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Japan and Hong Kong Exchange-Traded Funds (ETFs): Discounts, Returns, and Trading Strategies

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Abstract

Foreign exchange-traded funds (ETFs) trade on U.S. exchanges but provide broad exposure to foreign markets. ETFs are designed to minimize the deviation between price and value of the underlying securities. However, nonoverlapping trading hours between the United States and many foreign markets inhibit this mechanism. The data for Japan and Hong Kong iShares show that deviations exist between the ETF price and the value of the underlying securities. The deviations are positively related to subsequent ETF returns creating potential profit opportunities. A simple trading rule based on this observation produces impressive gross returns when compared to a buy-and-hold strategy.

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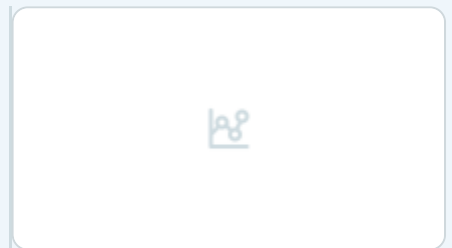
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Author information

Authors and Affiliations

Monfort College of Business, University of Northern Colorado, USA

Timothy E. Jares

University of South Dakota, USA

Angeline M. Lavin

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