

THE SENSITIVITY OF POSITIVE FEEDBACK TRADING TO CHANGES IN INTEREST RATES: EVIDENCE FROM SOUTH AFRICAN EQUITY RETURNS

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ABSTRACT

This study examines the impact of interest rate changes on positive feedback trading on South African stock market. The analysis employs an extended version of Shiller-Sentana and Wadhwani (SSW) trading model. The model is based on the existence of two groups of heterogeneous investors: rational expected utility maximizers and positive feedback traders. The study tests whether loose monetary conditions encourage investors to exercise positive feedback trading strategies. The evidence from South African stock market suggests that positive feedback trading is linked to the cost of credit (interest rate changes). The findings support the view that prolonged periods of low interest rates have the potential to encourage positive feedback trading. This, in turn, could lead to the emergence and bursting of asset price bubbles. Overall, the findings indicate that the role of the cost of capital is important in understanding investment trading behavior and market dynamics. The results also have implications for regulatory and portfolio management policies.

Keywords: *Feedback Trading , South African Equity Returns, SSW Trading Model*