

Institutional Trading Confirms Mispricing in Value and Glamour Stocks

Institutional investors exploit expectation errors in value versus glamour stocks by buying value stocks with strong fundamentals and selling glamour stocks with weak fundamentals.

A study examined institutional investors' buying and selling of mispriced value/glamour stocks based on book-to-market (the inverse of price-to-book value) anomalies, financial strength, institutional ownership and arbitrage availability. To determine book-to-market anomalies and financial strength of value and glamour stocks, quarterly observations were made on institutional ownership of stocks in the U.S. from 1982 to 2015 using the Thomson Reuters Institutional Managers Holdings database.

The researchers noted that institutional investors tended to buy fundamentally strong firms in value stocks and sell fundamentally weak firms in glamour stocks. Joseph Piotroski's F-Score, comprising nine fundamental factors, was used to measure financial strength: High F-Scores indicate undervaluation (strong fundamentals) and low F-Scores indicate overvaluation (weak fundamentals).

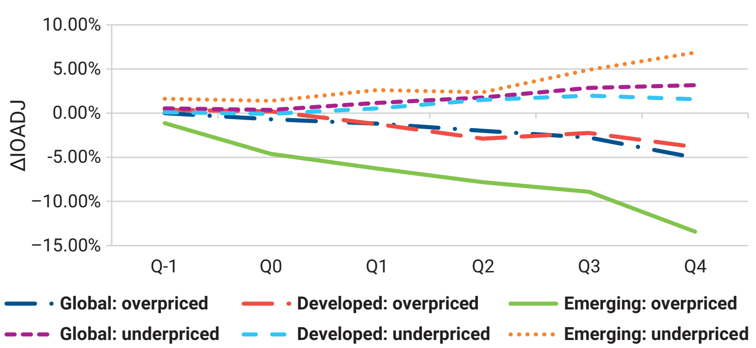
The returns on value/glamour stocks were largest in the stocks with expectation errors—i.e., high F-Score value stocks and low F-Score glamour stocks. Institutional investors were found to trade according to the book-to-market anomaly in undervalued/overvalued stocks. In the stocks that appear more fairly priced, more institutional buying takes place in glamour stocks (with strong fundamentals) and less in value stocks (with weak fundamentals).

Mutual funds and hedge funds were more likely to participate in these types of trades than passive-leaning institutional investors, such as banks and insurance companies.

The study's conclusions are useful for individual investors who utilize metrics, such as the F-Score, to exploit market mispricing. If investors can take advantage of these market mispricings, they may be able to create a strategic advantage.

Source: "Do Institutional Investors Exploit Expectation Errors in Value/Glamour Stocks?" by Iftekhar Hasan, Jianfu Shen and Chi Cheong Allen Ng; SSRN, December 2022.

Cumulative Changes of Size-Adjusted Institutional Ownership for Mispriced Stocks: Global Markets (excluding U.S.)



Clickbait or Cash Cow? The Cost of Following Finfluencers

Financial influencers on social media often give poor advice, prioritizing fame and money over genuine financial education.

A study by the Swiss Finance Institute analyzed over 29,000 tweets on the X platform to determine the impact of financial influencers—called finfluencers—on their followers and to assess the quality of the financial information being disseminated. The researchers categorized finfluencers into one of three groups—skilled, unskilled and "antiskilled" (defined in the study as having negative skill)—based on the value of their financial advice.

In the analysis, 56% of finfluencers were identified as antiskilled, consistently providing advice that results in negative returns (–2.3% monthly). Only 28% were determined to be skilled, generating positive returns (2.6% monthly). Sixteen percent were deemed unskilled, having no significant impact.

Users often follow finfluencers based on personal bias, not financial expertise. This tends to boost the popularity of poor advisers, which can harm investors and distort markets. The research suggests that betting against the recommendations of finfluencers with negative skill could be profitable due to their consistently poor advice.

The trend of social media platforms rewarding the loudest finfluencers, who make extraordinary claims to drive traffic and engagement, poses a significant challenge. This issue is particularly pronounced in the cryptocurrency space, where influencers with little expertise can promote dubious projects, leading to significant financial losses for their followers.

To combat this, social media users need to critically evaluate the quality of financial advice and favor content from knowledgeable sources. By doing so, accurate and beneficial financial information can reach a broader audience, ultimately improving overall financial literacy and reducing the influence of harmful advice. This approach not only helps individual investors make better decisions but also contributes to a healthier financial ecosystem overall.

Source: "The Power of Clicks, Likes, and Shares: Promote the Right Kind of Financial Content," by Alfonso Ricciardelli, CFA, and Pedram Parhizkari, CAIA; CFA Institute Enterprising Investor blog, May 16, 2024.