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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

Anonymity of markets

- Informed traders will seek to exploit their informational advantage optimally for as long as they hold this advantage
- Uninformed traders will want to learn this information through observing the trading of informed investors
- Financial markets are mostly anonymous and a trade can be initiated by an informed or an uninformed trader
- We will investigate how the informed trader optimally trades and what implications this has for the market

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
- We will explore how market efficiency and liquidity evolves over time

Trading with informed investors

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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

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.

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 markets become more efficient
- Combining price movements with information on trading volume gives us a more accurate assessment of information that may be hold by some traders

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