Passive Ownership and Price Informativeness

Marco Sammon

Discussant Slides by Michael Green

3-24-2022

Key contributions

- Challenges Grossman-Stiglitz (1980) and Kyle (1985) models of information utility and absorption by utilizing changes in market reaction to earnings events and links them to growth of passive market cap

- Utilizes discrete information-release events to introduce three new empirical measures of price informativeness that do no rely on model assumptions (e.g. Bai 2016) and have clearly defined timeliness
    1. Pre-earnings volume vs other periods
    2. Pre-earnings drift
    3. Earnings-day volatility

- Conclusion that "average price informativeness has decreased over last 30 years"

- Clever testing of causality with "placebo earnings reports" and utilization of Russell and S&P 500 rebalancing events (pairs well with Chinco & Sammon 2022) to eliminate reverse causality

- Proposed mechanism of "decreased attention" for high passive ownership with empirical evidence of lower and less frequent analyst coverage, higher standard deviation of analyst estimates and reduced downloads of corporate filings

ABSTRACT

How does passive ownership affect the incorporation of information into stock prices? Motivated by two canonical models, I propose three new empirical measures of price informativeness. I find average price informativeness declined over the past 30 years and passive ownership is negatively correlated with price informativeness. To establish causality, I show that price informativeness decreases after quasi-exogenous increases in passive ownership arising from index additions and rebalancing. Finally, I provide evidence for a mechanism: investors expend less effort gathering information about stocks with a larger fraction of passive owners.

Key findings

- Market pricing
  1. "a 15% increase in passive ownership implies about a 0.02 higher IV D (implied volatility difference per Kelly 2016) on average (40% of increase over sample)"
  2. "a 15% increase in passive ownership would lead to a decline cumulative abnormal pre-earnings turnover of -1.68 (vs realized -1 over sample, ie more than 100%)"
  3. "a 15% increase in passive ownership would decrease the pre-earnings drift by -0.008 (40% of realized decline)"
  4. "a 15% increase in passive ownership would lead to a decrease in QV S (author measure of earnings volatility) of 6.1% (about 1/3rd of realized)"
- Information channel
  1. "ETF ownership is negatively correlated with downloads of SEC filings"
  2. "ETF ownership is negatively correlated with analyst coverage"
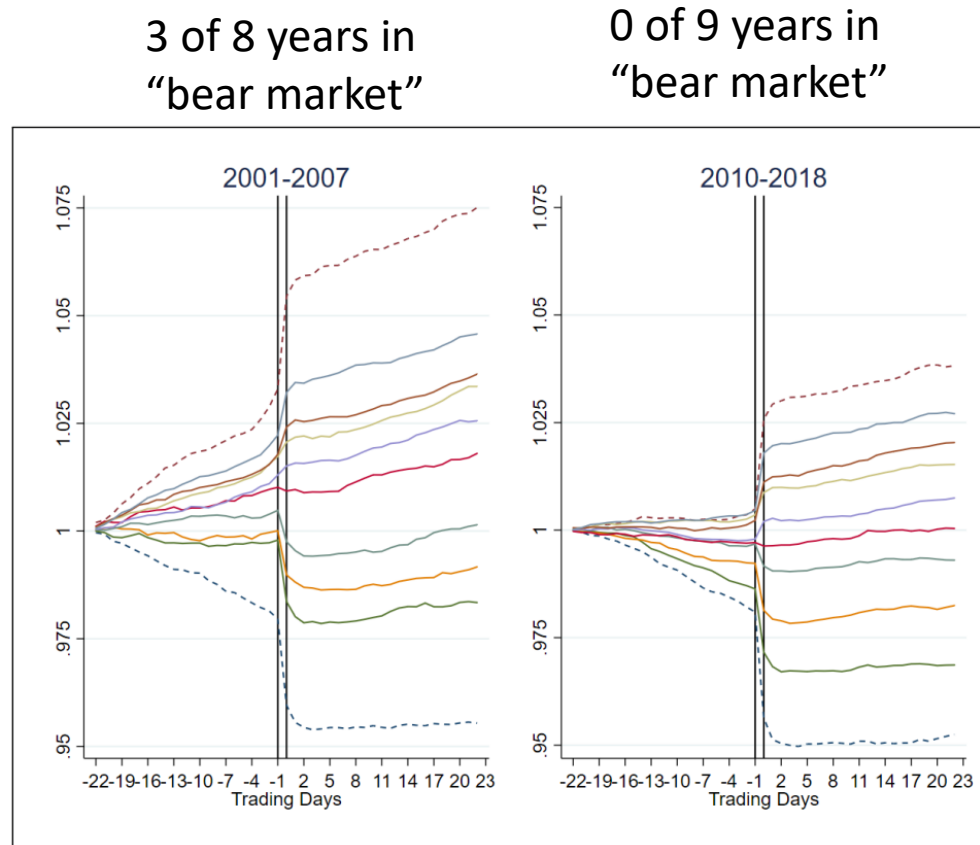
Concerns

Figure 4. Decline of pre-earnings drift by SUE decile. Each quarter, I sort firms into deciles on standardized unexpected earnings. Each line represents the cross-sectional average market-adjusted return of $1 invested at t=-22. The brown dashed line represents the average for firms with the most positive earnings surprises, while the blue dashed line represents the average for firms with the most negative earnings surprises. The solid lines represent the averages for deciles 2 to 9.

Concerns

- "Relative to total institutional ownership, passive ownership is still small, owning only 15% of the US stock market."
  - Chinco & Sammon 2022: "For rebalancing by non-ETFs to explain all the excess reconstitution-day volume in June 2020, 11.5% of the Russell 3000's total market value ($3.7t of all $32.5t) would need to be held by strict end-of-day indexers. These are passive funds that are not only benchmarked to the Russell 1000/2000 but required to match these portfolio weights at market close each day. This 11.5% number seems implausibly large. **It is 21× the combined AUM of all Russell-benchmarked ETFs."**