

FOREIGN INVESTOR FEEDBACK TRADING IN AN EMERGING FINANCIAL MARKET

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- **OVERALL SUMMARY**
- **PAPER FINDINGS AND NOVEL FACTS**
- **PAPER'S CONTRIBUTION AND ADDITIONAL PERSPECTIVES**

OVERALL SUMMARY - WHAT DOES THIS PAPER EXAMINE AND FIND?

- This paper examines the trading behavior of non-residents (foreigners) in Thai financial markets using detailed regulatory order flow data.
- The financial markets concern three asset classes: foreign exchange, equity, and fixed income markets.
- Additionally, the paper emphasizes heterogeneity concerning investors - (i) foreign (ii) local and (iii) within heterogeneity of local investors.
- Data sourced from the Thailand Stock Exchange Market, Thai Bond Market Associations and Bank of Thailand.

WHAT DOES THE PAPER FIND AND WHAT ARE THESE NOVEL FACTS

- **First**, foreign investors engage in positive feedback trading in all three asset classes, and their trading decisions resemble momentum trading rather than strong portfolio rebalancing activity between asset classes.
- **Second**, innovations to foreign investor order flows are informative of future returns, but the information is not based on local macro fundamentals. That is, informational content concerning future returns is not based on local macroeconomic fundamentals.

WHAT DOES THE PAPER FIND AND WHAT ARE THESE NOVEL FACTS

- **Third**, sophisticated local financial investors - institutional investors, asset managers and banks - tend to mimic foreign investor trading, while non-sophisticated investors (corporates and retail investors) consistently provide liquidity. Thus, sophisticated local investors follow the lead of foreign investors.
- **Fourth**, further tests in this study suggest that the profitability of momentum trading is positively related to the amount of foreign capital flowing into local financial markets.

WHAT DOES THE PAPER FIND AND WHAT ARE THESE NOVEL FACTS

- **Fifth and combining all these points**, this study shows that a higher degree of foreign investor participation in Thai financial markets, alters the trading behaviour of local investors and it can reduce the importance of local fundamentals in driving asset prices.
- Yet again, foreign investors bring new information to local markets and it literally pays to follow the behaviour of foreign investors. Additionally, this study finds that the explanatory power of macroeconomic news is substantially lower for foreign investor trading compared to local investors.

- **First contribution:** This paper contributes to several strands of literature exploring heterogeneous trading dynamics among investors, typically foreign and local investors.
- Relative to other studies, this paper progresses to use regulatory data concerning the investor conduct within local investors in the form of sophisticated local investors and unsophisticated local investors .
- Thus, trading behavior with emphasis on heterogeneity associated with investors.

- **Second contribution:** This paper contributes to the discussion about the differences in the information set of foreign and local investors and this is reinforced by the finding that foreign investors bring new information to Thai local markets. Additionally, this study finds that the explanatory power of macroeconomic news is substantially lower for foreign investor trading compared to local investors.
- **Third contribution:** This paper contributes to previous studies concerning Thai financial markets and this paper progresses from previous studies using regulatory Thai data by examining different investor types and across three asset classes.


- **Fourth contribution and implicit in the paper:** An upon impact question that may arise is why this paper has not examined or compared relative to Chinese financial markets?

There is validity with respect to such a question to the extent to which there is (i) rapid growth of the onshore and offshore market trading of the (Chinese) RMB and (ii) an increase in the RMB trading global share.

- **Additionally:** there is rapid development of the fixed income market concerning RMB bonds issued onshore by Corporates and Banks (Panda) and offshore (Dim-Sum Bonds).
- See, McCauley and Shu (2019) - Journal of International Money and Finance 95, 444-456 and BIS Triennial Central Bank Survey OTC foreign exchange turnover in April 2022.

- **Fourth contribution and implicit in the paper:** However, it is difficult to have access to a holistic account of investment flows, especially over a 10-year period for China.
- This is within a context of increasing RMB internationalization both regionally in Asia and globally. As a result, this is one of the major added advantage of this research study relative to an examination of Chinese financial markets or any emerging financial markets for that matter.

ADDITIONAL PERSPECTIVES

- Consistent with the findings discussed above, to examine the relationship between order flow across different investors and returns across the three asset classes, this study uses an instrumental variable approach in a VAR framework based on returns and order flows (buying and selling pressure).
- What stands out the most and are reinforcing results is that relative to other asset classes, Thai equity markets exhibit a reinforcing effect.
- Following a positive returns shock to equity, the response of foreign investor buying of Thai equities is more persistent and it remains positive and statistically significant for almost two weeks of trading activity.
- This is evident with a positive upon impact increase in foreign investor buying and an additional increase that reaches a peak. 

- For other assets, the effect of a positive returns shock usually lasts for about a day of foreign investor trading activity, with a gradual adjustment thereafter. This follows an upon impact increase in foreign investor buying.
- On the other hand, a one unit positive shock to foreign investor buying, generate higher asset returns across all three asset classes.

- **However**, what stands out is that the response of Thai equity is an upon impact increase in returns by almost 200 basis points relative to a 27 basis points and 75 basis points increase in fixed income securities and foreign exchange.
- Thus, Thai equity markets exhibit a reinforcing effect and particularly with respect to impact of foreign investor buying pressure on driving and increase Thai equitiy returns.
- Similarly, increases in Thai equity returns generating persistent buying pressure from foreign investors in a manner consistent with momentum strategy buying.

THANK YOU FOR YOUR ATTENTION!

- Bank for International Settlements - Triennial Central Bank Survey OTC foreign exchange turnover in April 2022.
- Bank for International Settlements - Triennial Central Bank Survey OTC interest rate derivatives turnover in April 2022 OTC interest rate derivatives turnover.
- Federal Ministry for Economic Affairs and Climate Action of Germany (BMWK), 2022. Facts about German Foreign Trade, July 2022.
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