Policy Announcements and Stock Market Response

Nodir Adilov
Indiana University-Purdue University Fort Wayne

Lawrence Haber
Indiana University-Purdue University Fort Wayne

Nick Fiechter
Indiana University-Purdue University Fort Wayne

Abstract

Literature on market efficiency argues that financial markets are efficient and that stock prices fully reflect publicly available information (semi-strong form of market efficiency). Furthermore, economic models assume that investors rationally evaluate future market performance and that there is no systematic bias in investor expectations. This paper empirically evaluates these hypotheses by analyzing stock market responses public policy announcements. The findings indicate that traders become extremely risk averse right before the uncertainty regarding the policy decision is resolved, and this creates profitable arbitrage opportunities.