

Reexamining Contrarian Trades as a Proxy of Informed Trades: Evidence from China's Stock Market

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Abstract : This paper reexamines the appropriateness of contrarian trades as a proxy of informed trades, using high frequency Chinese stock data. Employing this measure for 5 minute intervals, a U-shaped intraday pattern of probability of informed trades (PIN) is found for the CSI300 stocks, which is consistent with previous findings for other markets. However, while dividing the trades into different sizes, a reversed U-shaped PIN from large-sized trades, opposed to the U-shaped pattern for small- and medium-sized trades, is observed. Drawing from the mixed evidence with different trade sizes, the price impact of trades is further investigated. By examining the relationship between trade imbalances and unexpected returns, large-sized trades are found to have significant price impact. This implies that in those intervals with large trades, it is non-contrarian trades that are more likely to be informed trades. Taking account of the price impact of large-sized trades, non-contrarian trades are used to proxy for informed trading in those intervals with large trades, and contrarian trades are still used to measure informed trading in other intervals. A stronger U-shaped PIN is demonstrated from this modification. Auto-correlation and information advantage tests for robustness also support the modified informed trading measure.

Keywords : contrarian trades, informed trading, price impact, trade imbalance

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