Can Institutional InvestorsTrade on News? Evidence from Macroeconomic and Firm-Level Announcements

Klakow Akepanidtaworn, Rick Di Mascio, Alex Imas, Lawrence Schmidt*

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Abstract

Using the database of holding and trades of global institutional investors, we show that discretionary, long-only equity investors pay immediate attention to both macroeconomic and firm-level news. On earnings and macro announcement days, the number of traded positions and trade sizes increase by 20%-50%, regardless of news content, for both buy and sell trades. The increases in trading activities are high and persistent over time. However, not all trades on announcement days are informed. The informed trades lie in one domain - trading on the firm-specific information. Earnings announcement news helps investors make informed trades, especially the sell trades. The average sell performance on earnings announcement increases by about 1%-3% per year, compared to sell trades on non-announcement days. This skill on trading on firm-specific information is not subject to decreasing returns to scale. Investors who trade more on earnings announcement news also have higher fund alpha by nine basis points at the one-year horizon for every 1% increase in trading activity on earnings announcement. Despite increases in trading activities on macroeconomic announcement days, trading performances on those days add little value, and are worse than trades on non-macroeconomic announcement days on average. These results are consistent with the fractionation hypothesis and the difficulty in trading upon the macroeconomic information. Institutional investors overextend their domain of skills in trading on firm-specific information to other types of unfamiliar, hard-to-trade information.

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