David Veredas:

TITLE
How much of ask-bid quotes variance is information and how much is noisy?

ABSTRACT
Using a dynamic state-space co-integration model for ask and bid quotes, we disentangle liquidity-driven (noisy) volatility from information-driven (long run) volatility. We next compute its reduced form. The unconditional volatilities of the ask-bid returns turn out to be a linear combination of three components. One is the variance of the common efficient return. The other two are the noisy ask and bid variances. And similarly for the covariance and autocovariances. For a sample of heterogeneous assets traded in the Spanish stock market, we show that the most liquid and capitalized stocks have quotes closer to the efficient price in the sense that most of the variance, covariances and autocovariances are attributable to information. Likewise, the proportion of noise in the variance, covariances and autocovariances increases as volume, trades and capitalization decreases.

This is a joint work with Roberto Pascual