

SUMMARY

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In this project we examined the impact of short sales constraints on trading and price efficiency by focusing on activity surrounding securities class action lawsuits. Because of a Securities and Exchange Commission program beginning in 2005, certain stocks (“pilot stocks”) had short sales constraints temporarily lifted. We compared trading and price information for pilot stocks and non-pilot stocks that were facing shareholder litigation by analyzing stock data for the dates around the filing of the lawsuits. The interest of the research was to ascertain whether removing short sales restrictions changed the way that information was incorporated into trading. Because of the unique events surrounding each class action lawsuit, further analysis is required to determine what effect the constraint-lifting had on stock trading.

As research assistant, I began my work by doing a literature review of journal articles on two topics: short sales constraints and securities class action lawsuits. I read and summarized key articles relevant to our interests. I also added information to our database of securities class action lawsuits (which came from the Stanford Securities Class Action Clearinghouse) by researching ticker name changes, mergers, acquisitions, and bankruptcies affecting the companies which faced litigation. I then was introduced to the statistical software program SAS, and I learned basic programming functions. I used SAS to analyze price, volume, depth, liquidity, and other trading measures to compare pilot and non-pilot stocks. Next, I wrote a Macro program in SAS to create matches between pilot and non-pilot stocks, based on book-to-market ratio, trading volume, and size, and I then performed more analysis using only these matched pairs. (There were many more non-pilot than pilot stocks facing class action lawsuits.) Finally, I used the Factiva online database to search for newsworthy events (e.g., earnings reports, rating changes, results of clinical trials) in the months surrounding the lawsuit filings.

I learned much about how the market works from this experience. From the background literature, I began to understand how short-selling takes place, why constraints were in place, and what impact they might be having. I also learned how to use SAS, giving me access to a tool that makes analyzing hundreds of thousands of pieces of information a quick procedure. Perhaps most importantly, I learned how economics research takes place, from the questions and background research to the data-gathering, analysis, and interpretation.

For these reasons, I was very happy with my SRO experience. I gained exposure to what life as an economics researcher might be like, I acquired specific knowledge regarding an aspect of financial markets, I learned how to use a type of statistical software, and I had the opportunity to think critically about the work that I was doing. I was pleased with the experience, and I look forward to performing more economics research in the future.