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Individual investors surpass their reputation: Trading behaviour on the Polish futures market

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ABSTRACT

This paper examines individual investors' trading behaviour by testing the presence of Monday and January anomalies on the Polish futures market, where individuals are the predominant trader type. Both anomalies are well established in the literature, and they are at least partially attributed to individual investors' trading activities. We conduct an intraday analysis of trading volume, open interest, returns, and return volatility on the futures market in Poland and find the contribution of individuals to market anomalies to be grossly overstated. Hence, individual investors' trading on the Polish futures market surpasses the prediction by the majority of investigations for mature stock markets.

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1. Introduction

A number of studies analyse investment decisions by individual traders, with the majority of authors arguing that these investors tend to be uninformed regarding fundamentals and therefore exhibit sentiment-driven trading behaviour. Moreover, some of the evidence suggests that stock market anomalies such as the Monday and January effects can be at least partly attributed to individual investors. As stock market transactions cannot, in general, be separated into those initiated by individuals and those originating from institutions, it is difficult to test empirically which investor

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type is the driving force behind calendar anomalies. However, the Polish futures market offers an extraordinary testing ground for analysing individual investors' trading behaviour, since the vast majority of trading activity in Polish stock index futures is attributed to individuals. We investigate the Monday and January effects on the Polish WIG20 stock index futures market with a comprehensive set of variables covering trading volume, open interest, return, and return volatility.

On the Polish futures market, two thirds of the trading volume are accounted for by individual investors, turning them into the predominant trader type. Moreover, basket securities as underlyings are traded, for which adverse selection costs tend to be lower than in markets for individual securities (Subrahmanyam, 1991). As low adverse selection costs are especially attractive for uninformed investors, they tend to prefer basket securities over individual securities. Thus, the WIG20 futures market is likely to have an even higher share of individual traders than the overall futures market.

In contrast to individual investors, institutions employ financial analysts that gather firm-specific and macroeconomic information. As a result, institutions tend to be better informed than individuals (Dennis and Weston, 2001) and can exploit economies of scale in data processing. They therefore prefer stocks that a large amount of information is published about (Falkenstein, 1996). These are large, liquid stocks, for which research on fundamentals is profitable. By contrast, individual investors are generally employed in activities other than fundamental research and therefore tend to invest in attention-grabbing stocks (Barber and Odean, 2008; Nofsinger, 2001). Moreover, individuals' trading decisions are more biased by behavioural aspects than institutions' investment strategies, which also contributes to institutions outperforming individuals (Kamesaka et al., 2003).

In this study, we focus on two well-established anomalies, the Monday effect and the January effect. The former refers to the observation that stock returns on Mondays are statistically significantly lower than on the other days of the week, with Monday returns often being negative. This anomaly can be explained with the particularly high costs to individuals of conducting fundamental research on weekdays. Instead, they defer their investment decisions to the weekend. As a result, individual investors are more active traders Monday morning than on other days (Abraham and Ikenberry, 1994). At the same time, institutional investors devote Monday morning to strategically planning the remaining week, thereby being less active traders than usual (Lakonishok and Maberly, 1990). Abraham and Ikenberry (1994) argue further that brokers will primarily issue buy recommendations during the week, while individuals make their sell decisions over the weekend. The relative weight of individuals' transactions on Mondays and their bias towards sell orders are an explanation for the Monday effect being driven by individuals, which is supported by the empirical evidence of Brooks and Kim (1997).

The second stock market anomaly is the January effect, which describes the phenomenon of significantly high returns for small stocks in January. Dyl and Maberly (1992) find that it can partly be explained by the tax-loss-selling argument, according to which individual investors sell poorly performing stocks at the end of the year in order to deduct the losses from their tax burdens. In January, individuals re-invest in the same stocks, thereby increasing stock returns. In between these transactions, the proceeds are parked (Ritter, 1988). The window-dressing hypothesis predicts returns to move in the same direction, as institutional investors re-balance their portfolios towards the end of the year by selling 'losers' and buying 'winners'. However, Sias and Starks (1997) find that primarily individuals cause the January effect.

More recent studies find that the Monday and the January effects have become weaker or disappeared altogether since these phenomena became widely known. In particular, Marquering et al. (2006) examine anomalies before and after they were published. The empirical evidence suggests that both anomalies vanished in the U.S. market at the time of the relevant academic publications. Szakmary and Kiefer (2004) add the finding that the January effect in the U.S. cash and futures markets is no longer present after 1993, with the Monday effect having vanished in the U.S. post-1975 (Connolly, 1989). However, Dubois and Louvet (1996) report evidence of a persisting Monday effect for West European markets. All of these studies focus on developed financial markets that are dominated by institutional investors, whereas we investigate a market with a vastly different investor structure. It can therefore be hypothesised that either anomaly continues to exist on the Polish futures market where individual investors are the major trader type.

While the studies mentioned above examine the spot market, there is only a limited number of investigations of the futures market. Among these is Cornell (1985), who finds no empirical evidence

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