UNIVERSITY OF MACAU

FACULTY OF BUSINESS ADMINISTRATION

AN EMPIRICAL STUDY ON CALLABLE BULL/BEAR CONTRACT --- DETECTION OF INFORMED TRADER AND CORRELATIONS BETWEEN RETURN OF UNDERLYING STOCKS AND CBBC ISSUANCE ACTIVITY

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Abstract

It is important to investigate the degree to which the Callable Bull/Bear Contract (CBBC) issuance activity affects the price and volume of the underlying stock. As a newly introduced financial structured product as of 2006, a key feature is that a CBBC issues a call-back price. As a result, there has been dramatic growth in the number of issuances and in trade volume. Hence, in this paper, we examine the relationship between the underlying stock price and the volume associated with the related CBBC issuance and mandatory call-back event to show the existence of the informed trader. We discover that the informed trader trades during the CBBC announcement day and during hedging activity, thus causing a significant effect on price and trading volume during the issuance of a CBBC. These findings are consistent with the previous literature on the derivation warrant (DW). However, we contribute to the field by discovering the price manipulation and rewinding hedge position during the mandatory call-back event, which induces the abnormal return and volume for the underlying stock during the mandatory call-back for both callable bull contracts (bull contract) and callable bear contracts (bear contract) in our empirical result. We test the correlation between the bull/bear ratio of the underlying stock and its return and find that the results indicate that outside investors do not have any

advantages with this number. In fact, information asymmetry is usually on the side of the issuer.

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