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Do institutions trade ahead of false news? Evidence from an emerging market

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Highlights

- We study how institutional investors trade in false news events.
- We find that institutions engage in abnormal trading preceding false news breaks
- We show institutional prerelease trading may not base on their own knowledge.
- We show that the early information may come from the media outlets reporting the false news
- We also find evidence that institutions reverse their positions several days after denial releases rather than when the news breaks.

Abstract: Many studies examine the use of false news as a method of stock price manipulation. Empirical research shows, for example, that false news generates persistent abnormal returns and affects trading volume. Studies also show that institutions often know about news before it breaks. However, the role institutions play in false news events is still unclear. To understand that role, we track institutional order flow around the release of false news in the Chinese stock market. We find that institutions seem to have early information about false news releases. Their prerelease order flows predict false news sentiments and market reactions. We further find that the early information may come from the media outlets reporting the false news. We also find evidence that institutions reverse their positions several days after the denial releases rather than when the news breaks. In turn, our evidence shows which trading patterns could bring more potential profits than reversing right on the news breaks. Our results provide unique insights into price movements and institutional reactions on false news, as well as evidence regarding regulating institutions, media platforms, and information manipulation in the stock market.

Keywords: institutions, informed trading, false news, media, stock returns

JEL classification: G11; G14; G15

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