University of South Australia | School of Commerce

# Behavioral Finance and Capital Markets Conference

## 16 September 2011

Rockford Hotel, 164 Hindley Street
Adelaide, South Australia
Australia

Presented by the Centre for Applied Financial Studies and the School of Commerce, Division of Business, University of South Australia and co-sponsored by Capital Markets CRC, SIRCA and Q Group Australia

# Program

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|---|---|---|
| 8:20 - 8:50 | **REGISTRATION** | |
| 8:50 - 9:00 | *Welcome Address* | Prof. Gerry Griffin<br>PVC Business (UniSA) |
| | Session/Presenter | Chair |
| 9:00 - 10:00 | **Keynote Address I**<br>**Albert S. (Pete) Kyle** (University of Maryland)<br>*High Frequency Trading and Market Microstructure* | Alex Frino<br>(Capital Markets CRC) |
| 10:00 - 10:20 | **MORNING TEA** | |
| | Session/Presenter | Chair/Discussant |
| 10:20 - 12:20 | **Behavioral Finance and Capital Markets I** | Michael Burrow (UniSA) |
| | *Company Name Fluency, Investor Recognition, and Firm Value*<br>T. Clifton Green (Emory University), **Russell Jame** (UNSW) | Madhu Veeraraghavan<br>(Monash University) |
| | *Trading Volume, National Culture and Momentum around the World*<br>**Graham Bornholt** (Griffith University),<br>Paul Dou (Monash University),<br>Mirela Malin (Griffith University),<br>Cameron Truong and Madhu Veeraraghavan (Monash University) | Barry Oliver (ANU) |
| | *Market Uncertainty and Sentiment, and the Post-Earnings Announcement Drift*<br>**Ron Bird** (UTS), Daniel F.S. Choi (Waikato University),<br>Danny Yeung (UTS) | Takeshi Yamada (The University of Adelaide) |
| 12:20 - 13:20 | **LUNCH BREAK** | Rockford Restaurant |
| 13:20 - 14:00 | Poster Session | Presenter |
| | *Does Investor Mood Really Affect Stock Prices?* | Noel Harding (UNSW) |
| | *Framing and Disposition Effects in Stockholders Dividend Preferences: Evidence from Optional Scrip Dividends* | James Murray<br>(Independent) |
| | *The Disposition Effect Revisited* | Tarah Heinrich (UniSA) |
| | *Pre-trade Transparency and the Information Content of the Limit-Order Book* | Kevin Sun (UniSA) |
| | *Information Asymmetry, Liquidity and Volatility: Analysing the Impact of Regulatory Change on the Hong Kong Stock Exchange* | Ka Nok Chan (UNSW) |

# Program

| | Session/Presenter | Chair |
|---|---|---|
| 14:00–15:00 | **Keynote Address II**<br>**Avanidhar (Subra) Subrahmanyam** (UCLA)<br>*Funding Constraints and Market Efficiency* | Petko Kalev (UniSA) |
| 15:00–15:20 | **AFTERNOON TEA** | |

| | Session/Presenter | Chair/Discussant |
|---|---|---|
| 15:20–17:20 | **Behavioral Finance and Capital Markets II** | Ron McIver (UniSA) |
| | *Systematic Trading Behaviour and Cross-Sectional Stock Returns on the OMXH*<br>Henry Leung, Annica Rose, **P. Joakim Westerholm** (The University of Sydney) | Huu Duong (Deakin University) |
| | *Asymmetric Effects of Sell-Side Analyst Optimism and Broker Market Share by Clientele*<br>**Andrew Grant**, Elvis Jarnecic and Mark Su (The University of Sydney) | Doug Forster (ANU) |
| | *Pretty Pennies: Realtor Attractiveness and Home Prices*<br>Joakim Bång and **Robert Tumarkin** (UNSW) | David Gallagher (MGSM) |
| 17:20–17:30 | Closing Address | Petko Kalev (UniSA) |
| 18:30–19:30 | Pre-Dinner Drinks | Rockford Hotel |
| 19:30–22:30 | **DINNER** | Rockford Hotel |

# Abstracts

**Keynote Address I: 9:00–10:00**

*High Frequency Trading and Market Microstructure*
Professor Albert S. (Pete) Kyle

The Flash Crash, a brief period of extreme market volatility on May 6, 2010, raised questions about the current structure of the U.S. financial markets. We use audit-trail data to describe the structure of the E-mini S&P 500 stock index futures market on May 6. We ask three questions. How did High Frequency Traders (HFTs) trade on May 6? What may have triggered the Flash Crash? What role did HFTs play in the Flash Crash? We conclude that HFTs did not trigger the Flash Crash, but their responses to the unusually large selling pressure on that day exacerbated market volatility.

**Keynote Address II: 14:00–15:00**

*Funding Constraints and Market Efficiency*
Professor Avanidhar (Subra) Subrahmanyam

We explore the premise that the degree of market efficiency changes dynamically, as investment funds face time-varying funding constraints to arbitrage capital. We show that the returns to a composite long-short hedge strategy that encompasses relative value, momentum, short-run reversals, and accounting profitability, are higher when past returns to the strategy are low, and past volatility is high, which is when fund managers are particularly likely to be impeded in attracting funds. Furthermore, returns to the strategy also are higher when there are net outflows from funds that load heavily on the returns to the composite strategy. Our results support the notion that the efficiency of stock pricing is not a static concept but varies across time as agents face time varying constraints on arbitrage capital.

**Morning Session: 10:20–12:20**

*Company Name Fluency, Investor Recognition, and Firm Value*
T. Clifton Green and Russell Jame
We find companies with short, easy to pronounce names have higher breadth of ownership, greater share turnover, and lower transaction price impacts. The relation is stronger among small firms and is consistent with companies with more fluent names having higher levels of investor recognition. Fluent company names also translate into higher valuations. After controlling for size and proxies for growth, we find that firms with more fluent names have higher Tobin's Q and market-to-book ratios. Corporate name changes increase fluency on average, and fluency improving name changes are associated with increases in breadth of ownership, liquidity, and firm value.

*Trading Volume, National Culture and Momentum around the World*
Graham Bornholt, Paul Dou, Mirela Malin, Cameron Truong and Madhu Veeraraghavan

Lee and Swaminathan (2000) document that past trading volume predicts both the magnitude and persistence of price momentum for US stocks. This paper investigates the robustness of trading volume in predicting the magnitude and persistence of price momentum for stocks listed in 37 countries. For volume-based momentum we determine whether cultural differences influence the returns of the strategies. Our findings show that past trading volume forecasts the level and the persistence of momentum profits and is useful in explaining the short-term under-reaction and long-term over-reaction effects. We also show that early stage volume/momentum is superior to late stage volume/momentum and pure momentum. Finally, we show that the difference in profitability between the early and late stage strategies is negatively related to individualism.

*Market Uncertainty and Sentiment, and the Post-Earnings Announcement Drift*

Ron Bird, Daniel F.S. Choi and Danny Yeung

The post-earnings announcement drift (PEAD) was first identified over 40 years ago and seems to be as much alive today as it ever was.. There have been numerous attempts to explain its continued existence. In this paper we provide evidence to support a new explanation: the PEAD is very much a reflection of the level of market uncertainty and sentiment that prevails during the post-announcement period. The finding that uncertainty plays a role in explaining how investors respond to information suggests that it should be included as a factor in our pricing models while the fact that market sentiment also has a role is another instance of the importance of human behaviour in establishing prices.

**Afternoon Session: 15:20–17:20**

*Systematic Trading Behavior and Cross-sectional Stock Returns on the OMXH*

Henry Leung, Annica Rose and P. Joakim Westerholm

This paper investigates the association between investor behavior and cross-sectional stock returns for different investor categories on the NASDAQ OMX Helsinki. For the whole market and in the short term, the high signed small trade turnover (SSTT) stocks significantly outperform the low SSTT stocks, in the medium term, the difference in performance is insignificant, and in the long term, the high SSTT stocks significantly underperform the low SSTT stocks. The results for different investor categories are consistent in the short term, but are varied in the medium and long term so that SSTT by individual investors has a negative correlation to stock returns while SSTT by institutional investors and foreign nominees are not related to stock returns. Systematic trading behavior appears to be a more adequate explanation to the excess return generated by the low SSTT portfolio relative to the high SSTT portfolio, compared to traditional risk factors in the CAPM and Fama-French models.

*Asymmetric Effects of Sell-Side Analyst Optimism and Broker Market Share by Clientele*

Andrew Grant, Elvis Jarnecic and Mark Su

Using broker level data we demonstrate that relatively optimistic and relatively pessimistic analyst earnings forecasts both generate trade for their brokerage firms. This relationship is found to be asymmetric as the influence of relatively optimistic analyst forecasts on own broker market share is larger than the influence of relatively pessimistic analyst forecasts. Furthermore, upgrades and downgrades in recommendations also generate significantly higher broker market share, suggesting that sell-side institutions are rewarded for providing new information to the market. This study also provides evidence for the first time on how different broker clienteles react to earnings forecast and stock recommendations. Greater trade volume is found to be associated with optimistic earnings forecasts and stock recommendations are stronger for analysts affiliated with retail brokerage firms than those affiliated with institutional brokerage firms. Further the asymmetry between trade generated by relatively optimistic and pessimistic forecasts is greater fore retail investors, consistent with retail investors facing higher short sales constraints.

*Pretty Pennies: Realtor Attractiveness and Home Prices*
Joakim Bång and Robert Tumarkin

Although buying one's home is by far the largest financial transaction in most people's lives, micro-level behavioral research on home pricing has been quite limited. We test for a simple behavioral effect; does the attractiveness of a realtor influence the final purchase price of a home? To do so, we take advantage of two unique structural characteristics of the Australian real estate market in which (i) buyers rarely use their own realtor and (ii) homes are commonly sold both by auction and by negotiated price private treaty. Our results show that buyers pay a 2.3% average premium (approximately USD 16,000) for their house when the realtor is one standard deviation of attractiveness above average. This premium is concentrated in homes sold by auction, which is consistent with a behavioral interpretation where private treaty home buyers partially filter the impact of realtor appearance over time.

**Poster Session: 13:20–14:00**

*Does Investor Mood Really Affect Stock Prices?*
Noel Harding and Wen He

In a laboratory setting, we find evidence that investors who are induced into a positive mood are less risk averse than investors who are induced into a negative mood. The evidence establishes that changes in investor mood cause changes in investors' risk aversion. However there is little evidence that mood changes affect investors' forecasts of earnings and cash flow, as well as their willingness to invest in a particular company. Our results lend support to archival studies that, contrary to classic economic and finance theories, find that changes in stock prices are associated with events which, while impacting on social mood, are unrelated to economic fundamentals.

*Framing and Disposition Effects in Stockholders Dividend Preferences: Evidence from Optional Scrip Dividends*
James Murray

I study the cash dividend payments of Hong Kong firms paying optional scrip dividends to examine the relationship between investment returns and stockholders' dividend preferences. I find an inverse relationship between cash dividend preference and stock returns which is consistent with stockholders segregating dividend yield from capital loss, but is not consistent with them segregating multiple forms of positive return. I also find the default form of an optional dividend, cash or scrip, frames how stockholders determine their dividend preference. While these results do not support the main arguments for behavioral dividend preferences they do provide new evidence on the nature of those dividend preferences.

# Abstracts

*The Disposition Effect Revisited*

Tarah Heinrich

In this project we investigate the disposition effect amongst Finnish local retail investors over a fourteen and a half year period. This is a longer period than other studies and includes four distinct market conditions, including the lead up to the dot com crisis, the dot com crisis, the lead up to the financial crisis of 2008 to 2009. This extended period of time allows an examination of whether the disposition effect changes over time and across market conditions, giving a greater insight in to the driving forces behind the disposition effect. We also examine whether there is an interaction between retail investors' tendency towards the disposition effect and capital gains overhang based on the performance of their individual portfolios.

*Pre-trade Transparency and the Information Content of the Limit-Order Book*

Huu Nhan Duong, Petko S. Kalev and Kevin Sun

This paper investigates the influence of improved pre-trade transparency on the information content of the limit-order book. We examine two natural experiments when the Sydney Futures Exchange increased the limit-order book disclosure from the best bid and ask level to the best three price levels in 2001 and from the best three to the best five price levels in 2003. We find that the limit-order book contains information on future return and volatility. The limit-order book also becomes more informative after the two improvements in pre-trade transparency, with stronger result for the first increase. Our finding highlights a diminishing benefit of additional limit-order book disclosure.

*Information Asymmetry, Liquidity and Volatility: Analysing the Impact of Regulatory Change on the Hong Kong Stock Exchange*

Michael J. Aitken, Ka Nok Chan and Kathryn Wong

This paper examines the effectiveness of the Securities and Futures Ordinance (SFO) which was introduced in 2003 to improve the market quality of securities markets in Hong Kong. Based on a comprehensive analysis of changes in information asymmetry, volatility and liquidity on the Hong Kong Stock Exchange (HKSE), we find that the information asymmetry and spread declined after the implementation of SFO. Small and medium quintile stocks experience a greatest reduction in information asymmetry. Our findings show that volatility increase in the post-SFO period. Overall, the increased disclosure obligation imposed on substantial shareholders only had a limited effect in facilitating information dissemination.

# Keynote Speakers

**Professor Albert S. (Pete) Kyle** has been the Charles E. Smith Chair Professor of Finance at the University of Maryland's Robert H. Smith School of Business since 2006. He earned his B.S. degree in mathematics from Davidson College (summa cum laude, 1974), studied philosophy and economics at Oxford University as a Rhodes Scholar from Texas (1974-1977), and completed his Ph.D. in economics at the University of Chicago in 1981. He has been a professor at Princeton University (1981-1987), the University of California Berkeley (1987-1992), and Duke University (1992-2006). Professor Kyle's research focuses on market microstructure, including topics such as high frequency trading, informed speculative trading, market manipulation, price volatility, the informational content of market prices, market liquidity, and contagion. His current research also deals with concepts from industrial organization to value companies. His teaching interests include market microstructure, institutional asset management, venture capital and private equity, corporate finance, option pricing, and asset pricing. He is a Fellow of the Econometric Society (since 2002). He has been a board member of the American Finance Association (2004-2006), a staff member of the Presidential Task Force on Market Mechanisms (Brady Commission, 1987), a consultant to the SEC's Office of Inspector General, a member of NASDAQ's economic advisory board (2004-2007), a member of the FINRA economic advisory committee (2010-2011), and a member of the CFTC's Technology Advisory Committee (2010-2011).

**Professor Subrahmanyam (Subra)** is currently the Goldyne and Irwin Hearsh Chair in Money and Banking at UCLA. He received his Ph.D. in finance from the Anderson School in 1990. He is among the most-cited scholars in his research cohort; his Web of Science cite count works out to be more than 2000. Another study cited him as being among the 25 most productive scholars in the world during the period 1953-2002, a noteworthy fact because he received his Ph.D. in 1990. He has received several awards for his research, including best paper awards at the Journal of Finance, Journal of Financial Economics, and the Western Finance Association meetings and has been nominated for best paper awards several times at the Journal of Finance. He has been on the editorial boards of two of the three best finance journals (Journal of Finance and Review of Financial Studies).

# Presenters

**Ron Bird** is Professor of Finance at the University of Technology, Sydney and Director of the Paul Woolley Centre for the Study of Capital Market Dysfunctionality at UTS. Ron studied at Monash University prior to taking up a lectureship at Macquarie University in 1970. He moved to the ANU in 1973 and was subsequently promoted to a Chair and Head of the Commerce Department. After leaving in 1988, ANU awarded him the title of Emeritus Professor. Initially in his private sector career, he headed up Towers Perrin's asset consulting operations in the Asian region while also being in charge of their global research. He moved to funds management in 1992, first being in charge of research and product development at Westpac Investment Management prior to founding GMO Australia in 1995. He returned to academia in 1999 and took up his current position at UTS. Over the last 10 years, he has also acted as an academic adviser for several funds management firms.

**Dr Graham Bornholt** worked in the financial services industry until joining academia in 2003, after being awarded a PhD from the University of Sydney in 1990. Graham is currently a Lecturer in Finance at the Gold Coast campus of Griffith University in the Department of Accounting, Finance and Economics. Dr Bornholt's research falls into two main areas (a) asset pricing theory and the implications for corporate finance practice, and (b) cross-sectional anomalies and the predictability of asset class returns. His publications cover momentum strategies, enhancing momentum strategies using past volatility, the 52-week high strategy, a two-year effect in market index returns, and an alternative method for estimating cost of capital (the reward beta approach).

**Ka Nok (Jacob) Chan** started his PhD degree in Finance at the University of New South Wales in 2009. He received his Master's degree of commerce major in Finance and Bachelor's degree of Computer Engineering from the University of New South Wales. Before starting his PhD degree, He had worked as an Analyst Programmer in the Information Technology and Finance industries for 3 years. His research interests are in Capital Market/Market Microstructure and Corporate Governance and Market Efficiency.

**Dr Andrew Grant** is a lecturer in the Finance Department at the School of Business, University of Sydney. He received his PhD from the University of Sydney in 2008. Dr Grant's research focuses on the use of information in analysts' forecasts both financial and gambling markets, with areas including incentive design, forecast evaluation, and asset allocation models relating to the use of the forecasts. He is also interested in behavioural finance, including the evolution of individual investor behaviour and cross-sectional differences in stock returns due to investor biases.

**Associate Professor Noel Harding** joined the School of Accounting at the Australian School of Business UNSW in 1994 after a number of years in practice. Noel teaches financial accounting at postgraduate level and is a supervisor of BCom(Hons), MPhil and PhD candidates in the areas of behavioural auditing and financial accounting. In addition to The University of New South Wales, Noel has held academic positions at Macquarie University, Fudan University, and The Shanghai University of Finance and Economics. Noel's research interests are the behavioural aspects of auditing and financial accounting and he is regularly invited to present his research at national and international accounting conferences. Noel's research has been published in leading international journals including Accounting Organizations and Society, Contemporary Accounting Research, Auditing: A Journal of Practice and Theory, and Accounting and Finance. His research is currently supported by a 3 year Australian Research Council (ARC) Discovery Grant in the amount of $169,000 as well as a number of smaller external and internal competitive research grants.

**Tarah Heinrich** is an Honours student with the Centre for Applied Financial Studies, School of Commerce at the University of South Australia. Tarah previously completed a Bachelor of Psychology in 2000 with the University of South Australia. Following this Tarah worked in the human services industry including in positions of management. Tarah has also finished a double degree in Commerce and Applied Finance at the University of South Australia. Her research interests are in Behavioural Finance and Market Conditions.

**Dr Russell Jame** joined the University of New South Wales as a Senior Lecturer of Finance in July 2010. His research interests include investments and behavioral finance. Much of his research focuses on the investment strategies of individual and institutional investors, and how such strategies affect security prices. Russell received his B.S. in Finance and International Business from the McDonough School of Business at Georgetown University and his PhD in Finance from the Goizueta Business School at Emory University.

**Dr James Murray** is an independent researcher. James gained his PhD in Finance from Monash University in 2008 where he taught for the period of 1998 to 2010. Prior to this James was a tutor at Lincoln University in New Zealand (1996-1997). Dr Murray's main research interests are in the area of corporate finance, in particular looking at alternative approaches to corporate finance such as dividend reinvestment plans (DRPs), bonus share plans (BSPs), and special purpose acquisition corporations (SPACs).

**Yang (Kevin) Sun** is a current PhD student at the University of South Australia and the Capital Markets Cooperative Research Centre (CMCRC). His research interests are on Market Microstructure and Derivatives Markets. Kevin finished his undergraduate study at Monash University with the double Finance and Accounting majors. He also holds a Master of Applied Finance degree from Monash University. Kevin achieved First Class Honours (H1) with the major in Finance at Deakin University. He is the sole winner of the John Scouller prize for the best Honours student in the School of Accounting, Economics and Finance for the 2010 Academic Year (Medalist). Kevin also has extensive professional experience and he is the Associate Member of CPA Australia.

**Robert Tumarkin** is a Senior Lecturer in the School of Banking and Finance at the Australian School of Business, University of New South Wales. He joins the ASB after completing his PhD in Finance at the Stern School of Business, New York University. His current working papers study how buyer perceptions influence home prices, the value created by CEO incentive packages, and methods for inferring an executive's behavioral bias from option exercise patterns. Published work examines how Internet message board activity impacts stock prices and market efficiency. Rob holds PhD (2010), MPhil (2008), and MBA (2000) degrees in Finance from the Stern School of Business, New York University and a ScB (1995) in Biomedical Engineering from Brown University. His work experiences include investment management at a New York based fund-of-hedge funds and research and design engineering for a medical device manufacturer.

# Presenters

**P. Joakim Westerholm** has a PhD in Finance from the Swedish School of Economics and Business Administration (Hanken), in Helsinki, Finland. Joakim has nine years industry experience in broking, dealing and funds management. Dr Westerholm's teaching and research interests are in the areas of market microstructure, behavioral finance and mergers and acquisitions. Dr Wsterholm's publications include a doctoral dissertation, research articles in Journal of Trading, Pacific Basin Finance Journal, Australian Journal of Management and International Review of Finance among others. Joakim's research articles in market microstructure and behavioural finance have been accepted for presentation at top Finance conferences such as the Western Finance Association Meeting (WFA), the European Finance Association (EFA) and the Financial Management Association International Meetings in USA and Europe, and have also been presented at specialist conferences in Market Microstructure. Joakim received the SIRCA Research Excellence Award at the Australian Banking and Finance Conference in 2003 and 2004.

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