JIFS, Volume 13, Number 3, 2013 ISSN: 1945-2950

MARKET INFORMATION EVENTS AND INFORMED TRADING

Dr. Orkunt Dalgic, State University of New York at New Paltz, USA

dx.doi.org/10.18374/JIFS-13-3.4

ABSTRACT

New information attributable to changes in macro-economic fundamentals, such as the interest rate, the rate of inflation, the unemployment rate, industrial output, and GDP, affect the long-term prices of many financial instruments simultaneously, including corporate stock and bond prices. These market information events impact the present values of stocks, for example, by altering companies' expected future cash flows and/or their discount rates. Furthermore, such events are more likely than not to lead to convergent trading activities in all stocks. For example, a fall in expected interest rates is more likely to prompt market-wide buying than selling, whereas a rise in oil prices is more likely to do the opposite. This study uses the Easley, Kiefer, and O'Hara (1997) approach to develop a model for estimating the probability of informed trading due to market information events. As an illustration, the study then estimates the model empirically for two companies to determine the pervasiveness of informed trading prompted by such events.

Keywords: