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Momentum in the Chinese Stock Market: Evidence from Stochastic Oscillator Indicators

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ABSTRACT

We explore whether investors earn profits through the use of stochastic oscillator indicators (SOI) for trading stocks. The results reveal that investors might use momentum strategies when trading constituent stocks of SSE 50 as the overbought trading signals emitted by SOI. We infer that the results might be caused by herding behaviors of Chinese investors since overoptimistic moods are likely to exist as evidenced by the 80 percent trading volume traded by individual investors in the Chinese stock market.

KEY WORDS:

contrarian strategy momentum strategy overreaction hypothesis stochastic oscillator indicators

Notes

1. Stochastic oscillator indicators (SOI) such as K and D values will be explained in detail in a later section.

2. For SOI indicators, such as K and D values, the K values over eighty (below twenty) are regarded as overbought (oversold) zones in accordance with the SOI trading rule. The selling signals are emitted as SOI falls into the overbought zone; buying signals are emitted as the SOI falls into the oversold zone.

3. The overbought zone is set as K value > 80 in general. This study also sets stricter overbought zones such as K > 85 and K > 90. Similarly, the oversold zone is set as K < 20 in general. We also set sticker oversold zones, such as K < 15 and K < 10.

4. The nine-day K and D values often applied in the real world are employed (i.e., N is set as nine in this study). We would also treat RSV = Kfor (4) when no prior K is available, and K= D for (5) when no prior D is available.

5. The five-day MA is regarded as weekly MA whereas the twenty-day MA is deemed as monthly MA because a week is composed of five trading days and a month has about twenty trading days.

6. The holding period returns include the one-, two-, three-, four-, and five-day CARs defined as short-run holding period returns and the ten-, twenty-, thirty-, forty-, and fifty-day CARs defined as long-run holding period returns in this study.