Week 5: Microstructure and Asset Pricing

Empirical Asset Pricing

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Market Microstructure

- Price discovery: How information transmits and impounds into market prices.
  - Grossman (1976): Costly information and the importance of noise in the price system.
  - Grossman and Stiglitz (1980): The information content of price when information is costly.
- Transitory price vovements, bid/ask spreads, and liquidity.
  - Inventory risk: Ho and Stole (1981).
  - Information asymmetry: Glosten and Milgrom (1985) and Kyle (1985).
- Motives for trading:
  - Private information.
  - Difference in preferences or beliefs.
  - Difference in endowments: hedging needs.

Empirical Studies

- Roll (1984): Orange juice futures and weather forecast.
- Roll (1984): Price reversal and bid-ask spreads.
- Glosten and Harris (1988): Components of bid/ask spreads.
- Lee and Ready (1991): Inferring trade direction from intraday data.
- Campbell, Grossman, and Wang (1993): Price reversal after high trading volume.
- Hu, Pan, and Wang (2017): Tiered information disclosure.

High Frequency Trading

- Market fragmentation.
- The race to speed.
- Algo trading.
- Flash crashes: 2010-5-6 Stock and 2014-10-15 Treasury.

Measuring Market Liquidity

- Equity.
- Corporate Bonds.
- Treasury Bonds.
- Options.