
**Seminar in Business Finance
FINANCE 631 – Spring 2009**

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Focus of Course: This course will focus on financial markets – primarily in an area called market microstructure. The readings in this course will expose you to a broad base of literature, both theoretical and empirical, regarding the market microstructure of financial markets.

Course Materials:

Various Journal Articles – see reading list.

Other (reference) material:

Market Microstructure Theory, by Maureen O'Hara. Blackwell Publishing

Trading and Exchanges, Market Microstructure for Practitioners, by Larry Harris. Oxford University Press.

Course Pedagogy:

This seminar will examine financial markets with an emphasis on the market microstructure of financial markets. The journal readings are primarily empirical, but the references in the articles can direct you to the theoretical motivation of the studies (also, the Market Microstructure Theory book by O'Hara is an excellent reference book for theory). We will read many articles in this course in order to provide you with a broad-base of knowledge in the research which is (and had been) done regarding market microstructure, investments and finance.

Each student is expected to read each of the assigned readings each week before class. With the course being a seminar, students are to present the journal articles they are assigned to the class. Class time will be spent with the presentations and discussions of the material which is presented.

Each student is expected to complete a term (research) paper. This paper can take one of two forms: (1) an original paper, or (2) a replication of a well-known journal article with newer (different) data. It is preferred that a student will produce an original piece of research for this class – as once you are a faculty member you will be expected to produce original research, a replication can be done as a project (since this is not a original piece of work, the highest grade that will be given on a replication is a 92).

The presentation of the project will be made to the class on the last class day of the semester. The topic must be approved – which should be done by the first to second week in February. An initial presentation of the topic (a brief, informal presentation) will be made to the class on March 2.

Grading:

In class presentations and class participation (30%)
Research project (35%)
Final Exam (35%)

Discussion/Presentation of Articles:

The discussion/presentation of articles (articles will be assigned to each student) are to be informal, but each person in the class should be given a copy of an outline (summary) of the article by the person who is discussing/presenting the article. In the outline several things need to be explicitly mentioned:

- Theoretical Basis of Research
 - What is the theoretical motivation of the research?
 - What theories are tested?
- Methodology of Research
 - What types of tests are used?
 - Anything interesting in the sample (did they have matched samples? if so, how?)
- Major Findings of Research
 - What are the major findings of the study?
 - How did this add to the field of finance?

Tentative Course Outline:

Date	Topic	Coverage
Jan 26		Introduction
Feb 2	Intraday Market Behavior	Section I: Articles
Feb 9	Short Sales	Section II: Articles
Feb 16	Trading	Section III: Articles
Feb 23	Trading II and Options	Section IV: Articles
Mar 2	Nasdaq Controversy and Market Changes	Section V: Articles – Project topics
Mar 9	Execution Costs	Section VI: Articles
Mar 16	Spring Break	
Mar 23	Competition	Section VII: Articles
Mar 30	Bonds	Section VIII: Articles
Apr 6	Market Microstructure and Stealth Trading	Section IX: Articles
Apr 13	Volatility and NYSE Hybrid	Section X: Articles
Apr 20	Additional Microstructure Issues	Section XI: Articles
Apr 27	Project Presentation	
	Final	

***I reserve the right to alter the class schedule as circumstances dictate. Changes to the syllabus will be announced in class. Students not attending are responsible for obtaining this information.

Reading List

I. Intraday Market Behavior

- 1 McInish, T., Wood, R., Ord, K. 1985. An investigation of transaction data for NYSE stocks. *The Journal of Finance* 40, 723-739.
- 2 Harris, L., 1986. A transaction data study of weekly and intradaily patterns in stock returns, *Journal of Financial Economics* 16, 99-117.
- 3 McInish, T., Wood, R., 1992. An analysis of intraday patterns in bid/ask spreads for NYSE stocks. *The Journal of Finance* 47, 753-764.
- 4 Chan, K., Christie, W., Schultz, P., 1995. Market structure and the intraday pattern of bid-ask spreads for Nasdaq securities. *Journal of Business* 68, 35-60.
- 5 Lee, C., Mucklow, B., Ready, M., 1993. Spreads, depths, and the impact of earnings information: an intraday analysis. *The Review of Financial Studies* 6, 345-374
- 6 Chung, K., Van Ness, B., Van Ness, R., 1999. Limit orders and the bid-ask spread. *Journal of Financial Economics* 53, 255-287.

II. Short Sales

- 1 Christophe, S., M. Ferri, and J. Angel, 2004. Short-Selling prior to earnings announcements. *The Journal of Finance* 59, 1845-1875.
- 2 Boehmer, Jones, and Zhang, 2008. Which shorts are informed? *The Journal of Finance* 63, 491-527.
- 3 Diether, Lee, Werner, 2009. Short-Sale strategies and return predictability. Forthcoming, *The Review of Financial Studies*.
- 4 Diether, Lee, Werner, 2009. It's SHO Time! Short-Sale price-tests and market quality. Forthcoming, *The Journal of Finance*.
- 5 Chang, Cheng, and Yu, 2007. Short-sale constraints and price discovery: Evidence from the Hong Kong Market. *The Journal of Finance* 62, 1097-2121.

III. Trading

- 1 Battalio, Ellul, and Jennings, 2007. Reputation effects in trading on the New York Stock Exchange. *The Journal of Finance* 62, 1243-1271.
- 2 Kaniel, Saar, and Titman, 2008. Individual investor trading and stock trading. *The Journal of Finance* 63, 273-310.

- 3 Barber and Odean, 2008. All that glitters: The effect of attention and news on the buying behavior of individual and institutional investors. *The Review of Financial Studies* 21, 785-818.
- 4 Shane A. Corwin and Jay F. Coughenour, 2008. Limited attention and the allocation of effort in securities trading. *The Journal of Finance*, 63, 3031-3067
- 5 Shane A. Corwin, Andrew Ellul, Robert Jennings, 2007. Reputation effects in trading on the New York Stock Exchange. *The Journal of Finance* 62, 1243-1271.
- 6 Anand, Chakravarty, and Chuwonganan, 2008. Cleaning house: Stock reassignments on the NYSE. Working paper, Purdue University.

IV. Trading II and Options

- 1 Irvine, Lipson, and Puckett, 2007. Tipping. *The Review of Financial Studies* 20, 741-768.
- 2 Madureira and Underwood, 2008. Information, sell-side research, and market making. *Journal of Financial Economics* 90, 105-126.
- 3 Juergens and Lindsey, 2009. Getting out early: An analysis of market making activity at the recommending analyst's firm. Forthcoming, *The Journal of Finance*.
- 4 Battalio, Hatch, and Jennings, 2004. Toward a national market system for U.S. Exchange-listed equity options. *The Journal of Finance* 59, 933-962.
- 5 Battalio and Schultz, 2006. Options and the bubble. *The Journal of Finance* 61, 2071-2102
- 6 DeFontnouvelle, Fische, and Harris, 2003. The Behavior of Bid-Ask Spreads and Volume in Options Markets during the Competition for Listings in 1999. *The Journal of Finance* 58, 2437-2464.

V. Nasdaq Controversy, Clustering, and Market Changes

- 1 Christie, W., Schultz, P., 1994. Why do NASDAQ market makers avoid odd-eighth quotes? *The Journal of Finance* 49, 1813-1840.
- 2 Christie, W., Harris, J., Schultz, P., 1994. Why did NASDAQ market makers stop avoiding odd-eighth quotes? *The Journal of Finance* 49, 1841-1860.
- 3 Harris, L., 1991. Stock price clustering and discreteness. *The Review of Financial Studies* 4, 389-416.
- 4 Barclay, M., Christie, W., Harris, J., Kandel, E., Schultz, P., 1999. The effects of market reform on the trading costs and depths of Nasdaq stocks. *The Journal of Finance* 54, 1-34.

- 5 Chung, K., Van Ness, B., Van Ness, R., 2001. Can the treatment of limit orders reconcile the differences in trading costs between NYSE and Nasdaq issues. *Journal of Financial and Quantitative Analysis* 36, 267-286.

VI. Execution Costs

- 1 Huang, R., Stoll, H., 1996. Dealer versus auction markets: a paired comparison of execution costs on NASDAQ and the NYSE. *Journal of Financial Economics* 41, 313-357.
- 2 Bessembinder, H., 1999. Trade execution costs on Nasdaq and the NYSE: a post-reform comparison. *Journal of Financial and Quantitative Analysis* 34, 387-408.
- 3 Goldstein, M., Kavajecz, K., 2000. Eighths, sixteenths and market depth: changes in tick size and liquidity provision on the NYSE. *Journal of Financial Economics* 56, 125-149.
- 4 Bessembinder, H., 2003. Trade execution costs and market quality after decimalization. *Journal of Financial and Quantitative Analysis*, 747-777.
- 5 Boehmer, E., 2005. Dimensions of execution quality: Recent evidence for U.S. equity markets. *Journal of Financial Economics*, 553-582.
- 6 Bessembinder, Panayides and Venkataraman, 2009. Hidden liquidity: An analysis of order submission strategies in automated markets. Working paper, university of Utah.

VII. Competition

- 1 Blume, M., Goldstein, M., 1997. Quotes, order flow, and price discovery. *The Journal of Finance* 52, 221-244.
- 2 Bessembinder, H., 2003. Quote-based competition and trade execution costs in NYSE-listed stocks. *Journal of Financial Economics*, 385-422.
- 3 Goldstein, Shkilko, Van Ness, and Van Ness, 2008. Inter-Market competition on NASDAQ. *Journal of Financial Markets* 11, 113-143.
- 4 Reiss, P. and I. Werner, 2005. Anonymity, adverse selection, and the sorting of interdealer trades. *The Review of Financial Studies* 18, 599-633
- 5 Boehmer, Jennings, and Wei, 2007. Public disclosure and private decisions: Equity market execution quality and order routing. *The Review of Financial Studies* 20, 316-358.

VIII. Bonds

- 1 Bessembinder, Maxwell and Venkataraman, 2006. Market transparency, liquidity externalities, and institutional trading costs in corporate bonds. *Journal of Financial Economics* 82 (2), 251-288.

- 2 Bessembinder, Kahle, Maxwell and Xu, 2009. Measuring abnormal bond performance. Forthcoming: *The Review of Financial Studies*.
- 3 Mahanti, Nashikkar, Subrahmanyam, Chacko, and Mallik, 2008. Latent liquidity: A new measure of liquidity, with an application to corporate bonds. *Journal of Financial Economics*, 88 (2), 272-298.
- 4 Pasquariello and Vega, 2007. Informed and strategic order flow in the bond markets. *The Review of Financial Studies* 20, 1975-2019.
- 5 Alessandro Beber, Michael W. Brandt, Kenneth A. Kavajecz, 2009. Flight-to-Quality or Flight-to-Liquidity? Evidence from the Euro-Area bond market. Forthcoming. *The Review of Financial Studies*.

IX. Market Microstructure – AFA Presidential Addresses and Stealth Trading

- 1 Stoll, H., 2000. Presidential Address: Friction. *The Journal of Finance* 55, 1479-1514.
- 2 O'Hara, M., 2003. Presidential Address: Liquidity and price discovery. *The Journal of Finance* 58, 1335-1354.
- 3 Barclay and Warner, 1993. Stealth trading and volatility: which trades move prices. *Journal of Financial Economics*, 34, 281-305.
- 4 Chakravarty, 2001. Stealth trading: which traders' trades move stock price? *Journal of Financial Economics*, 61, 289-307.
- 5 Alexander and Peterson, 2007. An analysis of trade-size clustering and its relation to stealth trading. *Journal of Financial Economics* 84(2), 435-471.

X. Volatility and NYSE Hybrid

- 1 Corwin and Lipson, 2000. Order Flow and liquidity around NYSE trading halts. *The Journal of Finance* 55, 1771-1801.
- 2 William G. Christie, Corwin and Jeffrey H. Harris, 2002. Nasdaq trading halts: The impact of market mechanisms on prices, trading activity, and execution costs. *The Journal of Finance* 57(3), 1443-1478.
- 3 Goldstein and Kavajecz, 2004. Trading strategies during circuit breakers and extreme market movements". *Journal of Financial Markets* 7(3), 301-333.
- 4 Michael J. Barclay, Terrence Hendershott, and Charles M. Jones, 2008. Order consolidation, price efficiency, and extreme liquidity shocks. *Journal of Financial and Quantitative Analysis* 43, 93-122.
- 5 Hendershott and Moulton 2008. Speed and stock market quality: The NYSE's hybrid. Working paper, University of California.

XI. Some additional Market Microstructure Issues

- 1 Hendershott and Jones, 2005. Trade-through prohibitions and market quality. *Journal of Financial Markets* 8(1), 1-23.
- 2 Xin Zhao and Kee H. Chung, 2007. Information disclosure and market quality: The effect of SEC Rule 605 on trading costs. *Journal of Financial and Quantitative Analysis* 42, 657-682.
- 3 Kumar Venkataraman and Andrew C. Waisburd, 2007. The Value of the designated market maker. *Journal of Financial and Quantitative Analysis* 42, 735-758.
- 4 Amber Anand and Avanidhar Subrahmanyam, 2008. Information and the intermediary: Are market intermediaries informed traders in electronic markets. *Journal of Financial and Quantitative Analysis* 43, 1-28.
- 5 Goldstein, Irvine, Kandel and Weiner, 2009. Brokerage commissions and information allocation. Forthcoming: *The Review of Financial Studies*.

Additional Topical Reading

Electronic Markets and Pre-After Hours Trading

- 1 Venkataraman, K., 2001. Automated versus floor trading: an analysis of execution costs on the Paris and New York exchanges. *The Journal of Finance* 56, 1445-1488.
- 2 Bessembinder, H., and K. Venkataraman, 2004. Does an electronic stock exchange need an upstairs market?, *Journal of Financial Economics*, 3-36.
- 3 Barclay, M., and T. Hendershott, 2003. Price discovery and trading after hours. *The Review of Financial Studies*, 1041-1073.
- 4 Barclay, M., and T. Hendershott, 2004. Liquidity externalities and adverse selection: Evidence from trading after hours. *The Journal of Finance*, 681-710.
- 5 Boehmer, E., G. Saar, and L. Yu, 2005. Lifting the veil: An analysis of pre-trade transparency at the NYSE. *The Journal of Finance*, 783-815.

Measuring the Spread, and Spread Components

- 1 Stoll, H., 1989. Inferring the components of the bid-ask spread: theory and empirical tests. *The Journal of Finance* 44, 115-134.
- 2 George, T., Kaul, G., Nimalendran, M., 1991. Estimation of the bid-ask spread and its components: a new approach. *The Review of Financial Studies* 4, 623-656.
- 3 Huang, R., Stoll, H., 1997. The components of the bid-ask spread: a general approach. *The Review of Financial Studies* 10, 995-1034.
- 4 Bollen, N., T. Smith, and R. Whaley, 2004. Modeling the bid/ask spread: Measuring the inventory-holding premium. *Journal of Financial Economics*, 97-141.
- 5 Van Ness, B., Van Ness, R., Warr, R., 2001. How well do adverse selection components measure adverse selection? *Financial Management*, 30 (3), 77-98.

Other Issues and Market microstructure

- 1 Easley, D., S. Hvidkjaer, and M. O'Hara, 2002. Is information risk a determinant of asset returns? *The Journal of Finance* 57, 2185-2223.
- 2 LaPlante, M., Muscarella, C., 1997. Do institutions receive comparable execution in the NYSE and Nasdaq markets? a transaction study of block trades. *Journal of Financial Economics* 45, 97-134.
- 3 Schultz, P., 2000. Stock splits, tick size, and sponsorship. *The Journal of Finance* 55, 429-450.

- 4 Ellis, K., Michaely, R., O'Hara, M., 2002. The making of a dealer market: from entry to equilibrium in the trading of Nasdaq stocks. *The Journal of Finance* 57, 2289-2317.
- 5 Kavajecz, K., and E. Odders-White, 2004. Technical analysis and liquidity provision. *The Review of Financial Studies*, 1043-1071.
- 6 Korajczyk, R., and R. Sadka, 2004. Are momentum profits robust to trading costs?, *The Journal of Finance*, 1039-1082.
- 7 Avramov, D., T. Chordia, and A. Goyal, 2009. The impact of trades on daily volatility. forthcoming, *The Review of Financial Studies*.

Experimental Market Microstructure

- 1 Alevy, J., M. Haigh, and J. List, 2007. Information cascades: Evidence from a field experiment with financial market professionals. *The Journal of Finance*, 151-180.
- 2 Bloomfield, R., M. O'Hara, and G. Saar, 2008. How noise trading affects markets: An experimental analysis. Forthcoming: *The Review of Financial Studies*.
- 3 Bloomfield, R., M. O'Hara, and G. Saar, 2005. The "Make or Take" decision in an electronic market: Evidence on the evolution of liquidity. *Journal of Financial Economics*, 165-199.
- 4 Haruvy and Noussair, 2006. The effect of short selling on Bubbles and Crashes in experimental spot asset markets. *The Journal of Finance*, 1119 – 1157.
- 5 Bhojraj, Bloomfield, Tayler, 2009. Margin Trading, Overpricing, and Synchronization Risk, Forthcoming: *The Review of Financial Studies*.
- 6 Ackert, Church, and Jayaraman, 2001. An experimental study of circuit breakers: the effects of mandated market closures and temporary halts on market behavior. *Journal of Financial Markets*, 4 185-208.

Limit Orders:

- 1 Peterson and Sirri, 2002. Order submission strategy and the curious case of marketable limit orders. *Journal of Financial and Quantitative Analysis*, 37, 221-241.
- 2 Foucault, Kadan, and Kandel, 2005. Limit order book as a market for liquidity. *The Review of Financial Studies*, 18, 1171-1217.
- 3 Anand, Chakravarty and Martell, 2005. Empirical evidence on the evolution of liquidity: Choice of market versus limit orders by informed and uninformed traders. *Journal of Financial Markets*, 8(3), 288-308.
- 4 Ahn, Cai, and Cheung, 2005. Price Clustering on the limit-order book: Evidence from the Stock Exchange of Hong Kong. *Journal of Financial Markets*, 8(4) 421-451.

- 5 Hollifield, Miller, Sandas, and Slive, 2006. Estimating the gains from trade in limit order markets. *The Journal of Finance*, Dec. 2006.
- 6 Large, 2007. Measuring the resiliency of an electronic limit order book. *Journal of Financial Markets*, 10(1), 1-25.
- 7 Hall and Hautsch, 2007. Modelling the buy and sell intensity in a limit order book market, *Journal of Financial Markets*, 10 (3), 249-286.
- 8 Foucault and Menkveld, 2008. Competition for order flow and smart order routing systems, *The Journal of Finance*, 119-158.

Some Additional Tick Size Studies

- 1 Nicolas P. B. Bollen and Jeffrey A. Busse, 2006. Tick size and institutional trading costs: Evidence from mutual funds. *Journal of Financial and Quantitative Analysis*, 41 (4), 915-937.
- 2 Chakravarty, Panchapagesaon and Wood, 2005. Did decimalization hurt institutional investors? *Journal of Financial Markets*, 8(4), 400-420.