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Trading around macroeconomic announcements: Are all traders created equal?

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Abstract

This paper examines the effects of macroeconomic announcements on equity index markets using high frequency transactions data for the regular and E-mini S&P 500 index futures contracts. For ten types of announcements that significantly affect prices, we analyze the price adjustment process and the trading patterns of exchange locals and off-exchange customers around the announcements. We find a large increase in trading activity immediately after the announcement. The results also show that during this initial surge in trading activity, locals are able to time their trades better than off-exchange traders even when locals do not have the advantage of access to the order flow. The trading strategy followed by exchange locals in the first 20 seconds after the announcement tends to be profitable, while off-exchange traders tend to make losing trades over the same time period. These results lend evidence that local traders tend to react to the macroeconomic information faster than off-exchange traders.

JEL classification: G10; G14

Keywords: Macroeconomic announcements; Trading; Futures; Exchange locals

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1. Introduction

How the arrival of information is processed into prices continues to be an important research topic in finance. Theoretical studies by Grossman and Stiglitz (1980), Kyle (1985) and others argue that private information requires trading in order to be processed by the market. On the other hand, according to the traditional view expressed by French and Roll (1986), public information is reflected in prices before anyone is able to trade on it. A prominent example of public information releases is macroeconomic announcements. Empirical studies tend to show that the initial market reaction to macroeconomic announcements is very rapid. For example, Ederington and Lee (1993, 1995) and Fleming and Remolona (1999) show that a local equilibrium price level is established within a minute after the macroeconomic announcement.

Even such rapid initial price adjustment does not necessarily preclude some traders from extracting profits by trading on the public information. Ederington and Lee (1995) point out that if prices do not adjust fast enough "traders with quick access to the market may be able to earn excess trading profits based on the initial market response." Specifically, traditional futures exchanges allow traders to acquire an exchange seat to be able to trade for their own account without broker intermediation. Such traders are called "locals" to stress their privileged access to the trading floor. Empirical studies show that local traders have an information advantage over off-exchange traders. Manaster and Mann (1999) conclude that exchange locals in futures markets are able to exploit their information advantage by timing their trades before favorable price movements.

It is unknown, however, whether local traders can exploit their advantage over off-exchange traders around macroeconomic announcements. On the one hand, price movements immediately surrounding the information release are most likely to be dominated by the specific public information announcement, and all traders should be equally informed about the cause of the price change.[1] On the other hand, locals' access to the open outcry floor may give them an advantage during rapid price adjustment around macroeconomic announcements because they are able to react faster to market dynamics than off-exchange traders. Furthermore, access to the institutional order flow that arrives into the trading pit immediately after the announcement may help locals interpret implications of the news, since institutional traders are likely to have superior information-processing capabilities. Finally, in addition to their advantage derived from access to the trading floor, locals may have better ability to interpret information as compared to off-exchange traders.

The question this raises is: does any particular trader type have a trading advantage around macroeconomic announcements? The purpose of this paper is to address this question empirically. Specifically, by employing transactions data that contain trader type identification codes we examine trading patterns around macroeconomic announcements on

[1] The government agencies issuing new macroeconomic information follow almost identical release procedures that ensure instantaneous public information release at the scheduled time. Ederington and Lee (1993, 1995) and Fleming and Remolona (1999) provide a description of the release procedures.