Why Do Large Investors Disclose Their Information?

Ying Liu
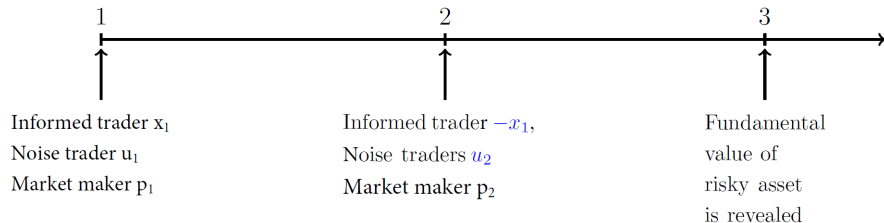
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EFA Doctoral Tutorial
August, 2016

Information Disclosure

- ▶ Important topic.

- ▶ Hedge funds advertise their trading ideas voluntarily.

- ▶ Why do they do that?

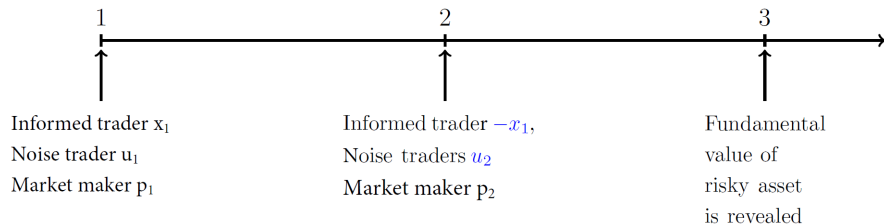- ▶ Is such information disclosure detrimental to price discovery?
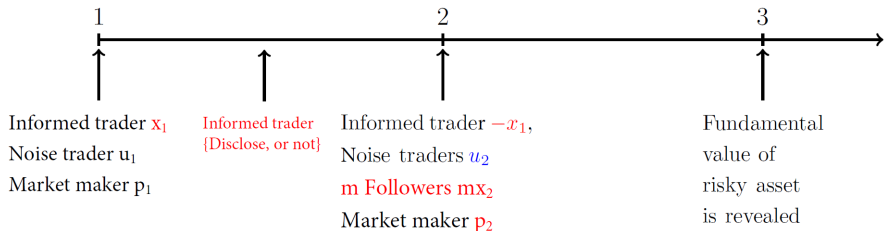
Model Summary

Benchmark model:

Informed trader x_1
Noise trader u_1
Market maker p_1

Informed trader $-x_1$,
Noise traders u_2
Market maker p_2

Fundamental value of risky asset is revealed

Model Summary

Benchmark model:

1

Informed trader x_1
Noise trader u_1
Market maker p_1

2

Informed trader $-x_1$,
Noise traders u_2
Market maker p_2

3

Fundamental
value of
risky asset
is revealed

With endogenous disclosure:

1

Informed trader x_1
Noise trader u_1
Market maker p_1

Informed trader
{Disclose, or not}

2

Informed trader $-x_1$,
Noise traders u_2
m Followers mx_2
Market maker p_2
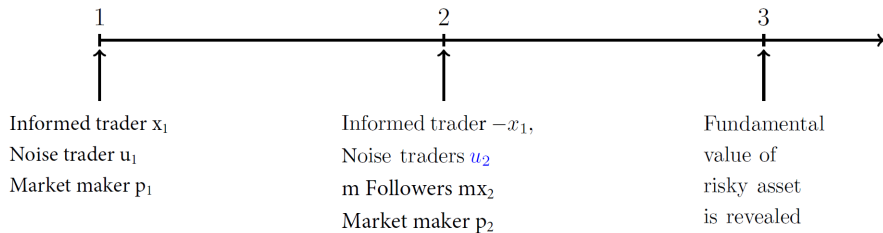
3

Fundamental
value of
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Key Predictions

▶ Informed trader may "free ride" on followers through information disclosure.

▶ Strategic disclosure by informed trader when

  • there are more followers.

  • there are more informed traders.

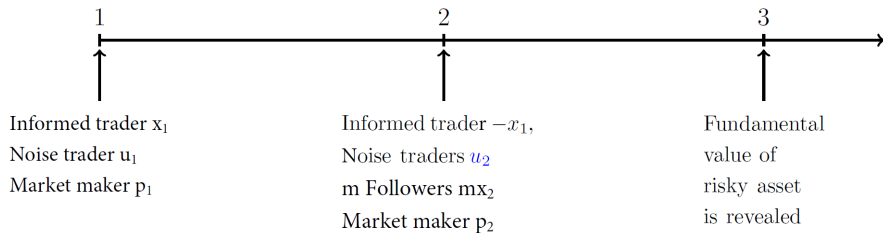▶ Information disclosure improves price discovery at $t = 2$, but is detrimental for $t = 1$!

An Alternative Benchmark model
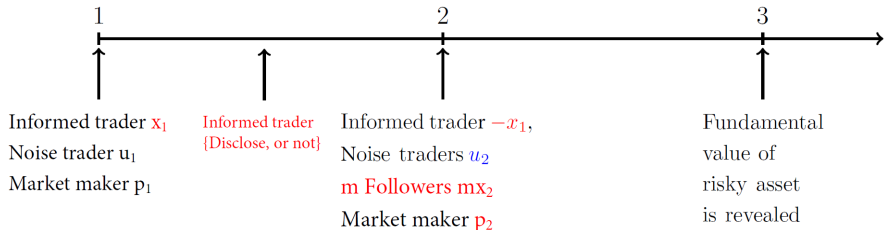
An alternative benchmark model:

1
2
3

Informed trader x_1
Noise trader u_1
Market maker p_1

Informed trader $-x_1$,
Noise traders u_2
m Followers mx_2
Market maker p_2

Fundamental
value of
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An Alternative Benchmark model

An alternative benchmark model:

1	2	3
Informed trader x_1	Informed trader $-x_1$,	Fundamental
Noise trader u_1	Noise traders u_2	value of
Market maker p_1	m Followers mx_2	risky asset
	Market maker p_2	is revealed

With endogenous disclosure:

1		2	3
Informed trader x_1	Informed trader {Disclose, or not}	Informed trader $-x_1$,	Fundamental
Noise trader u_1		Noise traders u_2	value of
Market maker p_1		m Followers mx_2	risky asset
		Market maker p_2	is revealed

Who has access to disclosed information?

- Information is only disclosed to followers – market maker does not observe disclosed information.

- Critical assumption in the model.

- This is different from "advertising private information at private talk or in the media."

- Informed trader can "free ride" followers.

- Alternative market maker clears market (Vives, Econometrica 2011).

Key assumption: Short horizon of informed trader

- Informed trader is forced to liquidate at $t = 1$.

- She wants to borrow followers' market force to improve her liquidation price.

- Long-horizon informed trader would not disclose information strategically.

- Do hedge funds really have short horizon?

- Or, do they advertise their trading idea in order to attract more funds?

Summary

- ► Very careful and mathematically sophisticated analysis on an excellent topic.

- ► Three comments:

    • A different benchmark model.

    • Let disclosed information be common knowledge.

    • How important/realistic is the short-horizon assumption?

- ► The paper provides a nice framework for alternative models.