

Chapter 1 : liquidity theory

Liquidity preference theory suggests that an investor demands a higher interest rate, or premium, on securities with long-term maturities, which carry greater risk, because all other factors being.

We measure both supply—the amount of shares available for investors to buy—and demand—the amount of money available to buy these shares. We explain the implications of changes in supply and demand indicators for stock prices: Increasing supply is bearish. All else being equal, more shares translate into lower stock prices. Conversely, decreasing supply is bullish. All else being equal, fewer shares translate into higher stock prices. Some demand indicators are leading, while others are contrary. Increasing demand is generally bullish, except when inflows become extremely high. We show investors how to use supply and demand indicators to make money. We offer five model portfolios in our weekly reports: Companies are among the biggest players in the stock market because they actively control the amount of shares available for investors to buy. We provide daily coverage of corporate buying through cash takeovers and stock buybacks. We provide daily coverage of corporate selling through new offerings—IPOs, follow-ons, secondaries, and convertibles—as well as insider selling. We offer comprehensive coverage of fund flows: Daily coverage of the flows and returns of 4, U. Daily coverage of the flows and returns of all U. Monthly coverage of the flows of saving vehicles. Our mutual fund and exchange-traded fund data can be aggregated by sector and sub-sector. We provide detailed coverage of margin debt, short interest, futures flows, and various sentiment indicators. The TrimTabs Demand Index uses regression analysis of fund flow and sentiment variables for intermediate-term market timing. The index has had an outstanding track record since its launch in September. We measure wage and salary growth and employment growth based on real-time income tax withholdings data from the U. We analyze a wide range of other leading economic indicators, including credit indicators, unemployment claims, surveys of manufacturers and purchasing managers, and housing indicators. The TrimTabs Macroeconomic Index is a correlation weighted index of weekly leading economic indicators. It has done an excellent job identifying major economic inflection points. It relies on the "publisher exclusion" from the definition of an investment adviser under Section a 11 of the Investment Advisers Act of and corresponding state laws. TTIR provides bona fide research services and investment newsletters that are generally available for subscription by the public. It does not provide any personalized advice.

Chapter 2 : Financial market - Wikipedia

In business, economics or investment, market liquidity is a market's feature whereby an individual or firm can quickly purchase or sell an asset without causing a drastic change in the asset's price.

Strahan The 2008 financial crisis was the biggest shock to the banking system since the 1930s, raising fundamental questions about liquidity risk. The global financial system experienced urgent demands for cash from various sources, including counterparties, short-term creditors, and, especially, existing borrowers. Credit fell, with banks hit hardest by liquidity pressures cutting back most sharply. Central bank emergency lending programs probably mitigated the decline. Ongoing efforts to regulate bank liquidity may strengthen the financial system and make credit less vulnerable to liquidity shocks. Financial institutions provide liquidity to depositors and creditors by standing ready to provide them cash on demand. In the traditional framework, liquidity risk stemmed from the possibility of bank runs. Such runs could make banks insolvent by initiating a chain reaction that forced a fire sale of illiquid loans. In the past, such instability was partly checked by reserve requirements tied to deposits, deposit insurance, and the availability of liquidity from central banks, the lenders of last resort. More recently, liquidity risk has come less from deposit outflows and more from exposure to a range of lending and interbank financial arrangements. These include undrawn loan commitments, obligations to repurchase securitized assets, margin calls in the derivatives markets, and withdrawal of funds from wholesale short-term financing arrangements. For example, banks today often lend by extending credit lines that borrowers can tap on demand, or by making other kinds of loan commitments. Increases in borrower use of these commitments make this business risky. When the overall supply of liquidity falls, borrowers draw on funds from existing credit lines en masse. Thus, in the 2008 financial crisis, nonfinancial firms lost access to short-term funds when the commercial paper market dried up. Commercial paper issuers turned instead to prearranged backup lines at banks to refinance their paper as it came due. Banks were obligated to fund such loans. As a result, funds became less available for new lending. Nonfinancial business demand for liquidity also increased during the crisis to meet high precautionary demands for cash. Many businesses drew funds from existing credit lines simply because they feared continued disturbances in the credit markets. Annual Call Reports for all U.S. Banks finance their balance sheets with more than just deposits and equity capital. Other liabilities include uninsured wholesale deposits, repurchase agreements, and other short-term unsecured debt instruments. These sources became scarce during the crisis. For example, repurchase agreements, known as repos, were often used to finance risky assets such as private-label mortgage-backed securities. Gorton and Metrick show that, in the middle of 2007, mortgage-backed securities could be almost completely financed with short-term borrowed funds in the repo market. Banks that used repos to finance purchases of mortgage-backed securities faced an unpleasant choice. They could sell their securities holdings into a falling market and take a big loss. Or they could find new, and presumably expensive, sources of credit. Figure 2 Cumulative business-loan growth since recession onset Source: In the case of nonbank brokerage firms, the collapse of the repo market was a calamity. However, it was less of a disaster for commercial banks because they could use increases in deposits to bridge the financing gap. Figure 1 shows how these sources of liquidity risk affected overall bank credit during the crisis. Off-balance-sheet loan commitments rose steadily from 2000 to 2007. Overall bank credit production, including both on- and off-balance-sheet credit commitments, started to fall in the middle of 2007. The decline accelerated sharply in the last quarter of 2008. By contrast, loans held on bank balance sheets continued to rise until the end of 2008. That rise in on-balance-sheet loans during the crisis was due to borrowers drawing down preexisting credit lines. Banks began cutting back new lending in the middle of 2008. This illustrates how bank obligations to existing borrowers crowded out new borrowers. Figure 2 uses weekly Federal Reserve data to show the cumulative growth of business loans on bank balance sheets. Unlike earlier recessions, loan balances continued to rise until almost 50 weeks into the Great Recession. This reflects movement of loans onto bank balance sheets from preexisting off-balance-sheet commitments, either credit lines or other guarantees Acharya, Schnabl, and Suarez, forthcoming. How did banks manage liquidity during the crisis? How did banks manage the liquidity shock of

the “crisis”? To what degree did banks boost their holdings of cash and other liquid assets as a buffer? More importantly, did bank efforts to raise liquidity reduce the availability of credit? The Federal Reserve sets aggregate liquidity in the banking system. Hence, focusing on aggregate liquidity merely tells us what the Fed is doing see Keister and McAndrews. By contrast, Cornett et al. These variations help explain differences in bank behavior during the crisis. This example ignores loan losses and provisions for simplicity. Banks more exposed to liquidity risk increased their holdings of liquid assets most. They also reduced new lending most. Liquidity exposure affected behavior along several dimensions. On the asset side, banks holding securities with low liquidity, such as mortgage-backed securities, expanded their cash buffers during the crisis and decreased new lending. Such banks were worried about their ability to finance securitized assets. They protected themselves by hoarding liquidity, to the detriment of borrowers. On the liability side, banks that relied more on wholesale sources of funding cut new lending significantly more than banks that relied predominantly on traditional deposits and equity capital for funding. Cornett and coauthors also test how banks managed sudden rises in loan demand during the crisis stemming from off-balance-sheet loan commitments. Banks with higher levels of preexisting commitments increased their holdings of liquid assets and simultaneously cut back on new credit origination. Thus, loan commitment drawdowns displaced new credit origination during the crisis. Table 1 illustrates how the balance sheet of a hypothetical bank might have adjusted to these liquidity pressures. Meanwhile, the bank loses half its short-term funds as markets dry up. The bank has no choice but to scale back its overall provision of credit. Avoiding another credit collapse Liquidity crises may be inherently hard to avoid, but can we minimize their adverse effects on credit supply? Cornett and coauthors consider this question by using a statistical model of changes in credit production. The model estimates how much bank efforts to strengthen balance sheets displaced lending during the fourth quarter of . The model also simulates the total credit production that would have occurred if all banks had entered the crisis with low liquidity-risk exposure. Since banks heavily exposed to off-balance-sheet commitments cut credit sharply, the model allows us to compute how much such a bank would have changed its credit production had it entered the crisis with low levels of commitments. Cornett and coauthors estimate similar adjustments across the other dimensions of liquidity-risk exposure. Each of these changes are calculated across the banking system to measure how loans and total credit would have changed. To be sure, this simulation is uncertain because of potential changes in regulation, technology, and banking industry structure. Nevertheless, the results suggest ways to make the banking system better able to withstand future liquidity shocks. For example, after these adjustments, bank accumulation of liquid assets during the fourth quarter of falls to almost zero. In other words, the model suggests there would have been no liquidity buildup had banks entered the crisis with low levels of liquidity-risk exposure. Conclusion The simulation highlights the importance of traditional deposits as a stabilizing source of funds and undrawn commitments as a potentially destabilizing source of asset-side liquidity exposure. These two effects are dominant, in contrast with other dimensions of liquidity exposure, such as investments in securitized assets. Moreover, this simulation suggests how to insulate credit provision from future liquidity shocks. The traditional banking framework managed liquidity risk through required reserves on deposits. As we have seen, deposits no longer bring liquidity risk. In fact, they insulate banks from such risk because deposits flow into banks when markets dry up. Thus, moving away from required reserves makes sense. Liquidity risk has not disappeared. It has simply changed form. These changes are recognized under the proposed Basel III regulatory framework, which would require banks to meet two liquidity-ratio tests. One, based on liquidity coverage ratio, focuses on the possibility that a bank would face cash demands over a day period under conditions of market stress. For example, increases in repo margins or systemic increases in loans taken down from existing credit lines would play an important role in these scenarios. Results from Cornett and coauthors suggest that such a requirement makes sense. Arrangements, such as off-balance-sheet commitments, that can rapidly ramp up cash demands on banks were a major reason why credit fell during the crisis. Gorton, Gary, and Andrew Metrick. Ivashina, Victoria, and David Scharfstein. Keister, Todd, and James McAndrews. This publication is edited by Sam Zuckerman and Anita Todd. Permission to reprint must be obtained in writing.

Chapter 3 : Liquidity Preference Theory

Amihud and Mendelson addressed this question more than thirty years ago in a paper in the Journal of Financial Markets. They said that postulating a liquidity risk premium resolves a puzzle raised by the capital asset-pricing model.

See Statistical analysis of financial markets , statistical finance Much effort has gone into the study of financial markets and how prices vary with time. This is the basis of the so-called technical analysis method of attempting to predict future changes. One of the tenets of "technical analysis" is that market trends give an indication of the future, at least in the short term. The claims of the technical analysts are disputed by many academics, who claim that the evidence points rather to the random walk hypothesis , which states that the next change is not correlated to the last change. The role of human psychology in price variations also plays a significant factor. Large amounts of volatility often indicate the presence of strong emotional factors playing into the price. Fear can cause excessive drops in price and greed can create bubbles. In recent years the rise of algorithmic and high-frequency program trading has seen the adoption of momentum, ultra-short term moving average and other similar strategies which are based on technical as opposed to fundamental or theoretical concepts of market Behaviour. The scale of changes in price over some unit of time is called the volatility. Large changes up or down are more likely than what one would calculate using a Gaussian distribution with an estimated standard deviation. Financial market slang[edit] Poison pill , when a company issues more shares to prevent being bought out by another company, thereby increasing the number of outstanding shares to be bought by the hostile company making the bid to establish majority. Bips, meaning "bps" or basis points. A basis point is a financial unit of measurement used to describe the magnitude of percent change in a variable. One basis point is the equivalent of one hundredth of a percent. Quant, a quantitative analyst with advanced training in mathematics and statistical methods. Rocket scientist , a financial consultant at the zenith of mathematical and computer programming skill. They are able to invent derivatives of high complexity and construct sophisticated pricing models. They generally handle the most advanced computing techniques adopted by the financial markets since the early s. Typically, they are physicists and engineers by training. IPO , stands for initial public offering, which is the process a new private company goes through to "go public" or become a publicly traded company on some index. White Knight , a friendly party in a takeover bid. Used to describe a party that buys the shares of one organization to help prevent against a hostile takeover of that organization by another party. Smurfing , a deliberate structuring of payments or transactions to conceal it from regulators or other parties, a type of money laundering that is often illegal. Bid-ask spread , the difference between the highest bid and the lowest offer. Pip , smallest price move that a given exchange rate makes based on market convention. The intermediary functions of financial markets include the following: Financial markets facilitate the transfer of real economic resources from lenders to ultimate borrowers. Financial markets allow lenders to earn interest or dividend on their surplus invisible funds, thus contributing to the enhancement of the individual and the national income. Financial markets allow for the productive use of the funds borrowed. The enhancing the income and the gross national production. Financial markets provide a channel through which new savings flow to aid capital formation of a country. Financial markets allow for the determination of price of the traded financial assets through the interaction of buyers and sellers. They provide a sign for the allocation of funds in the economy based on the demand and to the supply through the mechanism called price discovery process. Financial markets provide a mechanism for selling of a financial asset by an investor so as to offer the benefit of marketability and liquidity of such assets. The activities of the participants in the financial market result in the generation and the consequent dissemination of information to the various segments of the market. So as to reduce the cost of transaction of financial assets. Financial Functions Providing the borrower with funds so as to enable them to carry out their investment plans. Providing the lenders with earning assets so as to enable them to earn wealth by deploying the assets in production debentures. Providing liquidity in the market so as to facilitate trading of funds. Providing liquidity to commercial bank Facilitating credit creation.

Chapter 4 : Theory of Financial Markets - Oxford Scholarship

Research and Markets: Liquidity Modelling Guide on How to Model and Manage Liquidity Risk for Financial Market Practitioners Corporate and government notes and bonds accounted for 29 percent of all liquidity in , the largest single piece of liquidity for the year.

Overview[edit] This old church building for sale in Cheshire, England, has relatively low liquidity. It could be sold in a matter of days at a low price, but it could take several years to find a buyer who is willing to pay a reasonable price. A liquid asset has some or all of the following features: It can be sold rapidly, with minimal loss of value, anytime within market hours. The essential characteristic of a liquid market is that there are always ready and willing buyers and sellers. It is similar to, but distinct from, market depth , which relates to the trade-off between quantity being sold and the price it can be sold for, rather than the liquidity trade-off between speed of sale and the price it can be sold for. A market may be considered both deep and liquid if there are ready and willing buyers and sellers in large quantities. An illiquid asset is an asset which is not readily salable without a drastic price reduction, and sometimes not at any price due to uncertainty about its value or the lack of a market in which it is regularly traded. Before the crisis, they had moderate liquidity because it was believed that their value was generally known. Speculators are individuals or institutions that seek to profit from anticipated increases or decreases in a particular market price. Market makers seek to profit by charging for the immediacy of execution: By doing this, they provide the capital needed to facilitate the liquidity. The risk of illiquidity does not apply only to individual investments: Financial institutions and asset managers that oversee portfolios are subject to what is called "structural" and "contingent" liquidity risk. Structural liquidity risk, sometimes called funding liquidity risk, is the risk associated with funding asset portfolios in the normal course of business. Contingent liquidity risk is the risk associated with finding additional funds or replacing maturing liabilities under potential, future stressed market conditions. When a central bank tries to influence the liquidity supply of money, this process is known as open market operations.

Effect on asset values[edit] The market liquidity of assets affects their prices and expected returns. Theory and empirical evidence suggests that investors require higher return on assets with lower market liquidity to compensate them for the higher cost of trading these assets. Here too, the higher the liquidity risk, the higher the expected return on the asset or the lower is its price. The liquidity discount is the reduced promised yield or expected a return for such assets, like the difference between newly issued U. Treasury bonds compared to off the run treasuries with the same term to maturity. Initial buyers know that other investors are less willing to buy off-the-run treasuries, so the newly issued bonds have a higher price and hence lower yield. Some future contracts and specific delivery months tend to have increasingly more trading activity and have higher liquidity than others. The most useful indicators of liquidity for these contracts are the trading volume and open interest. There is also dark liquidity , referring to transactions that occur off-exchange and are therefore not visible to investors until after the transaction is complete. It does not contribute to public price discovery.

Managing liquidity is a daily process requiring bankers to monitor and project cash flows to ensure adequate liquidity is maintained. Maintaining a balance between short-term assets and short-term liabilities is critical. The investment portfolio represents a smaller portion of assets, and serves as the primary source of liquidity. Investment securities can be liquidated to satisfy deposit withdrawals and increased loan demand. Banks have several additional options for generating liquidity, such as selling loans, borrowing from other banks , borrowing from a central bank , such as the US Federal Reserve bank , and raising additional capital. In a worst-case scenario, depositors may demand their funds when the bank is unable to generate adequate cash without incurring substantial financial losses. In severe cases, this may result in a bank run. Most banks are subject to legally mandated requirements intended to help avoid a liquidity crisis. A lack of liquidity can be remedied by raising deposit rates and effectively marketing deposit products. A bank can attract significant liquid funds. Lower costs generate stronger profits, more stability, and more confidence among depositors, investors, and regulators.

Stock market[edit] In the market, liquidity has a slightly different meaning, although still tied to how easily assets, in this case shares of stock, can be converted to cash. Generally, this

translates to where the shares are traded and the level of interest that investors have in the company. For illiquid stocks, the spread can be much larger, amounting to a few percent of the trading price. When stock prices rise, it is said to be due to a confluence of extraordinarily high levels of liquidity on household and business balance sheets, combined with a simultaneous normalization of liquidity preferences. On the margin, this drives a demand for equity investments. Literature[edit] Christoph G. An empirical analysis of the impact of the financial crisis, ownership structures and insider trading. Abudy, Menachem Meni; Raviv, Alon Journal of Financial Stability.

Chapter 5 : Measuring Liquidity in Financial Markets

The Conference will include Game Theoretic Aspects of Liquidity and Financial Markets. It is organised by the Financial Research Centre, Corvinus University of Budapest and the Game Theory Research Group, Hungarian Academy of Sciences.

Chapter 6 : now publishers - Theories of Liquidity

CONFERENCE VOLUME 77 Financial Markets, Institutions and Liquidity Franklin Allen and Elena Carletti 1. Introduction One important reason for the global impact of the financial crisis was massive illiquidity.*

Chapter 7 : Market liquidity - Wikipedia

Liquidity in financial markets facilitates the efficient allocation of economic resources through the efficient allocation of capital and risk, the effective generation and dissemination of issuer-specific information, and the effectiveness of monetary policy and.

Chapter 8 : 9th Annual Financial Market Liquidity Conference | theinnatdunvilla.com

Liquidity plays a central role in the functioning of financial markets. Structural changes in the financial system that have been underway for some time increase the importance of market liquidity. The allocation of capital increasingly relies on securities markets, where funds for investment in the real economy are raised through the direct.

Chapter 9 : What Is Liquidity Preference Theory (LPT)?

Market liquidity refers to the extent to which a market, such as a country's stock market or a city's real estate market, allows assets to be bought and sold at stable prices.