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Dynamic relations between order imbalance, volatility and return of top gainers

Yong-Chern Su, Han-Ching Huang & Shiue-Fang Lin

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Abstract

Investors have been working hard to find the best trading strategy. Previous studies suggest that order imbalance can be a state variable in explaining cross sectional stock return. I ... ce, volatility and stoc ... d trading strategy ... Autoregr ... e intraday dynamic ... tive relation betw ... e effect propo ... order imbalan ... eous order imbalan ... gnificantly negative ... market maker e ... lance based trading strategy. To explore the profitability of our trading strategy, we examine the

causal relationship between return and order imbalance. We find that order imbalance is a good indicator for price discovery. Moreover, order imbalance is a better indicator for predicting returns in large firm size quartile.

Notes

[1] Small firm effect means that those companies with a smaller market capitalization outperform larger companies. This market anomaly is a factor used to explain superior returns in the three factor model by Fama and French (1992). The three factors are the market return, companies with high book-to-market values and small stock capitalization.

[2] VIX, VXN represent the implied volatility of options on S&P100, NASDAQ100, respectively. According to Arak and Mijid (2006), the value of VXN is always larger than that of VIX from 1995 to 2002.

[3] Lee et al. (2001) use 6-minute intervals with each interval containing nearly 12 trades on average. Ekinci (2004) constructs 5-minute intervals for an intraday analysis of stocks with 27.3 trades per interval on average. We shorten the time interval for the sample period of each stock is only one day. In addition, we use 1.5-minute intervals to catch the intraday seasonality for NASDAQ dealers are required to report trades within 1.5 minutes.