

Session 22

Information Trading: Trade on the news?

Test

1. In an efficient market, which of the following should happen when good news hits the market?
 - a. Stock prices should not change. In an efficient market, the news is already impounded in the price.
 - b. Stock prices should jump on the news announcement and be flat thereafter.
 - c. Stock prices should jump on the news announcement and continue to drift up in the periods after.
 - d. Stock prices should jump on the news announcement but then reverse themselves and drift down.
 - e. Stock prices should drop on the news announcement.
2. If you notice that prices start drifting up before good news reaches the market, what would you view it as a sign of?
 - a. An efficient market that starts impounding information into prices even before the information is public.
 - b. A slow learning market, because drifts are consistent with slow learning.
 - c. A market where insiders are trading ahead of information, legally or otherwise.
3. If you want to try to trade ahead of news announcements, which of the following variables will you need to track?
 - a. Trading volume on the stock
 - b. Stock prices
 - c. Activity in options listed on the stock
 - d. Earnings revisions from analysts
 - e. All of the above
4. If you believe that markets over react to news, which of the following actions would you take to generate excess returns?
 - a. Buy immediately if stock prices jump significantly on a news announcement.
 - b. Buy immediately if stock prices drop significantly on a news announcement.
 - c. Buy immediately if stock prices are flat on a news announcement.
5. If you believe that the market price for an asset has adjusted appropriately to a news announcement, but you feel that the volatility has increased too much (given the news), which of the following volatility trading strategies would you adopt?
 - a. Buy the stock
 - b. Sell short on the stock
 - c. Buy options on the stock, while minimizing price exposure.
 - d. Sell options on the stock, while minimizing price exposure.