Informed trading and price discovery before corporate events☆
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ABSTRACT
Stock prices incorporate less news before negative events than positive events. Further, informed agents use less price aggressive (limit) orders before negative events and more price aggressive (market) orders before positive events (buy-sell asymmetry). Motivated by these patterns, we model the execution risk that informed agents impose on each other and relate the asymmetry to costly short selling. When investor base is narrow, security borrowing is difficult, or the magnitude of the event is small, buy-sell asymmetry is pronounced and price discovery before negative events is lower. Overall, we show that the strategies of informed traders influence the process of price formation in financial markets, as predicted by theory.

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