of active stock funds recently (Gittelsohn, 2019), their significance has now become greater than ever before. Thus, this article aims to assess the effect of ETF investments by examining the impact of their flow and turnover on different characteristics of the underlying such as returns, liquidity and risk. 192 stocks belonging to Information Technology (IT) and Energy sectors in the US stock market between 2016 and 2019 has been used for this purpose. After controlling for other firm specific factors, the results indicate that returns decreased with both ETF flow and ETF turnover (trading) for IT and Energy sector stocks. However, ETFs have been beneficial to the underlying stocks in case of both liquidity and risk, by improving liquidity and reducing risk for both IT and Energy sector stocks .

Keywords: *ETF, arbitrage, flows, trading volume, Arbitrage Pricing Theory, Quantile Regression, ARFIMA*