The dynamics of international equity market expectations

Michael J. Brennan\textsuperscript{a,}*, H. Henry Cao\textsuperscript{b}, Norman Strong\textsuperscript{c}, Xinzhong Xu\textsuperscript{d}

\textsuperscript{a}The Anderson Graduate School of Management, University of California, Los Angeles, 110 Westwood Plaza, Box 951481, Los Angeles, CA 90095-1481, USA
\textsuperscript{b}CKGSB, Beijing, PR China
\textsuperscript{c}Manchester Business School, The University of Manchester, Booth Street West, Manchester M15 6PB, UK
\textsuperscript{d}Guanghua School of Management, Peking University, Beijing 100871, PR China

Received 25 July 2003; received in revised form 4 February 2004; accepted 11 June 2004

Available online 25 March 2005

Abstract

This paper develops a noisy rational expectations model of the way in which international investors adjust their expectations of asset payoffs in a given country in response not only to public information signals but also to private information signals whose precision differs across investors. The model predicts that the perceptions of investors in one country about the future market returns in another country are related differently to realized past returns depending on their informational disadvantage relative to other investors: the greater is that informational disadvantage, the greater is the change in perception associated with returns.

\footnote{We thank Gregory Brown, Jennifer Conrad, Bin Gao, Deon Strickland, Harold Zhang, and seminar participants at the Universities of Bristol, Cranfield, Essex, Lancaster, North Carolina, Houston, Rice, and Vienna for helpful comments. We also thank the referee whose thoughtful analysis and suggestions have improved the paper substantially. Brennan thanks New York University for their hospitality while this paper was being written. We thank Merrill Lynch for the use of information from their Fund Manager Survey in this research. Xu gratefully acknowledges financial support from the National Natural Science Foundation of China (grant 70432002).

\*Corresponding author. Tel.: +1 310 825 3587; fax: +1 213 740 6496.
E-mail address: michael.brennan@anderson.ucla.edu (M.J. Brennan).}

0304-405X/$ - see front matter © 2005 Elsevier B.V. All rights reserved.
doi:10.1016/j.jfineco.2004.06.008
The predictions are confirmed by monthly survey data of institutional money managers investing in developed markets from 1995 to 2000.

JEL classification: F3

Keywords: Home bias; International portfolio flows; Asymmetric information; Rational expectations; Foreign investor informational disadvantage

1. Introduction

There is now extensive evidence that international flows of equity capital are positively correlated with the returns on the markets of the destination countries. Brennan and Cao (1997) have shown that this positive correlation can be due to an asymmetry of information between foreign and domestic investors. According to this asymmetric information theory, the expectations of less well-informed foreigners respond more elastically to economic news than do the expectations of better-informed domestic investors. Good news for example, which is associated with positive stock returns, leads foreigners to purchase stock from domestic investors, creating a positive association between foreigners’ purchases of domestic stocks and domestic stock returns.

In this paper we develop the implications of the asymmetric information theory for changes in the degree of bullishness reported by domestic and foreign investors. Consistent with the theory, we find that there is a strong tendency for foreign institutional investors to become more bullish about a given national market following a positive return on that market. Thus, our evidence provides further support for the hypothesis that information asymmetry is an important determinant of international capital flows.

The framework for our analysis is a dynamic version of the multi-asset noisy rational expectations model of Admati (1985), which we use to analyze the determinants of the proportion of investors in country \( m \) who are bullish and bearish about the equity market in country \( k \). The basic assumption underlying the model is that domestic investors are better informed about the payoffs on domestic assets than are foreign investors. This causes the beliefs of foreign investors to be more sensitive to new public information than are the beliefs of domestic investors. As a result, foreign investors buy from domestic investors when there is good news and asset prices rise, and sell to domestic investors when there is bad news and asset prices fall, which can account for the observed trend-following behavior of foreign investors. In order to focus attention on the role of information asymmetry, exchange rate risk and interest rate differentials are ignored, and the analysis is conducted in a model with many trading periods but only a single terminal consumption period.

The implications of the model are tested using survey data on the perceptions of institutional investors about the future returns on the stock markets of various
متن کامل مقاله

دریافت فوری

امکان دانلود نسخه تمام متن مقالات انگلیسی
امکان دانلود نسخه ترجمه شده مقالات
پذیرش سفارش ترجمه تخصصی
امکان جستجو در آرشیو جامعی از صدها موضوع و هزاران مقاله
امکان دانلود رایگان ۲ صفحه اول هر مقاله
امکان پرداخت اینترنتی با کلیه کارت های عضو شتاب
دانلود فوری مقاله پس از پرداخت آنلاین
پشتیبانی کامل خرید با بهره مندی از سیستم هوشمند رهگیری سفارشات