Information asymmetry, speculation and foreign trading activity: Emerging market evidence

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Abstract

This paper provides evidence on the relation between private-information-based trading and foreign trading activity on the Istanbul Stock Exchange (ISE). We use a recently developed model that utilizes information in volume–return dynamics of individual stocks and show that variables such as size and Tobin’s Q explain the extent of speculative activity across firms traded on the ISE. We present evidence supporting the notion that foreign trading activity is associated with informed trading on the ISE. Implications of our findings for emerging markets research are also discussed.

Keywords: Foreign trading; Volume-return; Tobin’s Q

1. Introduction

It can be argued that asymmetric information problems are more prevalent in emerging markets. Corporate governance tends to be less developed in these markets, generating weak or non-existing insider trading laws, unprotected minority shareholder rights and an unequal environment for foreign and domestic investors. 1 Furthermore, recent literature also suggests that foreign investors should have an information advantage in international markets due to their better access to expertise and talent. Again, this effect is likely more important in emerging markets.

Our main goal in this study is to investigate the extent of asymmetric information induced trading and informational advantage of foreign traders in a unified framework. We accomplish

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