

Do options contribute to price discovery in emerging markets?

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Abstract

We examine the informational role of derivatives in price discovery in Taiwan. After controlling for market cycles, moneyness, and liquidity, we use three methodologies to measure the information content in different trading venues. We find that the trades on futures contribute the most to price discovery. However, the futures transactions are also the most costly in executing information trading. The information role of options varies with moneyness and market cycles. Options tend to be more informative during a downtrend period. This can be partially explained by short-sale constraints. Out-of-the money options have higher permanent price effects, greater price contributions, and larger information share than other options. The findings suggest that informed traders are more concerned about an option's leverage than its delta or vega. Thus, in examining price discovery in different trading venues, pooling options data, irrespective of market cycles and moneyness, may affect the empirical results.

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