

FTS DOW School Case (DJIA Stocks) Project: Efficient Markets with Public Information

Question: What is the profitability of trading on public information and how does this relate to the semi-strong form of the efficient market hypothesis?

Public information comes in many forms including economy wide information that affects all stocks, firm specific information that affects an individual stock and its competitors. The semi-strong form of market efficiency can be assessed relative to public information by studying both forecasts and realizations of events. When testing sources of public information, you must be careful to guard against biases that arise from data snooping, ex post selection and manipulation of information, ignoring transaction costs and risk.

The objective of this project is to become acquainted with some of these issues using the FTS DOW School case. You will test the semi-strong form of the efficient market hypothesis (EMH) under conditions that do not suffer from the biases listed above. To do so, complete the following five steps:

1. Identify a source of public information that you are interested in testing using any subset of the DJIA stocks. Be careful to identify whether this source is firm specific or economy wide, and whether or not it involves a forecast and/or a realization of an event.
2. Form a short term view for your subset of stocks and translate this view into a trading strategy.
3. Implement your trading strategy using the Real Time FTS Client. This may include exploiting both limit and stop order capabilities of the FTS Real Time client. This step controls against the biases raised above, because your strategy is implemented *ex ante*.
4. Analyze your trading strategies using the reporting capabilities of the real time FTS Client including additional analysis using Excel and the data export capabilities of the FTS Real Time Client.
5. Answer the following question: How profitable was your trading strategy when implemented over the time period tested? Is this consistent or inconsistent with the semi-strong form of the efficient markets hypothesis? Note: You should first define what the semi-strong form of the EMH is and then compare your realized trading results along important predicted dimensions of this hypothesis. Although you are constrained by the time horizon of the project you should consider the nature and speed of the market adjustment, whether or not the short term market reaction is consistent with your view and how to assess whether a risk adjusted return was earned.

Example:

A good starting place is to work from the pre-assigned links in the FTS Real Time Client by double clicking on any of the stock tickers to check current firm specific events and forecasts and then extend your search by using key words like "Economic Calendar, Forecasts" using a search engine or other sources you have access to. You will soon be immersed in a very large amount of public information.