# How after-hours trading sheds light on investor sentiment

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During the day, the stock market is a busy place but according to a new study, paying attention to overnight returns may help investors develop profitable trading strategies.

Omri Even Tov, an assistant professor of accounting at UC Berkeley's Haas School of Business, found that overnight market activity—between the time the market closes and re-opens the next day—provides a goldmine of information about investor sentiment at the firm level, or pertaining to specific stocks rather than the broader market.

Even Tov measured how much returns moved after the market closed and found that in the short term, up to 12 weeks, prices continued to trend in the same direction; what financiers called price "persistence." The effect was even stronger for firms that are typically more difficult to value.

The findings likely reflect investor sentiment because private investors are more likely to place orders when the market is closed. Also, private investors tend to rely more on sentiment and less on underlying fundamentals (a firm's intrinsic, not market, value) when making their trading decisions.

The study, "Overnight Returns and Firm-Specific Investor Sentiment," forthcoming in the *Journal of Financial and Quantitative Analysis*, is co-authored with David Aboody and Brett Trueman of the UCLA Anderson Graduate School of Management and Reuven Lehavy of the University of Michigan's Ross School of Business.

"Previous sentiment measures proposed in the literature focus on market-wide sentiment," says Even Tov. "In contrast, overnight returns allow us to capture what individual investors think and expect at the firm level."

The researchers studied overnight returns in the U.S. stock market between July 1992 and December 2013. In addition to short-term persistence, they also studied how stocks performed overnight over the longer term, or 12 months. High overnight returns underperformed while those with low overnight returns outperformed. The 12-month return on a strategy of buying and selling stocks based on overnight returns yielded a premium of 7.4 percentage points.

"People want to know the extent to which prices are efficient. Our measure is useful for investors by giving them a new way to determine whether stocks are overpriced or underpriced, which can help them make better decisions," says Even Tov.

Provided by University of California - Berkeley

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