

THE INFORMATION CONTENT OF ABNORMAL TRADING VOLUME

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Abstract

This paper investigates the role of abnormal trading volume on the Italian equity market as revealing new information. In an efficient market, volume should be correlated to simultaneous returns, but should have no predictive power for future returns. When new information arrives in the market, prices should adjust to a new equilibrium and the increase of volume should be the natural effect of informed trades. However, empirical evidence documents that the release of new information, price changes and volume increases are not necessarily simultaneous phenomena, as market efficiency would suggest. If information is not perfectly spread out in the market, but rather held by more informed traders, observation of trading volumes may enhance the information set. The hypothesis is that large changes in volume, especially when not accompanied by any news disclosure, incorporate a non-public information content and signal future excess returns.

Evidence confirms this intuition. I find strong excess returns (higher when no new information is simultaneously released) around extreme trading levels and strong evidence of price continuation, even though mainly concentrated on the day after the event. The magnitude of post-event excess returns is also profitably tradable with a portfolio strategy. These findings strongly corroborate the hypothesis of an information content of abnormal volume.