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Journal of Behavioral and Experimental Finance
Volume 20, December 2018, Pages 1-8

Trading aggression when price limit hits are imminent: NARDL based intraday investigation of magnet effect (Article)

Sifat, I.M., Mohamad, A.

Department of Finance, Kulliyyah of Economics and Management Sciences, International Islamic University Malaysia, Kuala Lumpur, 53100, Malaysia

Abstract

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Utilizing an experimental Non-linear ARDL technique (NARDL), this paper tests an ex-ante hypothesized side-effect of financial market circuit breakers called the magnet effect. The hypothesis states that, in large price swing scenarios, circuit breakers (limits or halts), by their very existence, invite trading activities toward themselves in a way that the prophecy of the trigger is fulfilled. Most empirical works testing this effect hail from East Asian exchanges, which typically employ a tight price band. Our empirical venue, Bursa Malaysia, is a marked exception, sticking to a ±30% limit since 1989. Employing high-frequency (millisecond) proprietary intraday data from 2015 to 2017, we examine the magnet effect through order aggression and price velocity as the possibility of a limit draws closer. We find evidence of moderate magnet effect for most stocks, suggesting accelerated trading activities proportionate to likelihood of a limit-hit. The effect is more pronounced for lower limit stocks. Interestingly, several upper limit scenarios also exhibit the opposite of magnet effect: the repellent effect, suggesting investors recoil from trading when a limit-hit appears imminent. We discuss several regulatory, industry, and academic implications of our findings. © 2018 Elsevier B.V.

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Author keywords

Circuit breakers Magnet effect Malaysia NARDL Price limits Trading halts

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Funding details

Funding sponsor	Funding number	Acronym
International Islamic University Malaysia	FRGS 15-232-0473	IUM

Funding text

We thank the Ministry of Higher Education of Malaysia and Research Management Centre of International Islamic University Malaysia for providing the research grant (FRGS 15-232-0473).

ISSN: 22146350

Source Type: Journal

Original language: English

DOI: 10.1016/j.jbef.2018.01.007

Document Type: Article

Publisher: Elsevier B.V.

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