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Investor inattention around stock market holidays[☆]

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ABSTRACT

We observe three results that lead to the conclusion investors are distracted by holidays. First, there is a substantial reduction in the trading volume adjacent to weekday stock market closings. Second, there are considerably fewer stocks with extreme abnormal returns in the trading days adjacent to a holiday. Third, those stocks with extreme abnormal returns in the trading days adjacent to a holiday drift on the subsequent trading day. These findings do not hold for weekend stock market closings. The evidence supports the hypothesis of inattentive investors, whose reactions are suppressed in the quiet trading sessions surrounding stock market holidays.

1. Introduction

In efficient capital markets, stock prices rapidly change to reflect new information causing future stock returns to be unpredictable since all available information is already incorporated. This requires a large number of active traders and the free flow of information. However, US stock exchanges are closed on weekends as well as for about nine weekdays per year for religious, patriotic, and social holidays. These closings prevent the market from incorporating new information quickly and may affect the flow of information to the market. While weekends are routine, holidays are political, religious, and social events that can alter the behavior and attentiveness of market participants. The infrequency and significance of holiday closings make them prime candidates to influence market efficiency.

We consider three consequences of the disruptions and distractions caused by holidays on US stock market activity. First, the trading volume adjacent to weekday stock market closings. Second, the frequency of stocks with extreme abnormal returns in the trading days adjacent to a holiday. Third, drifts, a tendency of abnormal returns to continue in the same direction, in trading subsequent to extreme abnormal returns adjacent to a holiday.

Holidays influence the trading behavior of investors. Several studies find a holiday "bounce" i.e. returns are better immediately before holidays than the remainder of the year. Ariel (1990) finds that 75% of the returns to a value-weighted index from 1963 to 1982 on the trading days before major holidays were positive, compared to 54% for the remaining days of the year. Also, the mean return in pre-holiday trading was 14 times greater than the mean for the other days. Other socially significant events, such as soccer (Edmans et al., 2007), have also been shown to influence the mood and trading behavior of investors.

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Research shows individual and institutional investors are influenced by religious and political views. Roughly 20% of all assets under professional management in the US, totaling 8.7 trillion dollars, employed socially responsible investing strategies in 2014 US SIF Foundation (2016). Renneboog et al. (2008) explain the inflows and outflows for socially responsible investing funds reveal that investors are willing to sacrifice returns for personal reasons. Hood et al. (2014) show that religion influences individual investors' stock portfolios – Christians shying away from companies with progressive labor practices and Mormons shunning sin stocks. Jiang et al. (2016) add that even institutional investors are influenced by social factors by showing that Republican analysts are more conservative in their forecasts. Since investors consider their religious and patriotic opinions in their investment portfolios, it is logical that holidays devoted to these matters alter their trading behavior.

Three studies in the post-earnings announcement drift (PEAD) literature show investor inattention is associated with a persistent drift in stock prices after an earnings announcement. This literature demonstrates that a portfolio of stocks with good earnings announcements shows substantially higher abnormal returns in subsequent trading periods than a portfolio of stocks with poor earnings announcements when investors are unable to focus on the announcement. Hirshleifer et al. (2009) show that a weaker immediate response and larger post-earnings announcement drift is positively correlated to the number of coincidental earnings announcements that compete for investor attention. DellaVigna and Pollet (2009) find the immediate response of earnings announcements on Fridays to be 40% of the total response compared to 60% on other days. They argue investors might be less able to synthesize information on Friday because they are distracted by the impending weekend. Pantzalis and Ucar (2014) find Easter to be a distraction by studying earnings announcements that take place during the latter part of Holy Week. The companies in the upper quintile (most positive) for earnings announcements that occur on the Wednesday, Thursday, and Friday before Easter have an extra 3% upward drift afterward compared to those in the same quintile that take place on the other days of the year. Additionally, companies with the most negative earnings announcements on those dates have an extra 10% downward drift.

2. Data

Data are gathered from CRSP from January 2, 2002 to December 31, 2014 to investigate investor inattention around stock market closings. Using the event study methodology to measure investor inattention, we require an estimation window of 250 days, an event window of 2 days, and a gap between the windows of 5 days from the data. Therefore, the dates in the study are from January 7, 2003 to December 30, 2014. The sample data is limited to stocks with the CRSP share code of 11: ordinary common shares and the CRSP exchange codes 1, 2, and 3: stocks listed on the NYSE, NYSE MRT, AMEX, and NASDAQ. Also, for every day from the beginning of the estimation window through the end of the event window the closing price must be at least one dollar, produce a minimum market capitalization of one hundred million dollars when multiplied by the shares outstanding, and produce a minimum of one million dollars when multiplied by the volume of shares traded.

The stock exchanges in the United States are closed for eight of the ten federal holidays. The markets close annually for New Year's Day, Martin Luther King Day, Washington's Birthday, Good Friday, Memorial Day, Independence Day, Labor Day, Thanksgiving, and Christmas. They are not closed for the two remaining federal holidays, Columbus Day and Veterans Day.

Four of these holidays are fixed to Mondays and one is fixed to a Thursday. The birthday of Martin Luther King, Jr is honored on the third Monday in January, and Washington's Birthday (commonly referred to as Presidents' Day) is honored on the third Monday in February. Memorial Day is celebrated on the last Monday in May and Labor Day is celebrated on the first Monday in September. Thanksgiving is observed on the fourth Thursday of November. The stock exchanges are closed for three days that are fixed in the calendar: New Year's Day, January 1st; Independence Day, July 4th; and Christmas, December 25th. When one of these holidays falls on a Sunday, the exchanges are closed on Monday. The exchanges are closed on Friday when Independence Day or Christmas falls on a Saturday but they are left open for New Year's Day when it falls on a Saturday.

Good Friday, the Friday before Easter, is the only stock market holiday that is not a federal holiday. Easter is the first Sunday after the first full moon after March 20th; it frequently coincides with the first Sunday in Spring. The date for Good Friday ranged from March 21st to April 22nd during the sample period. In addition to these annual holidays, announcements of market closings were made following the deaths of President Reagan for June 11, 2004 and President Ford for January 2, 2007 and for October 29 and 30, 2012 due to Hurricane Sandy. Trading days adjacent to any announced stock market closing are referred to in the tables as Adjacent, and frequently referred in the text as "holiday trading" to simplify the language.

We include nearly all U.S. stocks in our sample so as not to restrict the type of information entering the market. By not limiting the types of news affecting stocks we believe we give a broader look at the impact of market holidays on trading and returns. Similarly, we are inclusive on the definition of market holidays, preferring to include all weekday stock market closings, regardless as to the rationale, whether it be patriotic, religious, social, or inclement weather.

2.1. Evidence – reduced trading volume

Evidence for investor distraction around stock market holidays begins with the daily trading volume (in billions of dollars) on the New York Stock Exchange from January 7, 2003 to December 30, 2014. The stock market is closed for 109 weekdays in that period. Twice the market is closed for consecutive days, therefore there are 214 trading days adjacent to a stock market holiday. The average trading volume in holiday trading is $43.5 billion, $9.9 billion less than the trading volume