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The Effect on Spread and Volume of Switching to the NASDAQ National Market System

H. Kent Baker & Richard B. Edelman

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larly) be observed in times of exceptional market conditions. From a statistical perspective, it may be interesting to investigate how *sensitive* the results are to these events.

We reestimated Equation (2) with a **dummy variable** for October 1987. While the statistical significance of the results decreases (remaining, however, significant in three cases), the general picture is not very different: The size of the timing coefficients remains within the order of magnitude observed for professionally managed funds.

These findings are not very encouraging. While Cumby and Modest claim that the traditional Henriksson-Merton timing test is rather weak in discovering timing ability, our findings demonstrate that traditional performance tests are even likely to indicate excess performance for stock market indexes![8] Whether this perverse finding should be attributed to the statistical procedures or to the indexes under investigation (or both) is an open question. One could easily argue that the results simply illustrate the dubious quality of the indexes analyzed. It should, however, be kept in mind that *all* five indexes are widely used by the financial community and are regarded, because of their high correlation, as close substitutes.

We believe our findings illustrate how sensitive performance measures are to the empirical specification of the benchmark index.[9] There is no reason to suspect that this problem is limited to the Swiss market.[10]

Footnotes

1. *See, for example, M. Jensen, "The Performance of Mutual Funds in the Period 1945–1964,"* Journal of Finance *23 (1968), pp. 389–416; E. Chang and W. Lewellen, "Market Timing and Mutual Fund Investment Performance,"* Journal of Business *57 (1984), pp. 57–72; H. Henriksson, "Market Timing and Mutual Fund Performance: An Empirical Investigation,"* Journal of Business *57 (1984), pp. 73–96; M. Grinblatt and S. Titman, "A Comparison of Measures of Mutual Fund Performance on a Sample of Monthly Mutual Fund Returns,"* Journal of Business *62 (1989), pp. 383–416; and R. Cumby and J. Glen, "Evaluating the Performance of International Mutual Funds,"* Journal of Finance *45 (1990), pp. 497–521.*
2. *FTA world index as of September 28, 1990.*
3. *The FTA index is the most atypical of the indexes, because it does not include registered stocks.*
4. *This is because, over the sample period, bearer stocks exhibited a significantly lower average return than registered stocks (and the FTA index does not, as noted, include registered stocks).*
5. *This potentially explains the Pictet-SBC100 regressions, because the Pictet index contains a relatively large number of small firms compared with the SBC100. It fails to explain, however, the results for the Pictet-SPI regressions; the number of small firms is much higher in the SPI than in the Pictet index.*
6. *R. Merton, "On Market Timing and Investment Performance I: An Equilibrium Theory of Value for Market Forecasts,"* Journal of Business *39 (1981), pp. 363–406, and R. Merton and R. Henriksson, "On Market Timing and Investment Performance II: Statistical Procedures for Evaluating Forecasting Skills,"* Journal of Business *54 (1981), pp. 513–533.*
7. *This is documented in H. Zimmermann and C. Zogg-Wetter, "Performance-Messung schweizerischer Aktienfonds" (Discussion paper, Swiss Institute of Banking and Finance, Hochschule St. Gallen, 1991).*
8. *R. Cumby and D. Modest, "Testing for Market Timing Ability,"* Journal of Financial Economics *19 (1987), pp. 169–89.*
9. *Of course, the theoretical point about the mean-variance efficiency of the benchmark has been addressed several times, starting with R. Roll, "A Critique of the Asset Pricing Theory's Test: On Past and Potential Testability of the Theory,"* Journal of Financial Economics *4 (1977), pp. 129–76.*
10. *We thank Swiss Bank Corp, Pictet & Cie, Telekurs, Goldman Sachs and Morgan Stanley International for providing data for this study and the Grundlagenforschungsfonds at the Hochschule for partial financial support. Martin Drummen provided helpful comments.*

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H. Kent Baker,
Professor of Finance and Chair, Department of Finance and Real Estate, The American University,
Richard B. Edelman,
Professor of Finance, The American University

The over-the-counter market consists of several segments, the two most important being the NASDAQ and the NASDAQ/NMS. Each year, many companies switch from one segment to another. The evidence shows that moving from NASDAQ to NASDAQ/NMS tightens spreads and increases volume. These results suggest that NMS inclusion enhances liquidity by lowering transaction costs.

This note reports on the empirical results of an analysis of how bid-ask spreads and volume respond when a firm switches from the National Association of Securities Dealers' Automated Quotations system (NASDAQ) to the NASDAQ National Market System