

COURSE OUTLINE

January-February 2013

Information Economics A

Professors Massimo Massa and Hong Zhang

1. Course Objectives

The purpose of this course is to familiarize the PhD student with the most important theoretical and empirical research developments related to role of information for the functioning of financial markets.

The course should prepare the students to do independent research on the microstructure of financial markets. For this purpose, a critical discussion of the most important research papers in microstructure theory is undertaken with a particular emphasis on open and unsolved research questions which may lead to new thesis work.

2. Course Organization

The course is a blend of lectures and research paper discussions. The required reading assignment for each session consists of one or two journal article. Students are expected to have carefully read the articles marked by a star * and have to be prepared to summarize and discuss the key insights of these article. Sessions taught by Hong Zhang or Massimo Massa are marked HZ or MM, respectively.

3. Course Material

We recommend the following five books as general reading on the subject:

- Grossman, The Informational Role of Prices, MIT Press, 1989.
- Huang and Litzenberger: Foundations for Financial Economics, North-Holland 1988, Chapter 9, Sections 9.1-9.13.
- Jarrow et. al., Eds., Handbooks in OR & MS, Finance, Elsevier, 1995.
- O'Hara, Market Microstructure Theory, Blackwell, 1995.
- Harris, Trading and Exchanges, Oxford University Press, 2003.

4. Course Administration

Class participants can contact us any time by e-mail and/or make direct appointments.

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DETAILED COURSE SCHEDULE

Session 1 Rational Expectations and Learning MM

* Grossman, S., 1976: On the Efficiency of Competitive Stock Markets Where Traders Have Diverse Information, *Journal of Finance*, pp. 573-585.

* Grossman S. and J. Stiglitz, 1980; On the Impossibility of Informationally Efficient Markets, *American Economic Review*, 70, pp. 393-408.

* Grossman S. and J. Stiglitz 1976: Information and Competitive Price Systems, *American Economic Review*, 66, pp. 246-253.

* Hellwig M., 1980: On the Aggregation of Information in Competitive Markets, *Journal of Economic Theory*, pp. 477-498

* Hellwig M., 1982: Rational Expectations Equilibrium with Conditioning on past Prices: A Mean-Variance Example, *Journal of Economic Theory*, pp. 278-312

* Admati A., 1985: A Noisy Rational Expectations Equilibrium for Multi-Asset Securities Markets, *Econometrica*, pp. 629-657.

Diamond D. and Verrecchia, 1981: Information Aggregation in a Noisy Rational Expectations Economy, *Journal of Financial Economics*, pp. 221-235.

Grossman S., 1981: An Introduction to the Theory of Rational Expectations under Asymmetric Information, *Review of Economic Studies*, pp. 541-559

Session 2 Models with Information Acquisition MM

* Van Nieuwerburgh, S., and L. Veldkamp, 2009: Information immobility and the home bias puzzle, *Journal of Finance*, 64 3, 1187–1215.

* Van Nieuwerburgh, S., and L. Veldkamp, 2009: Information acquisition and portfolio underdiversification”

* Kacperczyk, M., S. van Nieuwerburgh and L. Veldkamp, Attention Allocation over the Business Cycle, 2010, Working Paper.

* Kacperczyk, M., and A. Seru, 2007, Fund manager use of public information: New evidence on managerial skills, *Journal of Finance*, 62, 485–528.

* Kacperczyk, M., C. Sialm, and L. Zheng, 2005: On the industry concentration of actively managed equity mutual funds, *Journal of Finance*, 60, 1983–2012.

* V. Glode, B. Hollifield, M. Kacperczyk, and S. Kogan, 2010, Is Investor Rationality Time Varying? Evidence from the Mutual Fund Industry NBER Working Paper 15038.

C. Sialm, and L. Zheng, 2005, 2008: Unobserved actions of mutual funds, *Review of Financial Studies*, 21, 2379–2416.

Session 3 Models with Endogenous Information Acquisition MM

* Admati A. and P. Pfleiderer 1987: Viable Allocations of Information in Financial Markets, *Journal of Economic Theory*, pp. 76-115.

* Admati A. and P. Pfleiderer 1986: A Monopolistic Market for Information, *Journal of Economic Theory*, pp. 400-438.

* Admati A. and P. Pfleiderer 1990: Direct and Indirect Sale of Information, *Econometrica*, pp. 901-928.

* Admati A. and P. Pfleiderer 1988: Selling and Trading Information in Financial Markets, *American Economic Review, Paper and Proceedings*, pp. 96-103.

* Grinblatt M. and S. Ross 1985: Market Power in a Securities Market with Endogenous Information, *Quarterly Journal of Economics*, pp. 1144-1167.

Admati A. and P. Pfleiderer 1993: Markets for Information: Selling and Trading on Information in Financial Market, *American Economic Review*, pp. 96-103.

Fishman M. and K. Hagerty 1995: The Incentive to Sell Financial Market Information, *Journal of Financial Intermediation*, pp. 95-115.

Admati A. and S. Ross 1985: Measuring Investment Performance in a Rational Expectations Equilibrium Model, *Journal of Business*, 58.

Daniel K., D. Hirshleifer and M. Subrahmanyam 1994: Security Analysis and Trading Pattern when some Investors Receive Information before others, *Journal of Finance*, pp. 1665-1699.

Verrecchia 1980: Consensus Beliefs Information Acquisition and Market Information Efficiency, *American Economic Review*, pp. 874-883.

Bhattacharya. and M. Spiegel 1995: Destructive Interference in an Imperfectly Competitive Multi-Security Market, *Journal of Economic Theory*, pp. 136-170.

Session 4 Models with Information Acquisition MM

* Cohen L. and D. Lou, *Complicated Firms*, Working Paper.

* Campbell, J.Y., S.J. Grossman, and J.Wang, 1993, Trading volume and serial correlation in stock returns, *Quarterly Journal of Economics* 108, 905–939.

* Llorente, G., R. Michaely, G.Saar, and J.Wang, 2002, Dynamic volume-return relation of individual stocks, *Review of Financial Studies* 15, 1005-1047.

* Gervais, S., R. Kaniel, and D.H. Mingelgrin. 2001. The high-volume return premium. *Journal of Finance* 56, 877–919.

* Barber, B. and T. Odean, 2008, All that glitters: the effect of attention and news on the buying behavior of individual and institutional investors, *Review of Financial Studies* 21, 785-818.

Session 5 Strategic Behaviour of Information Monopolists HZ

⇒ Kyle 1985: Continuous Auctions and Insider Trading, *Econometrica*, 536, pp. 1315-1336.

Admati and Pfleiderer 1988: A Theory of Intraday Patterns: Volume and Price Variability, *Review of Financial Studies*, 1, pp. 3-40.

Easley and O’Hara 1987: Price, Trade Size and Information in Securities Markets, *Journal of Financial Economics*, 19, pp. 69-90.

Easley and O’Hara 1992: Time and the Process of Security Price Adjustment, *Journal of Finance*, 47, pp. 905-927.

Glosten and Milgrom 1985: Bid, Ask and Transaction Prices in a Specialist Market with Heterogenously Informed Traders, *Journal of Financial Economics*, 13, pp. 71-100.

Grossman and Miller 1988: Liquidity and Market Structure, *Journal of Finance*, 43, pp. 617-637

Section 6: Evidence on the Use of Information in Delegated Management HZ

⇒ Mamaysky, H., M. Spiegel, and H. Zhang. 2008. Estimating the Dynamics of Mutual Fund Alphas and Betas. *Review of Financial Studies* 21:233–64.

Cremers, Martijn and Antti Petajisto, 2009, “How Active is Your Fund Manager? A New Measure that Predicts Performance,” *Review of Financial Studies*, 3329-3365.

Kacperczyk, Marcin, Clemens Sialm, and Lu Zheng, 2008, “Unobserved Actions of Mutual Funds,” *Review of Financial Studies*, 2379-2416.

Coval and Moskowitz 1999: Home Bias at Home: Local Equity Preferences in Domestic Portfolios, *Journal of Finance*, 54, pp. 2045-2073.

Coval and Moskowitz 2001: The Geography of Investment: Informed Trading and Asset Prices, *Journal of Political Economy*, 109, pp. 811-841.

Section 7: Strategic Behavior in Delegated Management HZ

Chevalier and Ellison 1997: Risk Taking by Mutual Funds as a Response to Incentives, *Journal of Political Economy*, 1056, pp. 1167-1200.

Berk, Jonathan and Green, Richard C. 2004, Mutual Fund Flows and Performance in Rational Markets, *Journal of Political Economy* 112-6, pp. 1269-95.

⇒ Spiegel, Matthew, and Hong Zhang, 2011, “Mutual Fund Risk and Market Share Adjusted Fund Flows,” working paper Yale School of Management.

⇒ Si Cheng, Massimo Massa, and Hong Zhang, 2011, Short-Sale Constraints and the Pricing of Mutual Funds, working paper.

Section 8: Correlated Trading (or TBA) HZ

- Trading due to fire sales and correlated flows

Greenwood, Robin and David Thesmar, 2010, Stock Price Fragility, *Journal of Financial Economics*, Forthcoming.

- Trading using correlated information

Brunermeier, Markus, and Lasse Heje Pedersen, 2005, “Predatory Trading,” *Journal of Finance*, 60(4), 1825-1864.

Colla, Paolo, and Antonio Mele, 2010, “Information Linkages and Correlated Trading,” *Review of Financial Studies*, 23(1), 203-246.

- Trading using public information

Kacperczyk, M., and A. Seru, 2007, Fund manager use of public information: New evidence on managerial skills, *Journal of Finance* 62, 485–528.

Chunmei Lin, Massimo Massa, and Hong Zhang, 2011, Stock Market Fragility and the Quality of Governance of the Country, *Working Paper*.