

Andreas Krause



Strategic trading

# Informed trading

- ▶ Some traders will acquire information about the value of an asset and seek to exploit their informational advantage
- ▶ Through their trading they will reveal some of the information they have obtained
- ▶ This information will be included into the price and this process leads to markets becoming efficient
- ▶ Prices can reflect information, even if the information itself has never been disclosed
- ▶ It is prices that can be used as a proxy for the information itself

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# Anonymity of markets

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- ▶ Uninformed traders will want to learn this information through observing the trading of informed investors
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# Informed traders optimising their demand

- ▶ Informed investors will have time to exploit their informational advantage until the information they hold become common knowledge
- ▶ Facing only uninformed traders with random demands, they will seek to submit buy or sell orders that are maximizing their total profits
- ▶ Their behaviour has implications for market efficiency and the general quality of markets, in particular its liquidity
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Trading with informed investors

# Market efficiency is not instant

- ▶ Markets become informationally efficient only over time and the more widespread information is held and the more often it can be used, the sooner the market becomes efficient
- ▶ The liquidity of a market similarly increases over time as the asymmetric information reduces and markets become more efficient
- ◉ Markets are constantly moving and do not seem to converge to a price reflecting the information; is this a sign of markets being inefficient?
  - ▶ Firstly, markets will move due to noise traders submitting their orders, price trends need to be assessed stripping out their impact; second, new information arrives continuously and changes the fundamental value, causing the prices trying to catch up permanently

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# Trading volume as a source of information

- ▶ Many market participants are usually not aware whether additional information exists, how widely it is known, and how precise it is
- ▶ These unknown factors make it difficult to use the price as a source of information
- ▶ An additional source of information is available, trading volume
- ▶ We will show how trading volume can be used to assess the degree of asymmetric information and improve the knowledge about information

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The information content of trading volume

# Informational asymmetry and trading volume

- ▶ Trading volume allows to assess the amount of information that is available in a market
- ▶ If price movements are accompanied by high trading volume, this suggests that the information is either widespread or precise
- ▶ Rumours circulate about a company receiving a bid to be taken over soon, if there is no increase in trading volume, can this rumour be dismissed?
  - ! The low trading volume is a sign that the information is either vague or few people hold this information, but it can nevertheless be true.



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## Summary of key results

- ▶ Prices can be used to assess the contents of information traders hold and markets become efficient over time
- ▶ Trading volume can be used to assess the degree of asymmetric information and high trading volume should decline over time as the market becomes more efficient
- ▶ Combining price movements with information on trading volume gives us a more accurate assessment of information that may be held by some traders

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