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Gunduz Caginalp, Mark DeSantis, Akin Sayrak

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The Nonlinear Price Dynamics of U.S. Equity ETFs

Gunduz Caginalp¹
University of Pittsburgh

Mark DeSantis
Chapman University

Akin Sayrak
University of Pittsburgh

Abstract

We investigate the price dynamics of large market-capitalization U.S. equity exchange-traded funds (ETFs) in order to uncover trader motivations and strategy. We show that prices of highly liquid ETFs can deviate significantly from their daily net asset values. By adjusting for changes in valuations, we report the impact of non-classical variables including price trend and volatility using data from 2008 to 2011. We find a cubic nonlinearity in the trend suggesting traders are aware not only of the underreaction of others, but also self-optimize by anticipating others' reactions, and sell when the uptrend is stronger than usual.

Key words: Exchange-traded funds, momentum, volatility, and nonlinear dynamics.

JEL classification: G02, G12, G14, G17

¹ Corresponding Author: Gunduz Caginalp is a Professor of Mathematics at the Department of Mathematics, University of Pittsburgh, Pittsburgh, PA 15260, E-mail: caginalp@pitt.edu, Phone: 412.624.8339, Fax: 412.624.8397.

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