

**FIRN Master Class 2008
Market Microstructure**

Tentative Readings and Course Outline

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Must Read:

Sanford J. Grossman and Joseph E. Stiglitz, "On the Impossibility of Informationally Efficient Markets," *American Economic Review*, 70.3:393-408, 1980.

Albert S. Kyle, "Continuous Auctions and Insider Trading," *Econometrica*, 53:1335-1355, 1985.

Albert S. Kyle, "Informed Speculation with Imperfect Competition," *Review of Economic Studies*, 56:317-356, 1989.

J. Campbell and A. Kyle, "Smart Money, Noise Trading, and Stock Price Behavior," *Review of Economic Studies* 60)1-34, 1989.

J.A. Scheinkman and W. Xiong, "Overconfidence and Speculative Bubbles," *JPE*, 2003.

A.S. Kyle and W. Xiong, "Contagion as a Wealth Effect," *JF*, 2001.

Useful Background Reading:

Books and surveys useful for background reading include the following:

Larry Harris, *Trading and Exchanges: Market Microstructure for Practitioners*, Oxford University Press, 2003, ISBN-0-19-514470-8 (643 pages). This book contains a wealth of institutional details, descriptions of issues, and discussion of microstructure at the level of an advanced layman.

Jack L. Treynor, *Treynor on Institutional Investing*, 2007, Wiley Finance.

Daniel F. Spulber, *Market Microstructure: Intermediaries and the Theory of the Firm*, Cambridge University Press, 1999. ISBN: 0521650259 (hardcover), 0521659787 (pbk.)

Hans R. Stoll, "Market Microstructure," *Handbook of the Economics of Finance*, edited by G.M. Constantinides, M. Harris, and R. Stulz, 2003, Elsevier Science.

Joel Hasbrouck, *Empirical Market Microstructure: The Institutions, Economics, and Econometrics of Securities Trading*, Oxford University Press, 2007

Maureen O'Hara, *Market Microstructure Theory*, Blackwell Publishing, 1995.

Maureen O'Hara, "Liquidity and Price Discovery," *The Journal of Finance*, Volume 58, Number 4, August 2003, pp. 1335-1354(20).

David Easley and Maureen O'Hara, "Microstructure and Asset Pricing," in *Handbook of Economics and Finance*, edited by G.M. Constantinides, M. Harris, and R. Stulz, Elsevier, 2003.

Y. Amihud, H. Mendelson, and L.H. Pedersen, "Liquidity and Asset Prices," *Foundations and Trends in Finance* (on-line)

Ananth Madhavan, "Market microstructure: A survey," *Journal of Financial Markets*, Volume 3, Issue 3, August 2000, Pages 205-258.

Andrei Shleifer, *Inefficient Markets: An Introduction to Behavioral Finance*, Oxford University Press, 2000.

N. Barberis and R.H. Thaler, "A Survey of Behavioral Finance," NBER, 2002. Different emphasis from this course.

Single-Period Models

John Muth, "Rational Expectations and The Theory of Price Movements," *Econometrica*, 1961.

Walter Bagehot (pseudonym for Jack Treynor), "The Only Game In Town," *Financial Analysts Journal*, March/April 1971, Vol. 27, No. 2: 12-14.

Paul Milgrom and Nancy Stokey, "Information, Trade, and Common Knowledge," *Journal of Economic Theory*, 26:17-27.

Sanford J. Grossman and Joseph E. Stiglitz, "On the Impossibility of Informationally Efficient Markets," *American Economic Review*, 70.3:393-408, 1980. (BP2, 123)

Albert S. Kyle, "Informed Speculation with Imperfect Competition," *Review of Economic Studies*, 56:317-356, 1989.

Sanford Grossman and Merton Miller, "Liquidity and Market Structure," *Journal of Finance*, 1988.

Hellwig, "On the Aggregation of Information in Competitive Markets," *Journal of Economic Theory*, 22:477-498, 1980.

Yakov Amihud and Haim Mendelson, "Asset Pricing and the Bid Ask Spread," *Journal of Financial Economics*, 1986..

Albert S. Kyle, "Market Structure, Information, Futures Markets, and Price Formation," in *International Agricultural Trade: Advance Readings in Price Formation, Market Structure, and Price Instability*, ed. by Gary Storey, et. al., Westview Press, 1984, 45-64.

Anat R. Admati and Paul Pfleiderer, "A Theory of Intraday Patterns: Volume and Price Variability," *Review of Financial Studies*, 1988.

D. Diamond and R.E. Verrecchia, "Information Aggregation in a Noisy Rational Expectations Economy," *JFE*, 1981.

Jordi Caballe and Murugappa Krishnan, "Imperfect Competition in a Multi-Security Market with Risk Neutrality," *Econometrica*, Vol. 62, No. 3 (May, 1994), pp. 695-704.

Dynamic Rational Expectations Models with Perfect Competition

J. Campbell and A. Kyle, "Smart Money, Noise Trading, and Stock Price Behavior," *Review of Economic Studies* 60)1-34, 1989.

Jiang Wang, "A Model of Intertemporal Asset Prices under Asymmetric Information," *Review of Economic Studies* 60:249-282, 1993

Jiang Wang, "A Model of Competitive Stock Trading Volume," *Journal of Political Economy* 102:127-168, 1994.

Dynamic Rational Expectations Models with Imperfect Competition

Albert S. Kyle, "Continuous Auctions and Insider Trading," *Econometrica*, 53:1335-1355, 1985.

Lawrence R. Glosten and Paul R. Milgrom, "Bid, Ask, and Transaction Prices in a Specialist Market with Heterogeneously Informed Traders," *Journal of Financial Economics*, 1985.

K Back, "Insider Trading in Continuous Time," *The Review of Financial Studies* 5:387-409, 1992.

K. Back and S. Baruch, "Information in Securities Markets: Kyle Meets Glosten and Milgrom," *Econometrica*, 2004.

D. Vayanos and M. Chau, "Strong-Form Efficiency with Monopolistic Insiders," *RFS*, forthcoming.

M. Guo and A. Kyle, "An Intemporal Asset Pricing Model with Strategic Informed Trading and Risk-Averse Market Makers, unpublished manuscript, 2004.

Forecasting the Forecasts of Others

R. M. Townsend, "Forecasting the Forecasts of Others, *Journal of Political Economy* 91:546-88, 1983.

F. Douglas Foster and S. Viswanathan, "Strategic Trading when Agents Forecast the Forecasts of Others", *Journal of Finance* 60:1537-1478, 1996

FD Foster, S Viswanathan , "Strategic Trading with Asymmetrically Informed Traders and Long-Lived Information," *Journal of Financial and Quantitative Analysis*, 1994.

K. Back, H. Cao, and G. Willard, "Imperfect Competition among Informed Traders," *JF*, 2000.

Douglas F. Foster and S. Viswanathan, "A theory of the Interday Variations in Volume, Variance, and Trading Costs In Securities Markets," *Review of Financial Studies*, *Review of Financial Studies*, 1990.

D. Bernhardt, P. Seiler, and B. Taub, "Speculative Dynamics," (formerly "Cladistic Asset Pricing"), unpublished manuscript? 2004.

Behavioral Finance

N. Barberis, A. Shleifer, and R. Vishny, "A Model of Investor Sentiment," *JFE*, 1998.

D. Hirshleifer, "Investor Psychology and Asset Pricing," *JF*, 2001.

J. Bradford De Long, Andrei Shleifer, Lawrence H. Summers and Robert J. Waldmann, "The Size and Incidence of the Losses from Noise Trading," *The Journal of Finance*, Vol. 44, No. 3, *Papers and Proceedings of the Forty-Eighth Annual Meeting of the American Finance Association*, Jul., 1989, pp. 681-696.

K Daniel, D Hirshleifer, A Subrahmanyam , "Investor Psychology and Security Market Under-and Overreactions, *The Journal of Finance*, 1998.

T Odean , "Volume, Volatility, Price, and Profit When All Traders Are Above Average," *The Journal of Finance*, 1998.

Albert S. Kyle and Albert Wang, "Speculation Duopoly with Agreement to Disagree: Can Overconfidence Survive the Market Test?" *Journal of Finance*, volume LII, number 5, December 1997, pp. 2073-2090.

Organized Exchanges

Duane J. Seppi, "Equilibrium Block Trading and Asymmetric Information," *JF* 45:1, 1990, pp. 73-94.

Fischer Black, "Noise," *Journal of Finance*, 41:529-543, 1986.

M. Pagano and A. Roell, "Transparency and Liquidity: A Comparison of Auction and Dealer Markets with Informed Trading," *JF*, 1996.

Biais, Bruno, Glosten, Lawrence R. and Spatt, Chester S., "The Microstructure of Stock Markets" (March 2002). CEPR Discussion Paper No. 3288. Available at SSRN: <http://ssrn.com/abstract=310105>

Bubbles and Contagion

MK Brunnermeier , *Asset Pricing Under Asymmetric Information: Bubbles, Crashes, Technical Analysis, and Herding*, 2001,.

J.A. Scheinkman and W. Xiong, "Overconfidence and Speculative Bubbles," *JPE*, 2003.

D. Abreu and M. Brunnermeier, "Bubbles and Crashes," *Econometrica*, 2003.

A.S. Kyle and W. Xiong, "Contagion as a Wealth Effect," *JF*, 2001.

L. Kodres and M. Pritsker, "A Rational Expectations Model of Financial Contagion," *JF*, 2002.

Manipulation, Predatory Trading, and Cash Settlement

P. Kumar and D.J. Seppi, "Futures Manipulation with Cash Settlement," *JF*, 1992.

B. Carlin, M. Lobo, and S. Viswanathan, "Episodic Liquidity Crises: The Effect of Predatory and Cooperative Trading," manuscript, 2004.

M. Brunnermeier and L.H. Pedersen, "Predatory Trading," *JF*, 2004.

S. Morris and H. Shin, "Liquidity Black Holes," *Review of Finance*, 2004.

Albert S. Kyle and S. Viswanathan, "How to Define Illegal Price Manipulation," *AEA Papers and Proceedings*, forthcoming, 2008.

Albert S. Kyle, "Cash Settlement, Price Manipulation, and the Modigliani-Miller Theorem," unpublished manuscript, 2007.