

SECURITIES RECOMMENDATIONS, SMALL INVESTORS AND INSIDERS: WHO BENEFITS?

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Introduction

- ◆ The acceptance of efficient market hypothesis has raised questions about the economic value of professional investment advice.
- ◆ If markets were efficient, investment advice would not create any significant economic profits. However, investors utilize investment advice.
- ◆ A few examples;
 - ◆ Low-cost financial publications in press;
 - ◆ Brokerage house recommendations;
 - ◆ Financial web sites.



Introduction

- Objective of the study is whether published investment advice generates higher returns for small investors.
- We investigated the impact of security recommendations in the financial press on common stock prices.
- Recommendations of *Yatirimci Ali* column of the weekly-published popular economics journal *Paramatik* constitutes our sample.
 - As one of the most widely read features of the *Paramatik*, the column has been published weekly since the periodical was introduced in 1993.
 - It gives us a consistent and relatively long term data set.
 - Topics covered in the column include macroeconomic conditions as well as information about a firm or a group of firms.



Introduction

- Investment advice that individual investors utilize might also be a basis for insider trading if the column is well known.
- “*Heard on the Street*” column of the daily *Wall Street Journal* had been involved in an insider trading scandal,
- Several authors presented evidence that there is significant abnormal stock price performance on the day of publication of “*Heard on the Street*” column.
 - Lloyds Davies and Canes, (1978)
 - Liu, Smith and Syed, (1990)
 - Beneish, (1991)
- In the Istanbul Stock Exchange, Kiymaz (1999) investigated the effect of stock market gossip published in weekly economics magazine *Ekonomik Trend* .



Data & Methodology

- The sample consists of 199 stock recommendations by *Yatirimci Ali* during the period 5 December 1993 – 12 July 1998. In this period he tipped 89 different stocks.
- The sample includes daily price data for 5 years for 89 securities and the ISE100 index figures.
 - The event date ($t = 0$) is taken as the first business day after the periodical is published on Sunday.
 - For each sample observation, the calendar time is converted to event time. Price reactions were measured in a 40 day event window ($t = -19, \dots, 0, \dots, +20$).



Data & Methodology

- The abnormal return on stock i on day t ,

- (1)
$$AR_{it} = R_{it} - M_t$$

- The average abnormal returns on n stocks at day t ,

- (2)
$$AR_t = 1/n \sum_{i=1}^n AR_{it}$$

- Average cumulative abnormal returns T days after the event date;

- (3)
$$ACAR_T = \sum_{t=0}^T AR_t$$



Data & Methodology

- Cumulative average returns for n securities, $ACAR_{\text{stock}}$, and cumulative average returns for ISE100, $ACAR_{\text{index}}$,

- (4)
$$ACAR_{\text{stock}} = \sum_{t=0}^T R_t$$

- (5)
$$ACAR_{\text{index}} = \sum_{t=0}^T M_t$$

- The t-statistics for $ACAR_T$ is computed as,

- (6)
$$t = \frac{ARt}{\sigma / \sqrt{T}}$$



Findings

- The results indicate that the publication of the *Yatirimci Ali* column has a significant impact on stock prices.
- Results presented in Table 1 and Figure 1 show that the Average Abnormal Return (AR) increased by approximately 2.49% on the first working day after investment advice was published in *Paramatik* on Sunday.
- The abnormal returns, though relatively smaller in magnitude, are also significant on day $t=-1$. The Average Cumulative Abnormal Return (ACAR) starts picking up on day $t = -8$.



Findings

- During the period covering $t = -8$ to $t = -2$, ACAR increases from -0.44% to 1.19% .
- A clear jump at the ACAR from 1.19% to 3.34% can be observed at the one business day before *Yatirimci Ali* advises the stock on Sunday.
- After the advice appears in *Paramatik* on Sunday, ($t = 0$) another significant jump to 5.83% can be observed.



Findings

- On the event date, which is the first Monday after investment advice is published, the abnormal returns are approximately 2.49%.
- After the event date ($t = +1$), the ACAR is constant at 5.8% and then decays gradually to 1.6% on day $t = +20$.
- So, between $t = +1$ and $t = +20$, we observe negative ACAR which is -4.2%.



Discussion

- Lloyds, Davies and Canes (1978) interpret the abnormal price movement by suggesting that the “Heard on the Street” column is a secondary dissemination of analysts’ recommendations.
- Our findings are consistent with previous studies. Similar to Liu, Smith and Syed (1990), Beneish (1991) and Kiymaz (1999).
 - We can not exclude the possibility of the insider trading
 - The significant abnormal returns preceding the publication of the column might very well be due to the advance trading based upon speculation or knowledge about the contents of the forthcoming *Yatirimci Ali* column.



Discussion

- One possible story can be the trading of ‘preferred investors’ who reach the information before the publication day.
- If investment advice was given to the magazine on Monday ($t = -5$) and tipped to ‘preferred investors’, they would buy the stocks five trading days before the advice was published.
- They could easily sell their stocks after the investment advice had become public information at ($t = 0$).
- Therefore, they could earn a weekly average return of 7.11% and weekly average abnormal return of 5.36%.



Discussion

- On the other hand, individual investors can have the information only after it has been published.
- So, they do not have a chance to buy the stock before ($t = 0$). In this case we can only run an investment strategy to buy at ($t = 0$) when the $ACAR_{stock}$ is 13.06% and sell at ($t = +4$) when $ACAR_{stock}$ is 14.14% (see Table 1).



Conclusion

- The findings of this paper are similar to previous studies on insider trading and investment advice columns.
- We found that buy recommendations published in the *Yatirimci Ali* column are associated with positive significant average abnormal stock price performance on the day of publication and the preceding day.
- The average abnormal return for the event date is 2.49% and the cumulative abnormal returns over a week period from the 5 days before publication to the publication day (-5 to 0) is 5.36%.



Conclusion

- Studies that are investigating the effect of investment advice in press has triggered some criminal inspections in United States.
- A collusive agreement between “Heard on the Street” reporter Winans and broker Brant led in April 1984 to a Securities and Exchange Commission (SEC) investigation and trial for misappropriation of information.
- The Judge held that “the information allegedly stolen from the Wall Street Journal was the timing, content, and tenor of market sensitive stories scheduled to appear in the paper.”



Conclusion

- On May 11, 1982, Paine Weber Inc. issued a research report recommending the purchase of the stock of a company.
- The firm was censured and fined \$30,000 because a research analyst had shared material information with one of the firm's traders.
- Trader then bought stocks before the firm's clients had had access to the analyst's research.
- This practice is known as front-running.



Conclusion

- The cases described above show us two further, important points:
 - Firstly; stock prices are effected by recommendations and abuse of this power is a common practise not only in ISE but also in the most advanced stock exchange market of the world.
 - Secondly; this sort of abuse could be diminished through strict and effective regulatory mechanisms.
- In light of the above examples, the question of how to make ISE more efficient and in what ways the existing (or new) legal regulations could be introduced and implemented to achieve such goals are possible subjects areas for new studies. This appears to be an open field for further research.



Table 1

| Day | ACAR | AR | t | ACAR _{stock} | AR _{stock} | ACAR _{index} | AR _{index} |
|----------|---------------|---------------|---------------|-----------------------|---------------------|-----------------------|---------------------|
| -19 | 0.0011 | 0.0011 | 0.4366 | 0.0022 | 0.0022 | 0.0011 | 0.0011 |
| -18 | 0.0035 | 0.0024 | 0.9248 | 0.0090 | 0.0068 | 0.0055 | 0.0043 |
| -17 | 0.0000 | -0.0035 | -1.3729 | 0.0121 | 0.0031 | 0.0121 | 0.0067 |
| -16 | 0.0014 | 0.0014 | 0.5471 | 0.0155 | 0.0034 | 0.0141 | 0.0020 |
| -15 | -0.0012 | -0.0026 | -0.9721 | 0.0158 | 0.0002 | 0.0169 | 0.0028 |
| -14 | -0.0018 | -0.0006 | -0.2451 | 0.0159 | 0.0002 | 0.0177 | 0.0008 |
| -13 | -0.0012 | 0.0005 | 0.2124 | 0.0199 | 0.0040 | 0.0212 | 0.0034 |
| -12 | -0.0029 | -0.0016 | -0.6928 | 0.0243 | 0.0044 | 0.0272 | 0.0060 |
| -11 | -0.0025 | 0.0004 | 0.1530 | 0.0274 | 0.0031 | 0.0298 | 0.0026 |
| -10 | 0.0024 | 0.0049 | 1.6205 | 0.0373 | 0.0100 | 0.0350 | 0.0051 |
| -9 | 0.0000 | -0.0024 | -0.9155 | 0.0362 | -0.0012 | 0.0361 | 0.0012 |
| -8 | -0.0044 | -0.0045 | -1.8098 | 0.0343 | -0.0019 | 0.0387 | 0.0026 |
| -7 | -0.0002 | 0.0042 | 1.7408 | 0.0456 | 0.0113 | 0.0457 | 0.0070 |
| -6 | 0.0014 | 0.0015 | 0.5543 | 0.0530 | 0.0075 | 0.0516 | 0.0059 |
| -5 | 0.0047 | 0.0033 | 1.0538 | 0.0595 | 0.0065 | 0.0548 | 0.0032 |
| -4 | 0.0056 | 0.0009 | 0.3453 | 0.0614 | 0.0020 | 0.0559 | 0.0011 |
| -3 | 0.0088 | 0.0032 | 1.2656 | 0.0704 | 0.0090 | 0.0616 | 0.0057 |
| -2 | 0.0119 | 0.0032 | 1.2974 | 0.0810 | 0.0106 | 0.0690 | 0.0074 |
| -1 | 0.0334 | 0.0215 | 6.4414 | 0.1062 | 0.0252 | 0.0728 | 0.0037 |
| 0 | 0.0583 | 0.0249 | 6.1889 | 0.1306 | 0.0244 | 0.0722 | -0.0005 |
| 1 | 0.0583 | 0.0000 | -0.0019 | 0.1319 | 0.0014 | 0.0736 | 0.0014 |
| 2 | 0.0563 | -0.0020 | -0.7866 | 0.1335 | 0.0016 | 0.0771 | 0.0035 |
| 3 | 0.0521 | -0.0042 | -1.7982 | 0.1358 | 0.0024 | 0.0837 | 0.0066 |
| 4 | 0.0559 | 0.0038 | 1.3874 | 0.1414 | 0.0055 | 0.0855 | 0.0018 |
| 5 | 0.0543 | -0.0016 | -0.6044 | 0.1398 | -0.0015 | 0.0855 | 0.0001 |
| 6 | 0.0529 | -0.0014 | -0.4747 | 0.1408 | 0.0009 | 0.0878 | 0.0023 |
| 7 | 0.0491 | -0.0038 | -1.4168 | 0.1420 | 0.0012 | 0.0929 | 0.0051 |
| 8 | 0.0489 | -0.0002 | -0.0875 | 0.1481 | 0.0062 | 0.0993 | 0.0064 |
| 9 | 0.0452 | -0.0036 | -1.5391 | 0.1474 | -0.0008 | 0.1022 | 0.0029 |
| 10 | 0.0453 | 0.0000 | 0.0181 | 0.1476 | 0.0002 | 0.1023 | 0.0002 |
| 11 | 0.0402 | -0.0050 | -1.9616 | 0.1425 | -0.0051 | 0.1022 | -0.0001 |
| 12 | 0.0361 | -0.0041 | -1.5995 | 0.1410 | -0.0015 | 0.1049 | 0.0026 |
| 13 | 0.0336 | -0.0025 | -1.0133 | 0.1454 | 0.0045 | 0.1119 | 0.0070 |
| 14 | 0.0348 | 0.0012 | 0.4335 | 0.1504 | 0.0050 | 0.1156 | 0.0038 |
| 15 | 0.0303 | -0.0045 | -1.7717 | 0.1474 | -0.0030 | 0.1171 | 0.0015 |
| 16 | 0.0268 | -0.0034 | -1.4210 | 0.1448 | -0.0026 | 0.1179 | 0.0008 |
| 17 | 0.0238 | -0.0031 | -1.4948 | 0.1457 | 0.0010 | 0.1220 | 0.0040 |
| 18 | 0.0241 | 0.0003 | 0.1212 | 0.1518 | 0.0061 | 0.1277 | 0.0058 |
| 19 | 0.0206 | -0.0035 | -1.2336 | 0.1511 | -0.0007 | 0.1306 | 0.0028 |
| 20 | 0.0163 | -0.0043 | -0.7837 | 0.1427 | -0.0084 | 0.1264 | -0.0042 |

Figure 1

Average Cumulative Abnormal Returns (ACAR)

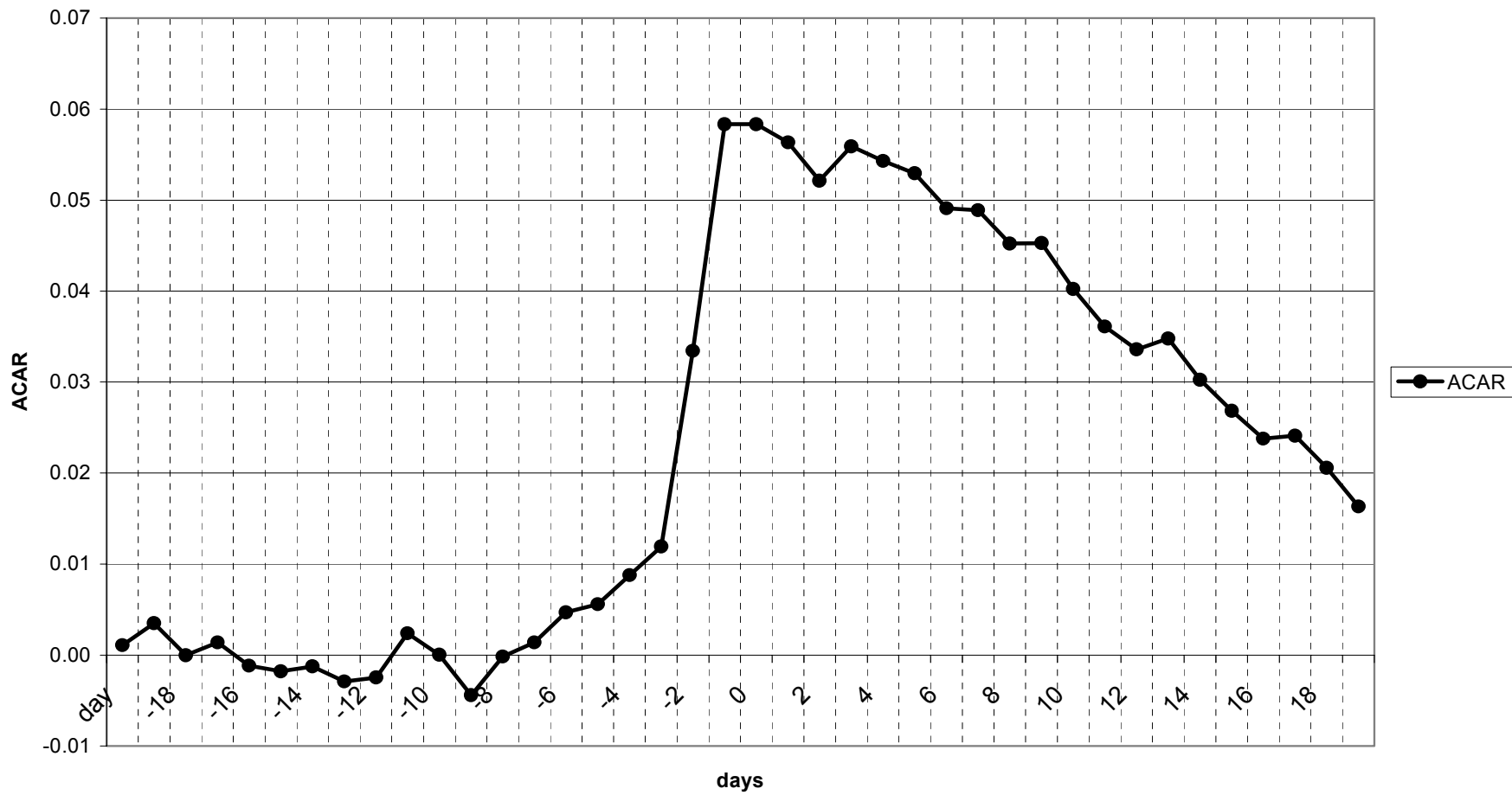
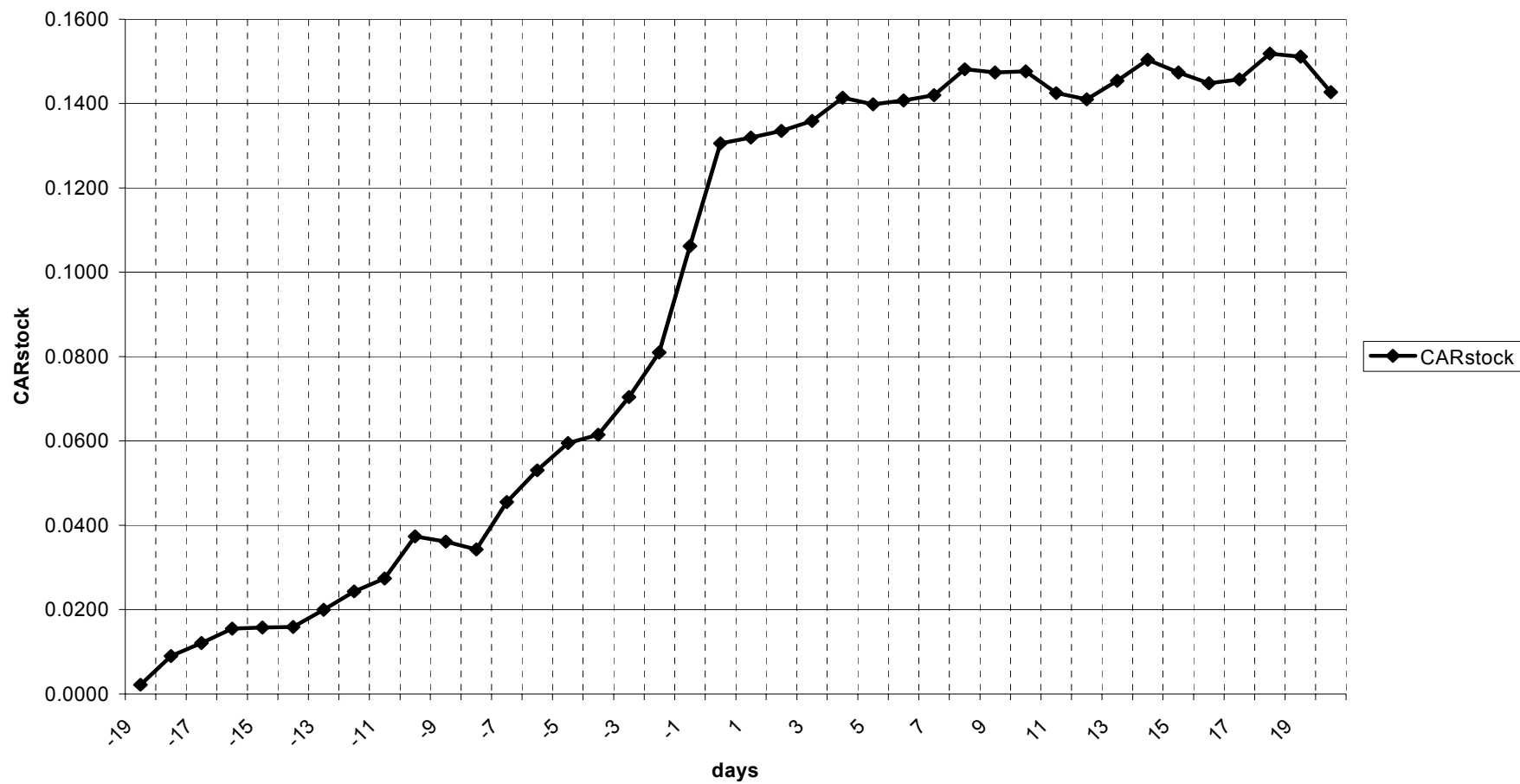




Figure 2

Cumulative Average Returns of the Stocks (CARstock)



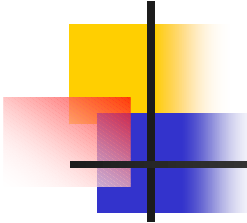


Figure 3

Cumulative Average Return of Index (CARindex)

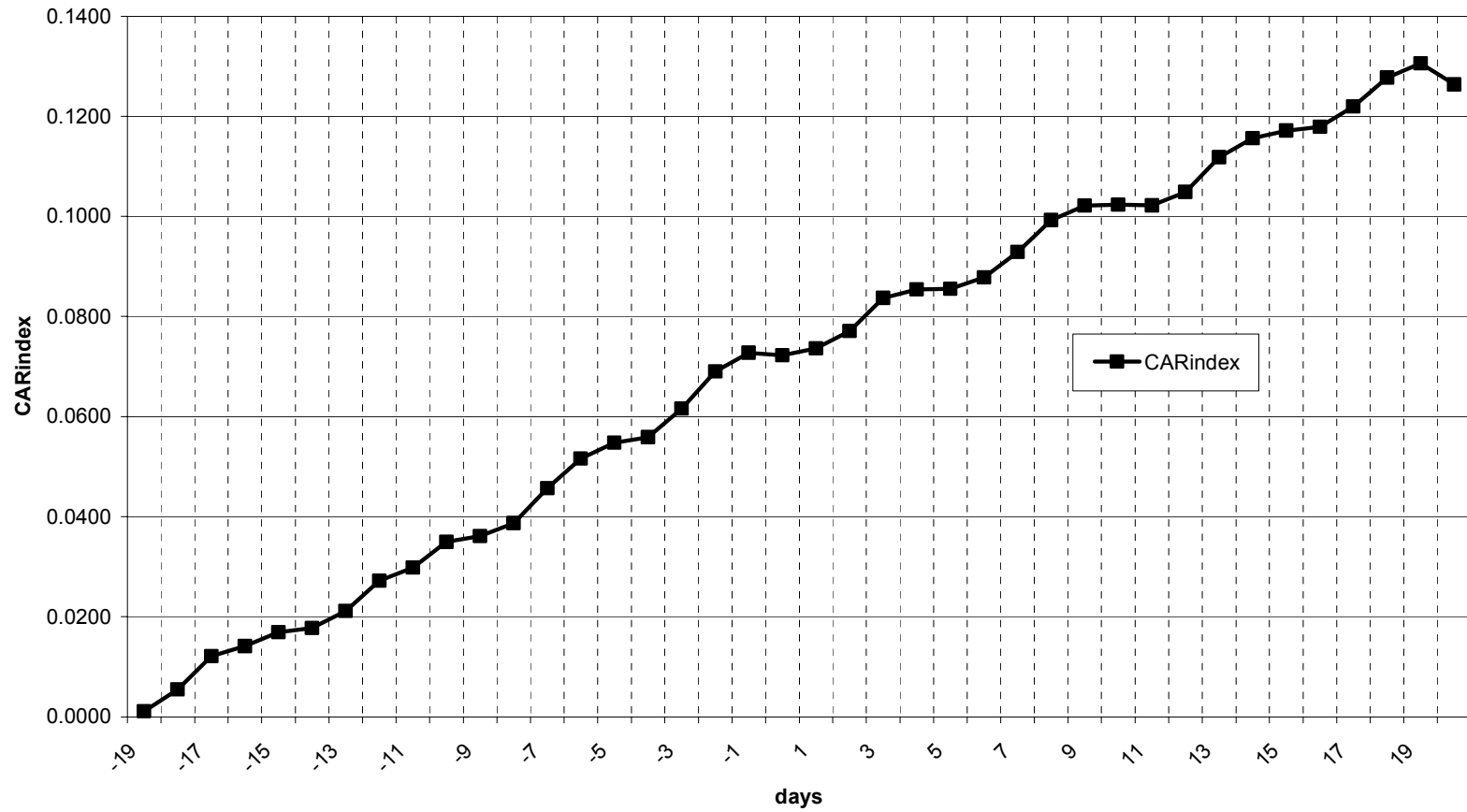


Figure 4

