Market Behaviour of Foreign versus Domestic Investors Following a Period of Stressful Circumstances

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Abstract

In this paper we analyse the short-term stock price behaviour following a period of large stock price changes. We compare the price behaviour of A shares owned by domestic investors and B shares owned by foreign investors in the two Chinese markets, Shanghai and Shenzhen. We find significant differences across the two types of shares. We show that, while the prices of the A shares are relatively random in the short-term window (up to 10 days) after the price shock, those of the B shares carry on increasing significantly after both the positive and negative shocks. This trend is more pronounced for large shares with high liquidity, in contrast to the efficient market hypotheses expectations, which suggests that any abnormal performance should be arbitraged away sooner in a frictionless (in this case liquid) market. In the post-2001 period when the B shares are open to domestic investors, we find a significant drop in the post-shock abnormal returns in B shares. We relate these results to the high level of optimism of foreign investors.

Key words: Efficient Markets, Market Stress, Overreaction, Momentum

JEL Classification: G1, F3.

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