INDEX PARTICIPATION UNITS AND THE STRUCTURE OF EQUITY MARKET DEMAND: EVIDENCE FROM NEW ISSUES AND REDEMPTIONS OF SPDRS

by

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ABSTRACT

This study examines the effects of trading in Standard and Poor's Depository Receipts on the pricing efficiency of the index options markets. Using the put-call parity model's no-arbitrage arguments, and intra-day S&P 500 index option data, three boundary conditions are formulated and tested for a total of 119,470 portfolios using intradaily data. Problems of non-synchronous prices are reduced by using intradaily data and also by considering only trades that occur at precisely the same time to the second. The tests indicate that there are significant violations of the arbitrage relations. After accounting that transactions costs including the bid-ask spread, it is apparent that the magnitude and frequency of violations of the arbitrage bounds has decreased, since the introduction of SPDRs. However, the dollar size of the violations that persist through time is substantial and may be worthy of future investigation.

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