

# Glued to the TV

## Distracted Noise Traders and Stock Market Liquidity

JOEL PERESS and DANIEL SCHMIDT \*

### ABSTRACT

In this paper we study the impact of noise traders' limited attention on financial markets. Specifically we exploit episodes of sensational news (exogenous to the market) that distract noise traders. We find that on "distraction days," trading activity, liquidity, and volatility decrease, and prices reverse less among stocks owned predominantly by noise traders. These outcomes contrast sharply with those due to the inattention of informed speculators and market makers, and are consistent with noise traders mitigating adverse selection risk. We discuss the evolution of these outcomes over time and the role of technological changes.

---

\*Joel Peress is at INSEAD. Daniel Schmidt (Corresponding author) is at HEC Paris, 1 rue de la Liberation, 78350 Jouy-en-Josas, France. Email: [schmidt@hec.fr](mailto:schmidt@hec.fr). We are grateful to David Strömberg for sharing detailed news pressure data, including headline information, and to Terry Odean for providing the discount brokerage data. We thank Thierry Foucault, Marcin Kacperczyk, Yigitcan Karabulut, Maria Kasch, Asaf Manela, Øyvind Norli, Paolo Pasquariello, Joshua Pollet (the AFA discussant), Jacob Sagi, Paolo Sodini, Avi Wohl, Bart Yueshen, and Roy Zuckerman for their valuable comments, as well as seminar/conference participants at the AFA, EFA, 7th Erasmus Liquidity Conference, ESSFM Gerzensee, 2015 European Conference on Household Finance, UC Berkeley, Collier School of Management (Tel Aviv University), Marshall School of Business, Frankfurt School of Management and Finance, Hebrew University, IDC Arison School of Business, Imperial College Business School, University of Lugano, University of Paris-Dauphine, and Warwick Business School. Joel Peress thanks the AXA Research Fund and the Institut Europlace de Finance for their financial support. The authors have nothing to disclose with respect to the *Journal of Finance's* Submission Guidelines and Conflict of Interest Disclosure Policy.

The literature on limited attention in financial markets focuses on informed agents—speculators and market makers—and on the speed with which they impound public information into stock prices. Less is known about how attention might affect a third, equally important, group of agents: noise traders. By trading stocks for reasons unrelated to stock fundamentals, noise traders allow speculators to profit from their information and market makers to recoup losses from trading with speculators. As summarized by Fisher Black in his Presidential Address, “Noise makes financial markets possible” (Black (1986, p. 530)). In this paper we aim to improve our understanding of how the limited attention of noise traders affects financial markets. Toward that end, we consider events that distract noise traders and we trace out their consequences for markets. We find that when noise traders are distracted from trading, liquidity and volatility decrease and prices reverse less. These effects are consistent with what theory predicts.

There are two main challenges to identifying the effect of noise traders’ attention on markets. First, events that draw attention to stocks are typically associated with material news about stocks’ fundamentals, which raises questions about whether any observed pattern is caused by attention itself or by news. Second, many attention-grabbing events affect investors at large and not just noise traders. We overcome these problems by exploiting events that (a) divert, rather than attract, investors’ attention and (b) appeal to irrational, “biased,” or sensation-seeking investors. Specifically, we identify episodes of sensational news that are exogenous to the stock market and temporarily distract traders. A vivid example of such an event is the murder trial verdict in the case of football and movie star O.J. Simpson on October 3 1995. Millions interrupted what they were doing to hear the verdict announcement. Long-distance telephone call volume declined, electricity consumption surged as viewers turned on televisions set, and water usage plummeted as they postponed using bathrooms (Dershowitz (2004)). More relevant for our purpose, and as Figure 1 shows, trading volume on the New York Stock Exchange (NYSE) plunged by 41% in the first five minutes after the announcement, and by another 76% in the next five minutes, before abruptly recovering. Because the O. J. Simpson trial was unrelated to the economy, such an episode speaks to a causal effect of (in)attention on the stock market. Moreover, a detailed analysis of who is distracted by sensational news demonstrates that it mainly affects noise traders.

[[ Insert Figure 1 about here ]]

To create a sample of such distraction events, we use a variable (introduced by Eisensee and Strömberg, (2007)) called news pressure. This variable measures the

median number of minutes that U.S. news broadcasts devote to the first three news segments. For example, the O.J. Simpson trial verdict received 16½ minutes of air time, the highest value for that year. Each year, we sort days into news pressure deciles and identify days belonging to the highest decile. We then parse through the headlines of news segments covered in the broadcasts and retain only those days for which the sensational news event is plausibly exogenous to the economy. Examples of such distracting news include the O.J. Simpson trial verdict, the Cessna plane crashing on the White House lawn, and the Challenger space shuttle explosion. Data on TV viewership confirm that these events drew the attention of U.S. households. Our final sample contains 551 days (distraction events) over the period from 1968 to 2014.

We begin by examining whether these news stories actually divert noise traders' attention away from the stock market. Detailed trading records of households (from a large discount broker) and institutions (from Abel Noser Solutions, or ANcerno) show that trading volume drops on distraction days by 6,5% and 4% respectively, before reverting to normal on the following day. We next construct several proxies for investor "biasedness, in particular, the extent to which investors make losses from trading, churn their portfolios, underdiversify, and trade stocks covered in the media, and, for households, their gender and whether they were quick to adopt online trading. These factors are all related to the tendency of traders to be sensation-seeking, overconfident, or susceptible to media coverage. We find that, among both households and institutions, more "biased" investors are more prone to distraction, which confirms that our sensational news episodes primarily distract noise traders. We therefore exploit these episodes to study how short-lived changes to noise trading affect financial markets.

We next examine how the stock market behaves on sensational news days (i.e., when noise traders are inattentive). Although we find weak results for the overall market, we uncover pronounced effects when focusing on subgroups of stocks with high retail ownership—stocks in which noise trading is expected to be more pronounced (e.g., Lee, Shleifer, and Thaler (1991)). We confirm that trading activity declines (by about 3%) in the bottom tercile of stocks in terms of firm size, stock price, and institutional ownership—three variables that are negatively correlated with retail ownership. Exploiting CRSP daily data as well as TAQ intraday data, we then report that, on distraction days, liquidity worsens by 1% to 6%, volatility falls by 3% and price reversals are reduced by 4%. These effects are statistically significant and robust across proxies and test methodologies (i.e., parametric versus nonparametric). Moreover, they are

concentrated in stocks with high levels of retail ownership and dissipate monotonically in the other terciles. Cross-sectional tests confirm that distraction events that see a greater decline in trading also exhibit a more pronounced reduction in liquidity, volatility, and reversals, thus establishing that these effects are related. To strengthen the causal interpretation of our results, we discuss, and ultimately dismiss, endogeneity concerns related to confounding effects from economic news and reverse causality, as well as alternative explanations based on distracting agents other than noise traders and investor sentiment.<sup>1</sup>

To summarize, we find that distraction days are associated with reduced liquidity, volatility, and price reversals among stocks owned predominantly by individual investors. Using a simple extension of the Kyle (1985) model, we demonstrate that these findings can be attributed to a common shock—a reduction in noise trading. Indeed, when noise traders exit, market makers face worse adverse selection because they are at greater risk of being “picked off” by informed speculators, and hence liquidity drops. To the extent that inventory risk is priced, the reduction in noise trading also reduces volatility and price reversals.<sup>2</sup>

Our findings on liquidity contrast with those of Foucault, Sraer, and Thesmar (2011), who report an improvement in liquidity following a reform that discouraged retail (noise) trading on the French stock exchange. They explain their findings by noting that because the reform permanently dampened noise trading and in turn volatility, it reduced the inventory risk borne by market makers, that is, the risk associated with the future unwinding of their inventory. We rationalize the difference in results by noting that our noise shocks are transitory and therefore have a negligible effect on inventory risk. Instead noise trading has an immediate effect on adverse selection risk, which implies that a reduction in noise trading decreases liquidity, as we find. Put differently, isolating the effect of noise trading on adverse selection requires fluctuations in noise trading that are sufficiently short lived to not affect future volatility. We argue that the short-lived distraction shocks studied here are ideally suited for this purpose.

In our next set of tests, we examine how distraction effects have changed over time. We analyze the data separately over three subperiods, 1968 to 1992, 1993 to 2006, and 2007 to 2014. The second subperiod corresponds to the advent of the Internet, and the

---

<sup>1</sup> See Section V for details.

<sup>2</sup> Inventory risk is not priced in the standard Kyle (1985) model with risk-neutral market makers, but it becomes priced when market makers are assumed to be risk averse (Subrahmanyam (1991)).

third to the rise of algorithmic traders—particularly high-frequency traders—who have come to dominate trading. We find that as we move from the first to the second period, the impact of distraction (among small stocks) is considerably greater for virtually all variables. As we proceed to the third period, the effect is further amplified for trading activity, volatility, and price reversals, but, surprisingly, it vanishes for liquidity.

Follow-up analyses suggest that these time-series patterns are linked to the development of the Internet in the 1990s, and to the rise of algorithmic trading post-2007. Regarding the Internet, we document that, over the 1993 to 2006 period, distraction effects for all variables are more pronounced among tech stocks, which are a natural habitat for tech-savvy investors (who were early adopters of online information gathering and trading platforms). These results are consistent with prior research indicating that, by creating illusions of knowledge (by facilitating access to information) and control (by enabling online trading), the Internet increases investor overconfidence (Barber and Odean (2001b, 2002)). An alternative interpretation is that the Internet causes an acceleration of news, which makes trading decisions less drawn-out over time and hence distraction effects more easily identifiable.

To evaluate the link between algorithms and the diverging trends we document in the post-2007 period, we sort stocks based on proxies for the intensity of algorithmic trading. For stocks with more algorithmic trading, we find that distraction effects for trading activity, volatility, and price reversals are more pronounced, whereas the effect for liquidity is attenuated, in line with our time-series evidence. We speculate that these patterns are explained by both technological advances—including improvements in hardware (e.g., computing power, custom-designed chips, ultra-fast communication lines) and software (e.g., pattern recognition algorithms, “Big Data,” artificial intelligence)—and new business practices (e.g., co-location, access to exchanges’ proprietary data feeds) that have made it easier to detect and anticipate noise trades. These changes may have allowed informed algorithmic traders to improve the timing of their trades (i.e., to trade when noise trading surges) and, perhaps more controversially, high-frequency traders to take advantage of noise traders by front-running their orders.<sup>3</sup>

The rest of this paper is organized as follows. Section I discusses our contributions to the literature. Section II reviews our data and methodology, and Section III considers the effect of distraction on retail and institutional investors. In Section IV we study how

---

<sup>3</sup> See Section VI.C for more details on these arguments.

distraction shocks affect the stock market, and in particular, the stocks held predominantly by noise traders. Section V presents results of robustness checks and discusses endogeneity issues, and in Section VI we investigate how distraction effects have changed over time. Section VII concludes. The Internet Appendix presents details on our model along with additional results.<sup>4</sup>

### **I. Related Literature and Contribution**

Our paper contributes to four strands of research. First, it adds to the growing literature on limited attention in financial markets. Prior work focuses largely on informed traders and the speed with which they impound public information into prices (see, for example, Cohen and Frazzini, (2008), DellaVigna and Pollet (2009), Hirshleifer Lim and Teoh (2009)), and, to a lesser extent, on market makers (Corwin and Coughenour (2008), Chakrabarty and Moulton (2012)). Our main contribution is to study noise traders—specifically, how their trading contributes to liquidity, volatility, and price efficiency.<sup>5</sup> We make an important methodological contribution by showing that distracting events can be exploited to study the causal effects of short-term fluctuations in noise traders' attention. More broadly, our findings suggest that the impact of attention ultimately depends on who is (in)attentive (see also Ben-Rephael, Da and Israelsen (2017)).

Second, our paper contributes to the literature on the determinants of liquidity. Microstructure theory has identified two opposing channels through which noise traders affect liquidity. On the one hand, adverse selection models (e.g., Glosten and Milgrom (1985), Kyle (1985)) demonstrate that insiders exploit noise trades to conceal their informed trades. When noise trading lessens, market makers face more risk of being adversely selected and seek compensation by increasing spreads and/or price impact. On the other hand, inventory risk models (e.g., Ho and Stoll (1981), Grossman and Miller (1988)) emphasize that market makers are concerned about fluctuations in their inventory's value, as might be triggered by future noise trading shocks. From this perspective, a reduction in noise trading improves liquidity. How liquidity is ultimately shaped by noise trading therefore remains an open question—and one that is hard to

---

<sup>4</sup> The Internet Appendix is available in the online version of the article on the *Journal of Finance* website.

<sup>5</sup> A few papers (e.g., Barber and Odean (2008), Da, Engelberg and Gao (2011)) study retail investors' attention to stocks. These authors exploit attention-grabbing events (as captured, for example, by extreme returns, high trading volume, media coverage, high Google search volume) to uncover trading and return patterns that are consistent with retail buying pressure. However, they do not examine volatility or liquidity. Moreover, such research is subject to the criticism that the events of interest are confounded by economic news.

---

answer empirically because noise trading is endogenous and could itself be a function of liquidity.<sup>6</sup>

To date, the evidence has relied on structural estimations (e.g., the “probability of informed trading” (PIN) model” of Easley, Kiefer, O’Hara, and Paperman (1996a)) or laboratory experiments (e.g., Bloomfield, O’Hara, and Saar (2009)). Only two papers offer causal evidence drawn from quasi-natural experiments, namely, Greene and Smart (1999) Foucault, Sraer, and Thesmar (2011). These papers exploit changes in noise trading triggered by, respectively, analyst recommendations published in the press and a stock market reform. But because these experiments involve long-lasting changes to noise trading, their findings on liquidity accentuate the inventory risk channel. This is striking in Foucault, Sraer, and Thesmar (2011), where the reduction in the intensity of noise trading is permanent and hence the reduction in inventory cost is so large that it swamps any adverse selection effect and thus results in a liquidity improvement.<sup>7</sup> In contrast, our single-day decline in the intensity of noise trading leads to no detectable reduction in inventory cost but does lead to reduced liquidity because adverse selection now dominates.<sup>8</sup> Overall, our findings highlight the importance of the adverse selection channel, the bedrock of a large literature on trading under asymmetric information and help reconcile prior conflicting evidence by emphasizing that the duration of noise trading shocks varies significantly across settings.

Our third contribution is to describe how attention interacts with behavioral biases, and in doing so offer a more nuanced view of attention—rather than being invariably good, attention can be bad for investors who trade poorly. Indeed, we find that more “biased” (e.g., unskilled, overconfident, sensation-seeking) investors are more prone to

---

<sup>6</sup> For instance, Grullon, Kanatas, and (2004) document that firms that spend more on advertising have more individual stockholders and are also more liquid. However, it is unclear whether these investors cause or instead are attracted by the improved liquidity. Likewise, evidence suggests that retail investors are drawn to volatile stocks—either because such stocks grab their attention (Barber and Odean (2008)) or because these investors prefer stocks with lottery-type payoffs (Kumar (2009))—and that volatile stocks tend to be illiquid (Benston and Hagerman (1974), Chordia, Roll, and Subrahmanyam (2000), Hameed, Kang, and Viswanathan (2010)).

<sup>7</sup> In a similar vein, an old literature on stock splits consistently documents that these events attract retail investors and are associated with an increase in stock return volatility and bid-ask spreads (e.g., Copeland (1979), Conroy, Harris, and Benet (1990)). Although there is some disagreement on the interpretation of these findings (e.g., Schultz (2000), Easley Engle, O’Hara, and Wu (2008)), it is worth noting that they are largely consistent with the inventory risk channel. In contrast, Abudy and Wohl (2018) report a positive association between retail trading and liquidity in a centralized corporate bond market.

<sup>8</sup> In the middle of this spectrum lies Greene and Smart (1999), who describe an increase in noise trading intensity that can last from 10 days to several weeks. In their setup, the adverse selection and inventory cost channels balance each other and thus the effect on overall liquidity is weak. Moreover, their experiment consists of one-sided shocks to noise trading (i.e., increased buying—but not selling—by noise traders), and thus, to the extent that such buying activity can be anticipated, it may not affect the adverse selection risk they face.

distraction, and thus, to the extent that their trading profits are insufficient to cover their trading costs (Odean (1999), Barber and Odean (2000)), their performance will actually improve by watching TV instead of trading.

Finally, by studying the effect of distraction on different measures of trading activity, we shed light on the role that attention plays in the decision-making process of a retail trader (data limitations prevent us from drawing clear-cut conclusions for institutional traders). More specifically, for retail investors we document that distraction has a strong negative effect on the extensive margin (i.e., whether or not to trade) but not on the intensive margin (i.e., how much to trade). These findings are difficult to reconcile with models in which investors gradually curb their trading intensity as they pay less attention (Peng and Xiong (2006), Van Nieuwerburgh and Veldkamp (2010)), but are consistent with models that assume a fixed attention cost for accessing the stock market (Merton (1987), Abel, Eberly, and Panageas (2007), Chien, Cole, and Lustig (2012), Abel, Eberly, and Panageas (2013)).

## II. Data and Methodology

### A. Distracting Events

We identify our candidate events using the *news pressure* measure of Eisensee and Strömberg (2007). News pressure is defined as the median number of minutes that U.S. news broadcasts devote to the first three news segments. The authors argue that this variable is a good indicator of the extent of newsworthy material available on a given day. “For instance, on October 3, 1995, a jury found O.J. Simpson not guilty of two counts of murder. That night, ABC, CBS, and NBC devoted all of their first three news segments to that story. The top three news segments comprised an average of sixteen minutes and thirty seconds—the highest value of that year” (Eisensee and Strömberg (2007, p. 207)).<sup>9</sup> Figure 2 provides a time-series plot of daily news pressure over the sample period. Daily news pressure oscillates around a mean of eight minutes with occasional spikes of 10 minutes or more.

[[ Insert Figure 2 about here ]]

We focus on the spikes in daily news pressure. In particular, for each sample year we select the 10% of business days with the highest news pressure to identify our candidate events. This procedure yields an initial list of 1,084 event-days. One might object that

---

<sup>9</sup> We are grateful to David Strömberg for providing us with an updated time series of daily news pressure that covers the 1968 to 2014 period and includes headline information. The raw measure, that is, the measure without headline information, can be downloaded from David Strömberg’s website (<http://perseus.iies.su.se/~dstro/>).

news pressure could be high because news broadcasts cover important economic news, which, rather than distract attention, actually draw attention to the stock market. We dismiss this concern on three grounds.

First, economic news would bias our results *against* finding a distraction effect. Indeed, a large literature documents that stock returns are orders of magnitude more variable on days with economic news (see, for example e.g. Cutler, Poterba, and Summers (1989), Ederington and Lee (1993)). In contrast, we expect (and find) less return volatility under our distraction hypothesis. Similarly, public news typically coincides with large increases in trading activity, which are attributed to increases in disagreement and/or differences in information processing speeds among market participants (Hong and Stein (2007), Foucault, Hombert, and Roşu (2016)). As with volatility, we expect (and find) the opposite effect under distraction. Moreover, the impact of economic news should be felt most strongly among large stocks (which are known to lead small stocks in terms of price discovery; see, for example, Lo and MacKinlay (1990), McQueen, Pinegar, and Thorley (1996), Hou and Moskowitz (2005)), whereas our distraction effects primarily affect small stocks.

Second, correlation analysis indicates that macroeconomic news releases, business activity indicators, and investor sentiment together explain only a small fraction of the variation in news pressure (see Internet Appendix III.B). It therefore appears that news pressure is driven by sensational stories that are mostly orthogonal to news about future cash flows and discount rates (i.e., economically important news).

Finally, we exclude high-news pressure days on which the headlines of any of our selected broadcasters' top three news segments contain at least one word from a list of economic keywords.<sup>10</sup> We are left with a list of 551 event-days from 1968 to 2014 that we are confident in classifying as both noneconomic and potentially distracting. The corresponding events comprise the sample of *distraction events* used in our analyses.

[[ Insert Table I around here ]]

Panel B of Table I presents a partial list of these events along with a short description of the day's major news headline. In particular, the panel lists the top two distraction events by news pressure for each year. The stories in this list involve accidents (e.g.,

---

<sup>10</sup> The keywords are banking, bankruptcy, default, depression, economic, economy, election, employment, equity, federal reserve, fed reserve, fed rate, finance, financial, inflation, interest rate, recession, stock market, treasury, and war.

---

*Challenger* explosion, Minneapolis bridge collapse), terrorist attacks (Lockerbie plane bombing, Oklahoma City bombing, London bombing),<sup>11</sup> assassination attempts (on President Reagan, on Pope John Paul II), shootings (Littleton school shooting, Virginia Tech massacre, Tucson shooting), criminal court rulings (O.J. Simpson, John DeLorean, William Calley), celebrity deaths (Lady Diana, Michael Jackson), military skirmishes (Grenada invasion, USS Stark incident, Iraq Fallujah uprising), natural disasters (Haiti earthquake, Oklahoma tornado), and political scandals (Watergate hearings, Iran-Contra scandal). In essence, our list spans news stories that captured national headlines but had an arguably negligible effect on the U.S. economy. These stories differ markedly from the type of news that has been shown to distract *rational* investors, such as other firms' corporate announcements or trading activity (Corwin and Coughenour (2008), Hirshleifer, Lim, and Teoh (2009), Chakrabarty and Moulton (2012)). Robustness tests reported in Section V show that our results are not sensitive to the inclusion (or exclusion) of any particular event or to the specific keywords employed as filters. Section V also offers a detailed discussion of potential endogeneity concerns.

An important prerequisite for the distraction hypothesis is that our events absorb the attention of potential investors (and thereby reduce the attention available for trading in the stock market).<sup>12</sup> We directly test the first part of this statement using television viewership data purchased from Nielsen Research for the 1992 to 2014 subperiod. More specifically, we conduct an event study to determine whether television viewership during the 6:30 p.m. to 7:00 p.m. news broadcasts by ABC, CBS, and NBC (from which the news pressure variable is calculated) increases on distraction days.<sup>13</sup> To ensure that any viewership increase is not confined to after-trading hours, we complement this measure with the average daily viewership of CNN, a dedicated news channel. Panel A of Table I reports the results. The viewership for CNN (column (1)) and for other broadcasts' news programming (column (2)) is, respectively, 33% and 3% higher on distraction days—an effect that is both economically and statistically highly significant.<sup>14</sup> We

---

<sup>11</sup> September 11 does not enter our sample because stock exchanges remained closed from September 11 to September 17, 2001.

<sup>12</sup> To be clear, we do not claim that investors are distracted from trading *because* they are watching evening news broadcasts. Rather, we use these broadcasts to identify news stories that draw investors' attention throughout the trading day. Figure 3 supports this interpretation: investors trade less on distraction days, but not on the day after, which would have been the case if the broadcast itself—since it is aired after trading hours—had distracted investors.

<sup>13</sup> Our event-study methodology is explained in Section II.C.

<sup>14</sup> The difference in these economic magnitudes may reflect households switching to CNN to follow news events in real time; these viewers may then be less likely to (also) watch the evening news broadcasts on any of the other three channels.

therefore find strong evidence that U.S. residents are “glued to the TV” on distraction days. We next describe our other data sources and explain our econometric methodology.

### *B. Other Data*

We employ three different data sets or trades to study the effect of distraction events on traders. The first source comprises about 1.9 million common stock trades executed by 78,000 households at a large discount brokerage house between January 1991 and November 1996 (for details, see Barber and Odean (2000)). Our sample contains 66 distraction events occur during that period. Our second source comprises data on institutional trades from Abel Noser Solutions, commonly known as ANcerno.<sup>15</sup> These data cover institutional stock transactions for 835 asset managers from 1999 to mid-2011, a period for which we have 99 distraction events. Although this data set does not allow us to track individual funds, it includes an identifier for the management company of the fund executing the trade, which enables us to follow management companies over time. The advantage of these two disaggregated data sets is that they allow us to determine which investors are more prone to distraction.

Our third data source on trades consists of aggregated transactions in all NYSE/AMEX/Nasdaq stocks. This information comes from the Institute for the Study of Security Markets (ISSM) and Trades and Quotes (TAQ) databases.<sup>16</sup> Although these data sets do not reveal traders’ identities, they do allow us to distinguish between small and large trades.<sup>17</sup> Small trades were an effective proxy for retail trading until the early 2000s, when order splitting by institutions became popular (Lee and Radhakrishna (2000), Barber, Odean, and Zhu (2009), Hvidkjaer (2008)). For this reason, we limit our analysis of aggregated transaction data to the period 1991 to 2000, during which 105 distraction events occurred.

We obtain stock market data from two sources. First, we use daily data from CRSP covering the period 1968 to 2014 (551 distraction events). Second, we again employ TAQ data for the period 1993 to 2014 (225 distraction events). We apply the filters and

---

<sup>15</sup> Ancerno Ltd. is the former name of Abel Noser Solutions. Puckett and Yan (2011) provide more information about this data set.

<sup>16</sup> We thank Søren Hvidkjaer for sharing the aggregated ISSM and TAQ volume data, broken down by trade size, for the period 1991 to 2000.

<sup>17</sup> Our size classification follows that described in Hvidkjaer (2006). Specifically, we sort stocks into quintiles based on NYSE/AMEX firm-size cutoffs and use the following small-trade (large-trade) cutoffs within firm-size quintiles: \$3,400 (\$6,800) for the smallest firms, \$4,800 (\$9,600), \$7,300 (\$14,600), \$10,300 (\$20,600), and \$16,400 (\$32,800) for the largest firms.

---

adjustments described by Holden and Jacobsen (2014) to address withdrawn or canceled quotes, and we use their interpolated time technique to improve the accuracy of liquidity measures.<sup>18</sup> All TAQ trades are signed using the Lee and Ready (1991) algorithm. Throughout our analyses, we focus on common stocks (share codes 10 or 11) and exclude penny stocks (closing price < \$1). We describe our stock market variables in Section IV, where we also present results for the marketwide analysis.

### *C. Methodology*

We start by purging any seasonal effects from all time-series variables (e.g., stock market data, brokerage trading volume, TV viewership) by regressing them on a set of dummy variables for years, calendar months, and days of the week (where the latter two are allowed to vary by year). We carry out our analyses on the residuals from these regressions, which ensures that the results are neither driven nor confounded by seasonal patterns.

Our event-study approach works as follows. Let  $X$  be an outcome variable of interest. We define *abnormal*  $X$  as the realization of  $X$  on the event date ( $t = 0$ ) minus its average over an estimation window. The estimation window consists of all trading days without economic news (i.e., after filtering out days with headlines featuring one of the economic keywords listed in footnote 10) in a 200-day window that is centered on the event day.<sup>19</sup> This setup allows us to compare distraction days with no economic news to nondistraction days that are also without economic news. Employing the same economic news filter across distraction and nondistraction days ensures that any differences we find can be attributed only to the distracting events. Formally:

$$\text{Abnormal } X = X_{t=0} - \text{Average } X_{0 < |t| < 101 \text{ \& noneconomic.}}$$

Our estimation window includes both the pre- and the post-event periods—to neutralize any trend in the data—although results are unchanged if the window includes only the pre-event period. For variables related to stock market outcomes, we first calculate abnormal  $X$  at the stock level and then calculate the equal-weighted average over the portfolio of interest (e.g., the entire market or stocks in the bottom tercile of institutional ownership) for each event date. We test for the significance of abnormal  $X$

---

<sup>18</sup> The code for making these adjustments is available on Craig Holden’s web page (<http://kelley.iu.edu/cholden/>).

<sup>19</sup> This choice of estimation window is motivated by our finding that effects of distraction events are so short-lived that they do not extend beyond the event date itself. Introducing a small gap between the event date and the estimation window leaves our results unchanged.

---

across events using the parametric Boehmer-Musumeci-Poulsen  $t$ -test (Boehmer, Musumeci, and Poulsen (1991)), or BMP for short, as well as a nonparametric rank test.<sup>20</sup>

### III. Distraction and Noise Trading

#### A. Overall Analysis of Retail and Institutional Trades

In this section we study the effect of distraction on trading activity. In addition to setting the stage for the marketwide investigation to follow, this analysis is valuable in its own right: because investors can be distracted only if they were attentive to begin with, this analysis sheds light on investors' decision-making process. In particular, we compare distraction effects across different measures of trading activity to identify which stages in the decision-making process are most sensitive to attention constraints. Our results thus inform the development of a positive theory of attention allocation.

We construct four measures of trading activity—which pertain to buys, sells, and their sum—for the retail and institutional data sets. The first measure,  $\log(\$volume)$ , is obtained by first aggregating the dollar value of all transactions on a given day and then taking logarithms. The remaining measures capture components of this aggregate measure. Our second measure,  $\log(trade\ size)$ , is the average (log) trade size, defined as the equal-weighted average per investor and stock, conditional on trading, of the logarithm of the trade value in dollars. The third measure,  $\log(\#stocks)$ , is the average number of distinct stocks traded, defined as the equal-weighted average of the logarithm of the number of different stocks traded on a given day by an investor with at least one trade on that day. Our final measure,  $\log(\#investors)$ , is the logarithm of the number of investors trading on a given day.

The last three measures above are intended to reflect different stages in an investor's decision-making process. The variable  $\log(\#investors)$  captures the decision of whether or not to trade (i.e., the extensive margin). A drop in this variable on distraction days would indicate that the process of directing attention to the stock market and transacting—which involves logging into one's brokerage account or calling up a broker—requires a fixed amount of attention, as in the models of Merton (1987), Abel, Eberly, and Panageas (2007, 2013), and Chien, Cole, and Lustig (2012). The  $\log(\#stocks)$  variable reflects how much more attention is required to *search for* and trade additional stocks conditional on having traded at least once on that day. Past research suggests that,

---

<sup>20</sup> The BMP  $t$ -test builds on the Patell (1976)  $t$ -test but does not require the former's assumption of no event-induced variance. Because the BMP test may not perform well when the outcome variable's distribution departs markedly from normal, we complement our inference with a nonparametric rank test.

for underdiversified and short-sale–constrained retail investors, buys require more attention than sells during this phase because their choice set for buys is much larger than that for sells (Barber and Odean (2008)). Finally, models of rational attention predict that investors trade less aggressively when the information they possess is less precise (e.g., Verrecchia (1982), Peng and Xiong (2006), Van Nieuwerburgh and Veldkamp (2010)), as would be the case if investors were distracted. We therefore expect distraction days to be associated with a reduction in  $\log(\text{trade size})$ , the average trade size conditional on trading on a given day.

[[ Insert Table II about here ]]

Panel A of Table II reports results using our retail brokerage data, for which there are 66 distraction events.<sup>21</sup> Dollar trading volume ( $\log(\$volume)$ ) is approximately 6.5% lower ( $p < 0.05$ ) on distraction days, almost symmetrically across buys and sells. Breaking up this effect, we find a statistically significant decrease in all three components of volume. However, the observed effect on the intensive margin is considerably weaker than that on the extensive margin: average trade size and the number of distinct stocks traded both decrease by less than 2%, whereas the number of trading retail investors falls by 5%.<sup>22</sup> Taken together, these findings are more consistent with models assuming a fixed attention cost for accessing the stock market than with models in which distraction reduces the (perceived) precision of retail investors' information. We also note that, in contrast to the other measures, the reduction in  $\log(\#stocks)$  is significantly greater for buys than for sells, which supports Barber and Odean's (2008) argument that retail buy decisions require more attention than sell decisions, due to the larger choice set for the former.

Panel B of Table II reports results of a similar analysis conducted on institutional trades.<sup>23</sup> Again we find a significant drop in trading volume ( $p < 0.05$ ), but its magnitude (about 4%) is smaller than for retail investors. Breaking up this effect yields results that

---

<sup>21</sup> To minimize the impact of structural breaks in the time series of the number of households covered in the data, we focus on households that report portfolio holdings for at least four of the six sample years. For the  $\log(\#investors)$  measure, we follow Barber and Odean (2002) and focus on the trades of 12,743 households with holdings throughout the full sample period.

<sup>22</sup> Moreover, in Internet Appendix III.G, we find that retail investors trading larger quantities on average are slightly more likely to stop trading on distraction days, which suggests that the reduction in the average trade size is due in part to a composition effect.

<sup>23</sup> Because we do not have portfolio holdings data for institutions, we cannot restrict our analysis—as we did with retail investors—to institutional investors that report holdings persistently over the sample period. We experimented with alternative filters (e.g., requiring institutions to trade at least once per month for a majority of the sample period) and obtained results that are similar to those reported here.

are more nuanced than those for retail investors: although all three components exhibit negative estimates, none is consistently significant. In particular, the evidence at the extensive margin (i.e., for  $\log(\#investors)$ ) is less compelling for institutional than for retail investors. This might be explained by professional investors facing lower fixed attention costs for trading, or by the ANcerno data not identifying investors with enough precision. Indeed, the data identify only the management company (e.g., the fund family), and hence some fund families—Fidelity as an extreme example—appear to trade almost continuously over the sample period.

[[ Insert Figure 3 about here ]]

A natural question that arises is whether investors eventually execute the trades that they missed while distracted, that is, whether they “catch up” on their trading. To answer this question, in Figure 3 we plot investors’ abnormal trading activity in event time. We use the trading measures that produce the most reliable results in Table II:  $\log(\#investors)$  for retail investors and  $\log(\$volume)$  for institutions. In neither case do we find any evidence of abnormal trading in the five trading days that precede or follow a distracting event; the only significant effect occurs on the distraction day itself. Thus, the figure confirms that our distraction events cause shocks to investors’ trading activity that are short-lived. The figure also suggests that the trades forgone on distraction days are superfluous in the sense that they do not lead investors to trade more once the distraction subsides. Such trades are more likely to be speculative, presumably executed by sensation-seeking investors, than liquidity trades motivated by a surplus or shortage of cash. In the next subsection we provide further evidence consistent with this interpretation.

#### *B. Which Retail and Institutional Investors are More Distracted?*

Having established that investors trade less on distraction days, we now seek to identify which investor types are more prone to distraction. To do so, we sort investors on the extent to which they are biased and/or make losses (or forgo profits) from trading.

Motivated by prior research, we employ seven proxies for investor biasedness. The first proxy, gender, is motivated by Barber and Odean’s (2001a) finding that men trade more frequently than women but earn lower returns. This pattern can be attributed to overconfidence (many studies in psychology demonstrate that men are more overconfident than women) or to the pleasure derived from trading (the excitement of gambling; see Dorn and Sengmueller(2009),Grinblatt and Keloharju(2009),Gao and Lin(2014)). We define the dummy variable *single-male* as an indicator equal to one for a

single male investor or zero for a single female investor; we focus on single households because they are likely to display starker differences (Barber and Odean(2001a)).

The second proxy is a dummy variable, indicating whether investors have switched from phone-based to online trading. Prior research shows that online investors are more overconfident (Barber and Odean (2002)). This may be because overconfidence makes investors switch to online trading or because the vast amount of investment information available on the internet provides an illusion of knowledge (Barber and Odean(2001b)). Information on gender and online trading status is available in the retail data only.

Our third proxy is portfolio concentration, which we capture using the average Herfindahl index over monthly portfolio holdings for retail investors and over monthly trading intensities (i.e., trading volumes across stocks) for institutions (since we do not observe their portfolio holdings). An investor who holds a concentrated portfolio forgoes the benefits of diversification, which indicates that either she has strong (possibly ill-placed) faith in her few selected stocks or she is seeking highly skewed (lottery-like) portfolio returns.

Our fourth proxy is trading intensity, which is measured as an investor's average trading volume over the sample period. This metric builds on past evidence that investors trade too much (Barber and Odean(2000), Kelley and Tetlock(2013)). Our fifth proxy is investment performance as measured by portfolio losses for individuals (the average portfolio return times minus one) or trading losses for institutions (the average post-trade return over the 12 months following a trade times minus one). The rationale here is that investors who are more overconfident or more sensation-seeking should perform worse. For our sixth proxy, we follow Goetzmann and Kumar (2008) and combine portfolio turnover and performance to capture the notion that overconfident or sensation-seeking investors underperform *because* they trade too much. Specifically, we multiply an investor's portfolio turnover rank by their losses rank. A higher product corresponds to more overconfident or sensation-seeking investors.

Finally, we conjecture that investors with a habit of buying attention-grabbing stocks are more prone to distraction. To capture this propensity, for each investor we calculate the fraction of buy decisions that occur on days when the purchased stock is covered in the media (specifically, in at least one of the four main U.S. newspapers: *New York Times*, *Wall Street Journal*, *Washington Post*, *USA Today*). We argue that investors who react strongly to such (stale) newspaper coverage are also more attracted to sensational news stories and might therefore be more distracted. Previous studies document that the

media is positively associated with noise trading (Tetlock (2007), Peress (2014)), and negatively associated with trading performance (Fang, Peress, and Zheng, (2014)).

For each of these proxies, we split our sample of investors into halves and then carry out the event study separately on each subsample. We conduct the analysis on both the individual and the institutional transactions data sets while focusing on the most reliable respective trade measures:  $\log(\#investors)$  for individuals and  $\log(\$volume)$  for institutions. The results are reported in Table III and reveal that, regardless of which proxy is used, investors classified as more biased—be they individuals or institutions—trade less on sensational news days. The difference across groups is remarkable: in 12 out of 12 cases, the distraction effect is larger in the top group than in the bottom group,<sup>24</sup> with the difference significant at the 10% level in five cases. The difference is also economically sizable: for eight of 12 proxies, the distraction effect in the top group is more than twice that in the bottom group.

[[ Insert Table III about here ]]

Taken together, the results suggest that the sensational news events studied in this paper primarily affect noise traders, that is, sensation-seeking, overconfident, or media-sensitive retail and institutional investors are more likely to be distracted from trading. It is ironic that, to the extent these investors trade too much because of their overconfidence (Barber and Odean (2001a)), they actually *benefit* from being distracted. This finding offers a more nuanced view of inattention. In particular, it suggests that inattention need not be detrimental, as is commonly assumed in the literature—when inattention interacts with behavioral biases, it may actually benefit the trader.

### C. TAQ Analysis

Our results so far indicate that both retail and institutional noise traders are prone to distraction. How strongly distraction affects the overall populations of retail and institutional investors thus depends on the proportion of noise traders within each group.

Table II, which reports that the decline in trading volume is one third larger for retail than for institutional investors, suggests that distractible noise traders are more prominent among retail investors. The difference between the two investor types might be even larger since prior evidence suggests that the ANcerno data set underrepresents skilled institutions. For instance, Jame (2017) and Choi, Laibson, and Metrick (2016) document no outperformance for the average hedge fund in ANcerno, whereas there is

---

<sup>24</sup> If the sign of these differences were random and i.i.d., such an outcome should occur with a probability of only  $0.5^{12} = 0.024\%$ .

evidence of skill in the broader population (Kosowski, Naik, and Teo. (2007), for a survey, see Agarwal, Mullally, and Naik (2015)). To the extent that ANcerno investors are less skilled than the average institution, they may also be more prone to distraction (Fang, Peress, and Zheng (2014)).

Our next analysis presents additional evidence that retail investors are more susceptible to distraction than are institutional investors. Specifically, we conduct an event study using TAQ data for all transactions involving stocks listed on NYSE/AMEX/Nasdaq from 1991 to 2000. The advantage of these data is that they cover all transactions and as a result offer a broad view of the market. A shortcoming is that they do not include traders' identities. However, prior research shows that, until decimalization in 2001, small trades were most likely to be executed by retail investors and large trades by institutions (Hvidkjaer (2008), Barber, Odean, and Zhu (2009)). Accordingly, we investigate how distraction effects vary with trade size.

Panel C of Table II reports results for the 105 distraction events that occurred during the period 1991 to 2000. Our measure of trading intensity,  $\log(\$volume)$ , is the (log) value of trades aggregated separately over small and large trades. On a distraction day, trading volume due to small trades declines by 2% ( $p < 0.1$ ) whereas the volume due to large trades declines by only a statistically insignificant 0.7%. Column (3) shows that the difference in distraction effects between small and large trades is significant. This suggests that distractible noise traders account for a larger share of retail trading (as proxied by small trade volume) than of institutional trading (as proxied by large trade volume). Thus, in the stock market analysis below, we expect distraction effects to be more pronounced for stocks with high retail ownership.

#### **IV. Distraction and the Market**

##### *A. Hypotheses*

Having established that noise traders trade less on distraction days, we now investigate the implications for the stock market. To do so, we consider an extension of the Kyle (1985) model; see Internet Appendix Section I for details. Specifically, building on a static model based on adverse selection, we introduce inventory concerns by making market makers risk-averse. The resulting model captures two important sources of illiquidity identified in the microstructure literature: adverse selection (Glosten and Milgrom (1985), Kyle (1985)) and inventory risk (Stoll (1978), Ho and Stoll (1980, 1981), Grossman and Miller (1988)).

Our model predicts that if noise traders are distracted (as modeled by a reduction in the variance of noise trading), then trading volume declines, liquidity worsens (higher Kyle's lambda), returns become less volatile, and the autocovariance of returns grows (is less negative).

The intuition for these predictions is as follows. Trading volume declines not only because there are fewer noise trades, but also because speculators, who try to conceal their information, scale their trades back.

Liquidity is affected by two opposing forces. On the one hand, a lower variance of noise trades implies that market makers face higher adverse selection risk, which induces them to decrease liquidity. On the other hand, a lower variance reduces inventory risk, which allows market makers to charge a lower risk premium and thus improve liquidity. It turns out that the former effect outweighs the latter, so that a reduction in the variance of noise trades unambiguously leads to reduced liquidity. This is because, in our model, noise shocks affect the amount of inventory that market makers need to absorb but do *not* affect the difficulty involved in unwinding this inventory going forward. In this respect our approach differs from classic models of inventory risk (Ho and Stoll (1980,1981), Grossman and Miller (1988), Hendershott and Menkveld (2014)), where market makers are concerned about fluctuations in the value of this inventory caused by *future* noise trading.<sup>25</sup> It is precisely this feature that makes our model well suited for deriving implications of short-lived distraction shocks such as those studied in this paper.

Finally, return volatility and autocovariance are driven by the inventory risk component of liquidity because that component leads to a transient price impact.<sup>26</sup> Less noise trading means fewer temporary shocks to prices, which reduces volatility and price reversals. Treating our distraction events as a natural experiment, we now set out to test these predictions.

### *B. Marketwide Analysis*

We start with a brief description of the variables used in this section.<sup>27</sup> We winsorize the data at the 0.5% level in both tails and then purge them of seasonal patterns (as described previously). Throughout our analysis, we focus on equally weighted averages

---

<sup>25</sup> See Foucault, Sraer, and Thesmar (2011), who exploit a quasi-permanent change in retail activity that resulted from a regulation change affecting the French stock market, for a test of this standard intuition about inventory risk.

<sup>26</sup> In contrast, the adverse selection component of liquidity is *not* associated with volatility because it changes only the timing of when uncertainty is resolved (see Kyle(1985)).

<sup>27</sup> The Appendix gives detailed definitions for the variables used in our study.

across stocks. Value-weighted averages yield weaker results, which suggests that our findings are concentrated among smaller stocks (we verify this later). To assess the effect of distraction events on stock market performance, we examine the (equal-weighted) average market return on all stocks in CRSP (denoted *mkt return*). For trading activity, we look at both the average of daily (log) turnover ( $\log(\textit{turnover})$ ), defined as the number of shares traded in a stock on a given day divided by the number of shares outstanding,<sup>28</sup> and the (log) aggregate dollar volume ( $\log(\$volume)$ ).

We use several measures of liquidity, which are broadly classified into three groups. The first group contains measures that reflect both adverse selection and inventory risk. It includes quoted bid-ask spreads (*closing bid-ask spread* from CRSP, available as of November 1982, and daily *average bid-ask spread* from TAQ, both measured relative to the mid-quote) as well as *effective spreads* from TAQ (i.e., the percentage increase in the ratio of the transaction price over the prevailing mid-quote prior to the transaction).<sup>29</sup>

The second group consists of four measures of adverse selection. The first is the Amihud (2002) illiquidity ratio, defined as a stock's (log) absolute return divided by dollar volume.<sup>30</sup> This measure, denoted  $\log(\textit{amihud})$ , is computed from CRSP data and thus is available for the entire sample period. Goyenko, Holden, and Trzcinka (2009) show that it does a good job of capturing adverse selection. The second measure is *price impact*, defined as the percentage change in the mid-quote from one second before to five minutes after the transaction. The third measure is the *absolute trade imbalance*. Easley, Engle, O'Hara, and Wu (2008), and Kaul, Lei, and Stoffman (2008) argue that this measure captures the intuition of the PIN introduced by Easley, Hvidkjaer, and O'Hara (2002) while having the advantage of being computable at the daily frequency. Our fourth adverse selection measure, *lambda*, is the slope coefficient from a regression of stock returns on signed order flow over five-minute intervals. It can be interpreted as the cost of demanding a certain amount of liquidity over five minutes. The last three of these measures all require high-frequency TAQ data, so they are available for only a subset of our distraction events.

---

<sup>28</sup> Because turnover can be zero, we follow Llorente et al. (2002) and add a small constant (0.00000255) before taking logs. Our results are robust to alternative choices for this constant, including dropping it altogether.

<sup>29</sup> In the paper, we report results for TAQ-based spread measures that are equal-weighted across trades. In Internet Appendix II.D, we document similar results for share-weighted and dollar-volume-weighted spread measures.

<sup>30</sup> Because this ratio can be zero, we add a small constant (0.00000001) before taking logs. The constant is chosen so as to make the Amihud ratio's distribution closer to a normal distribution. Our results are robust to alternative choices for this constant, including dropping it altogether.

The third group of our liquidity measures captures noninformational sources of illiquidity, such as inventory or order-handling costs. This “group” comprises *realized spread*, which is the part of the effective spread that accrues to market makers as compensation for providing liquidity.

Finally, we investigate the impact of distraction on three measures of return volatility and on return autocovariance. Two of the volatility measures—the average stock-level absolute return (*abs return*) and the logarithm of the ratio of daily high and low prices (*price range*)—are computed from CRSP data and thus are available for our full sample period. The remaining two measures are the intraday standard deviation of stock returns (*intraday volatility*) and the intraday autocovariance of stock returns (*intraday autocovariance*), both calculated from intraday returns obtained from TAQ.

Descriptive statistics for all stock market variables are reported in Internet Appendix IIA. The magnitudes are in line with previous literature (e.g., Goyenko, Holden, and Trzcinka (2009)) and, after our filters and data adjustments, the measures are reasonably close to a normal distribution, justifying the use of the parametric BMP test in our inferences.

Table IV reports results for the marketwide event study. We first note that distraction days have no discernable effects on market returns. This is reassuring since any effect on returns would cast doubt on the presumed noneconomic nature of these events. Other results are relatively weak. For example, dollar volume and turnover decline by 1.1% and 0.8%, respectively, with *t*-statistics of  $-1.5$  and  $-1.1$ . We uncover some significant increases—in closing bid-ask spreads, Amihud illiquidity ratio, and lambda—that are suggestive of an increase in adverse selection risk on distraction days. That being said, most of our measures show insignificant changes for the average stock in our sample. We therefore turn our attention to stocks for which we expect stronger distraction effects, that is, stocks for which noise trading is more pronounced—stocks predominantly held by retail investors (see Section III.C above).

[[ Insert Table IV around here ]]

### C. Sample Splits

We sort stocks into terciles based on three common proxies for retail ownership: firm size (market capitalization), the firm’s stock price, and the fraction of institutional ownership (drawn from firms’ 13(f) filings). For brevity, we only report the sample split results for firm size—those for stock price and institutional ownership are summarized below and relegated to Internet Appendix Sections II.B and II.C, respectively.

It is well documented (e.g., Lee and Leary (1991)) that small stocks are held proportionately more by retail noise traders, so we expect results to be strongest for the bottom tercile in terms of firm size. As Panel A of Table V reports, this is indeed what we find: in the lowest tercile, turnover is significantly reduced (by 2.4%) on distraction days. There is no such effect for stocks in the top tercile, and the *difference* between the highest and lowest terciles is strongly significant. A similar pattern emerges for trading volume.

[[ Insert Table V around here ]]

Small stocks also experience a drop in volatility: both the price range and intraday volatility are reduced by a significant 2% to 3% on distraction days (relative to their unconditional mean: see Table IA.II in the Internet Appendix). For the largest firms, volatility is unchanged (except for the price range, which exhibits a significant increase according to the parametric BMP test but not according to the nonparametric rank test). The difference between the bottom and top terciles is highly statistically significant. For absolute returns, a similar but statistically insignificant pattern is observed. The return autocovariance increases significantly for small firms, but is unchanged for large ones, implying that small firms have less inefficient (i.e., less negatively autocorrelated) prices on distraction days.

Panel B of Table V reports our findings for liquidity. We find that all measures display a significant increase for small stocks (with the exception of price impact, where the increase is only marginally significant) but are unchanged for large stocks. The difference is significant (again with the exception of price impact). In terms of economic magnitudes, the largest effect is observed for lambda, the regression-based price impact measure. Among small stocks, this measure increases by 11% relative to its unconditional mean, which indicates that demanding liquidity has become substantially more costly. For small stocks, the increase in our spread measures ranges from 2.4% (for average quoted spreads) to 3.8% (for realized spreads). The Amihud illiquidity ratio and the absolute trade imbalance rise by 2.4% and 1.1%, respectively.

In Internet Appendix Sections II.B and II.C, we sort stocks based on price and institutional ownership derived from 13(f) filings. Low-priced stocks and stocks with low institutional ownership are predominantly held by retail investors (e.g., Brandt et al (2010)). We therefore expect—and find—stronger results for such stocks: in the lowest terciles in terms of price (Table IA.III) and institutional ownership (Table IA.IV), we find a reduction in trading activity, volatility, and liquidity, as well as an increase in return autocovariance. These changes are typically statistically significant and tend to abate

monotonically in the other terciles. For most measures, the difference between the top and bottom terciles is also significant.

Taken together, our results are in line with what our model predicts when noise traders are distracted (see Section IV.A and Internet Appendix Section I). The increase in realized spreads further suggests that, for small stocks, the provision of liquidity—in addition to the demand for those stocks—is reduced. We return to this observation in Section V.D below.

#### *D. Cross-Sectional Test*

The results from our three sample splits paint a consistent picture: on distraction days, stocks with high levels of retail ownership experience a reduction in trading activity, volatility, price reversals, and liquidity, whereas stocks with low retail ownership are unaffected. Our model demonstrates that these findings can all be attributed to a common shock, namely, a reduction in noise trading. This interpretation further implies that distraction events that display a larger drop in trading should exhibit a more pronounced reduction in volatility, price reversals, and liquidity.

In this subsection, we test this prediction by regressing abnormal volatility, return autocovariance, and liquidity on abnormal trading activity in the cross-section of distraction events. The results are reported in Table VI. For all measures of volatility, we find a strong positive relation to abnormal turnover (from CRSP) in the subsample of firms in the bottom size tercile. This result suggests that distraction events with a larger drop (i.e., more negative) in turnover experience a larger drop (i.e., more negative) in volatility as well. Similarly, we obtain statistically negative coefficients when we regress liquidity measures on turnover, which suggests that events with a larger reduction in trading see a larger increase in spreads/illiquidity. Replacing share turnover with small TAQ trades, the number of retail traders from the brokerage data set, or institutional trading volume from the Ancerno data set yields similar but statistically weaker results, owing to the smaller number of observations for these shorter time series (see Table IA.XVI in the Internet Appendix).

[[ Insert Table VI around here ]]

Overall, the results above establish that our findings for trading activity, volatility, price reversals, and liquidity are all interconnected. The results therefore strengthen our interpretation, derived from the model, that all of these effects are caused by a reduction in noise trading.

## V. Robustness, Endogeneity, and Alternative Explanations

In this section we check the robustness of our results to both the choice of keywords used to construct the event list and event clustering. In addition, we address endogeneity concerns and we discuss alternative explanations related to distracting agents other than noise traders and investor sentiment.

### A. Robustness to the Event List

As described in Section II, we filter the initial set of 1,108 high-news pressure days down to 551 sample event-days using a list of economic keywords designed to address the possible confounding effects of news about the economy. In unreported analyses, we find that our results are robust to changes in the event list. For example, we check that our results are not driven by a few outlier events. We also experiment with a manual filter, since some events may have economic relevance even though no economic keyword appears in the headline (e.g., political party conventions, where economic policy agendas are announced and presidential candidates are determined). Results are very similar to those obtained with the arguably less subjective keyword filter.

The fact that specific keywords do not alter our results leads us to conclude that, despite their differences, most high-news pressure days are much alike: they feature sensational news stories that have little bearing on the economy. This inference is confirmed in Table IA.VII of the Internet Appendix, which uses all 1,108 high-news pressure days and reports even stronger results (due to the increase in statistical power resulting from doubling the number of events; the only exception is the return autocovariance, which yields slightly weaker results). Both trading activity and volatility decline significantly in the bottom terciles of firm size, stock price, and institutional ownership. All adverse selection measures increase significantly, including price impact, which was only marginally significant before. The other spread measures also increase.

### B. Robustness to Event Clustering

Given that some distraction events are separated by only a few days, the clustering of events over time may have lead us to overstate the statistical significance of our findings. According to Table I, for example, the two most newsworthy days in 1986 (January 28 and 29) each concerned the *Challenger* space shuttle explosion. Thus far, we treat such events as independent. In Table IA.VII of the Internet Appendix, we repeat our main analyses after restricting the sample to *distinct* distraction events, defined as events that occur at least five business days (one full calendar week) apart. This approach is conservative because it discards all of the information contained in an event that is close

to a previous one. Although only 382 events survive this requirement, our main results continue to hold: stocks with high retail ownership (as proxied by firm size, stock price, or institutional ownership) experience a significant decrease in trading activity, volatility, and liquidity, and an increase in return autocovariance. We therefore conclude that our findings are robust to event clustering.

### *C. Endogeneity*

News pressure—the criterion that we use to identify candidate distraction events—could be endogenous to the stock market, for two reasons.

The first endogeneity concern is that news pressure may be elevated on days with important *economic* news. In that case, the patterns we document for the market may be caused by the economic news itself—rather than by investor distraction, as we claim. The economic filters that we impose attempt to mitigate this concern. In addition, we show that news pressure is only weakly related to indicators of business activity, newspaper sentiment, or macroeconomic news releases (see Internet Appendix III.B), and that our event-study results are virtually unchanged after removing stocks that operate in sectors that might be affected by certain types of events (e.g., firms in construction or insurance for events involving natural disasters and firms in regulated industries for political events; see Internet Appendix II.G). Notwithstanding, it is impossible to guarantee that none of the events on our list affect the U.S. economy. We emphasize, however, that this concern is inconsistent two aspects of our results. First, we find that only small, low-priced, and low-institutional ownership stocks are affected. This observation does not fit with the well-established observation that large stocks lead smaller ones in terms of price discovery (e.g., Lo and MacKinlay (1990), McQueen, Pinegar, and Thorley (1996))—if our distraction events were about economic news, one would expect large stocks to respond first. Second and more importantly, economic news should bias our results *against* finding a distraction effect because economic news triggers more rather than less turnover and volatility.<sup>31</sup> In essence, our identification strategy draws on the discrepancy between the exuberant *news coverage* and the fundamental *newsworthiness* of a media story. Distraction effects such as those that we document prevail when the former outweighs the latter.

---

<sup>31</sup> In Internet Appendix III.A, we confirm this intuition by conducting event studies for two different lists of economic events. First, we examine 37 high-news pressure days on which the stock market is the topic of a news segment (these days are filtered from the list of distraction events thanks to our “stock market” keyword). Second, we look at scheduled meetings of the Federal Open Market Committee, which are among the most anticipated recurring macroeconomic news events. For both of these lists, we find a strong increase in trading volume and volatility.

The second endogeneity concern is reverse causality: news pressure may be especially high on days with *little* economic news. Indeed, TV news broadcasts may devote considerable time to economically irrelevant stories precisely because they have nothing newsworthy to report about the economy. This explanation is consistent with our finding that trading activity and volatility are low when news pressure is high. We make four counterarguments. First, if high news pressure is caused by the absence of newsworthy material on high-news pressure days, then one would expect to find lower TV viewership on those days. This explanation is difficult to reconcile with the surge in TV viewership documented in Table I. Second, by excluding economic news days from the estimation window, our event-study approach ensures that we compare high-news pressure days without economic news to other days without economic news. This means that our results cannot be driven by an implicit sorting on the absence of (macro-)economic news. Third, using different proxies for the amount of firm-specific news, we find no evidence that our distraction days exhibit fewer (or more) firm-specific news than other days (see Table IA.XV of the Internet Appendix). Fourth, we conduct a placebo analysis on *low*-news pressure days, where events consist of days with no economic news (as in the main analysis) but on which news pressure is in the lowest decile for the year (rather than in the highest decile, as in the main analysis). If the reverse causality argument were correct, days with low news pressure would feature lots of economic news, and we should expect these days to display heightened trading activity and volatility. The results of this placebo exercise, reported in Table IA.IX of the Internet Appendix, indicate no such effect. In short, our results are driven by positive spikes in news pressure unrelated to the economy, that is, by distracting events.

#### *D. Alternative Explanations: Distracting Insiders or Market Makers*

In this subsection, we evaluate whether our results can be explained by agents other than noise traders—namely, informed speculators or market makers—being distracted. Using our model in Internet Appendix Section I, we find that distracting either of these two types of agents yields predictions that do not match the facts. In particular, when speculators are distracted (as modeled by a decrease in their signal precision), liquidity should increase—not decrease as we find. This is because speculators trade less

aggressively when they are less well informed, which reduces adverse selection risk and hence prompts market makers to improve liquidity.<sup>32</sup>

In contrast, when only market makers are distracted (as modeled by a decrease in their signal precision), one expects returns to become more volatile and their autocovariance to decline—again the opposite of what we find. Intuitively, market makers' signal represents their interpretation of public information. As their signal becomes less precise, market makers assign more weight to the information conveyed by the order flow. This leads to greater price impact, which magnifies the return volatility. Likewise, the return autocovariance becomes more negative, that is, prices reverse more.

In sum, alternative explanations based on insider or market maker distraction are unable to jointly explain our findings for trading volume, volatility, and liquidity. These results reinforce the message that emerges from the trade-level analysis in Section III: the sensational news events studied in our paper primarily distract noise traders.<sup>33</sup>

#### *E. Alternative Explanation: Investor Sentiment*

Many of the distraction events in our sample carry a negative connotation because they pertain to natural disasters, terrorist attacks, accidents, or celebrity deaths. One may thus wonder whether our results could be explained (or confounded) by shocks to investor sentiment.<sup>34</sup> In our view, there are three reasons why this is unlikely. First, a negative shock to sentiment should be associated with a significantly negative return. Although we do observe a negative sign for the abnormal market return on distraction days (see Table IV), this effect is both economically small and statistically insignificant. Second, Garcia (2013) reports that both positive and negative shocks to investor sentiment lead to a surge in trading activity—yet we observe the exact opposite on distraction days. Finally, we manually split our distraction sample into positive, neutral, and negative events but fail to find a significantly lower return for the negative events

---

<sup>32</sup> In Internet Appendix III.A, we further show that our distraction events do not affect the speed with which earnings news is incorporated into stock prices, which suggests that they do not distract speculators trading on the earnings announcement drift.

<sup>33</sup> One piece of evidence—specifically, the increase in realized spreads—suggests that, in addition to a decrease in noise trading, there is less liquidity provision on distraction days. Additional analysis presented in Internet Appendix III.F, reveals that this effect is driven by contrarian traders, rather than specialist market makers, being distracted. Experimental evidence suggests that uninformed investors often behave as “contrarian noise traders” (Bloomfield, O'Hara, and Saar (2009)), so it may be the case that the distracted noise traders and the distracted contrarian traders are one and the same. In any case, the dominant effect is the reduction in noise trading, as our results (in particular, the drop in return volatility) are collectively inconsistent with only liquidity providers being distracted.

<sup>34</sup> Several papers study the effect of investor sentiment on stock returns. See, for example, Saunders (1993), Hirshleifer and Shumway (2003), Kamstra, Kramer, and Levi (2003), and Edmans, Garcia, and Norli (2007) for studies on exogenous mood variables pertaining to weather, lunar phases, or sports results, and see Tetlock (2007) and Garcia (2013), among others, for studies on sentiment extracted from newspaper columns.

(see Internet Appendix III.H). We conclude that the sensational news stories in our sample are at most remotely related to investor sentiment.

## **VI. Distracted Noise Traders and Technology**

Our distraction events span more than four decades—a period that has seen profound changes in both the composition of the investor population and the trading environment. In this section, we first examine how distraction effects have evolved over time. We then examine how these effects were impacted by two major developments: the Internet and algorithmic trading.

### *A. Distraction Effects over Time*

We conduct the event study separately over the three subperiods 1968 to 1992, 1993 to 2006, and 2007 to 2014. The second period captures the influence of the Internet, which revolutionized investment practices throughout the 1990s by facilitating access to information and enabling online trading. The start of the Internet era is hard to pin down precisely. The first web browser (written by Tim Berners-Lee at CERN) was released to the public in 1991. The hugely popular web browser Netscape and the search engine Yahoo! were created in 1994. The year 1993 thus seems a reasonable start date -it is also a convenient one as TAQ data start in 1993. The third period corresponds to one in which algorithmic traders—and chief among them, high-frequency traders—have come to dominate trading. According to a report by the SEC (2010), these traders accounted for more than half of the trading volume in U.S. equity markets in 2009. Deregulation (Regulation NMS, passed in 2005 and implemented in 2007) and technological advances (e.g., ultra-fast communication lines) have driven the growth of algorithmic trading.

The results of the subperiod analysis are reported in Table VII. As we move from the first to the second subperiod, the impact of distraction is substantially greater for virtually all variables. For example, the effect grows from  $-1.4\%$  to  $-3.2\%$  for turnover, and from  $-3.4\%$  to  $-6.6\%$  for the price range; the closing bid-ask spread, in relative terms, increases from  $1.7\%$  ( $= 0.074\%/4.23\%$ ) to  $3.1\%$  ( $= 0.075\%/2.54\%$ , where  $4.23\%$  and  $2.54\%$  are the average spreads over the first and second subperiods, respectively). The change from the second to the third subperiod reveals more contrasting patterns across variables. For trading activity, volatility, and price reversals, the impact of distraction is further amplified in the later period. For example, the effect grows from  $-3.2\%$  to  $-4.3\%$  for turnover, and similar increases are observed for return autocovariance and volatility.

In contrast, for liquidity, the effect vanishes altogether: in the most recent period, none of the liquidity variables worsens significantly on distraction days.<sup>35</sup>

[[ Insert Table VII about here ]]

It is worth noting that distraction effects have increased throughout the sample period (with the exception of liquidity in the later period) in spite of a secular decline in retail Chordia, Roll, and Subrahmanyam trading. Indeed, retail investors, who directly owned 57% of the stock market in 1991, saw their share slide to 37% by 2007 (Rydqvist, Spizman, and Strebulaev (2014)), with a concomitant decline in their share of trading (Chordia, Roll, and Subrahmanyam (2011)).<sup>36</sup> The persistence of distraction effects is consistent with our finding that institutional noise traders are distracted as well (see Section III).

In the following two subsections, we attempt to make sense of the time patterns of distraction effects, starting with the influence of the Internet.

#### *B. Distraction Effects and the Internet*

We find that distraction effects increased with the advent of the Internet. Previous work suggests that, rather than being a mere coincidence, the Internet may have caused this amplification through two distinct channels. The first is that the Internet reinforces investors' overconfidence. The vast amount of investment information that it offers gives investors an *illusion of knowledge*, leading them to overestimate their stock-picking ability (Barber and Odean(2001b)). Moreover, by enabling direct trading online, it increases investors' sense of control over the outcome of their trades. Consistent with an increase in overconfidence, Barber and Odean (2002) document that households trade more actively and less profitably after switching from phone-based to online trading (see also Choi et al. (2002), for evidence from 401(k) accounts). The second channel is the availability of timely information. Access to real-time data about the market, as well as the ability to execute orders rapidly and check portfolios several times a day, allow investors to respond to news more quickly. As a result, distraction effects are less protracted over time and thus appear amplified in the data.

---

<sup>35</sup> Recall that the cross-sectional tests in Section IV.D demonstrate that, on average, events associated with a larger decline in share turnover tend to be associated with larger declines in volatility, return reversals, and liquidity. Hence, the subperiod results cannot be explained by distinct events affecting distinct variables. Instead, the changes from the second to the third subperiod suggest that there are diverging time trends in the reaction of volume, volatility, return reversals, and liquidity to distraction events, presumably because of changes in the trading environment (e.g., the rise in algorithmic trading).

<sup>36</sup> Nevertheless, the proportion of retail ownership remains sizable among small stocks. For instance, we find that in the bottom size tercile, the average fraction of institutional ownership is still below 30% at the end of our sample period.

The evidence in Table III is consistent with both channels. Specifically, the table shows that households that trade online are almost twice as likely to be distracted as those that do not. To shed further light on the impact of the Internet, we compare tech to nontech stocks. We posit that, especially in the early days of the Internet, tech stocks were more likely to be held by tech-savvy investors, that is, early adopters of online trading. In line with this hypothesis, we find in our brokerage data set that tech stocks have a 24% larger probability of being traded online (z-stat of 4.9). We therefore expect tech stocks to exhibit stronger distraction effects. Table VIII presents event-study results after classifying stocks in the bottom size tercile—stocks that display significant distraction effects—as tech versus nontech based on SIC codes as in Loughran and Ritter (2004). The patterns in distraction effects that we observe across tech and nontech stocks mirror those that we find across the pre- and post-Internet eras: distraction effects for trading activity, volatility, and liquidity are all greater for tech stocks. This finding suggests that the Internet, by vastly increasing the amount and velocity of information available to investors and by speeding up their trading responses, is responsible for the amplification of distraction effects observed during the 1990s.

Table VIII about here

### *C. Distraction Effects and Algorithmic Trading*

As we proceed from the second to the third period, distraction effects display a striking divergence: they strengthen for trading activity, volatility, and price reversals, but they disappear for liquidity. Making sense of this divergence is not straightforward. For example, it might be rationalized by insiders, since 2007, being subject to distraction just like noise traders,<sup>37</sup> but this explanation strikes us as implausible. If anything, technology has made insiders more, rather than less, attentive over the post-2007 period (e.g., Chakrabarty, Bidisha, Moulton, and Wang (2018)). Alternatively, one might argue that inventory concerns have become more severe since 2007. Since the adverse selection and inventory risk channels have opposing effects on liquidity, a strengthening of the latter would explain why the distraction effect has dampened for liquidity. However, this explanation is difficult to square with the fact that liquidity has improved over the same

---

<sup>37</sup> Based on the predictions for distracted noise traders (Proposition 1) and for distracted insiders (Proposition 2), we expect the distraction effect for trading volume to be reinforced when both types of traders are simultaneously distracted (since the predictions for trading volume go in the same direction), whereas the distraction effect for liquidity would be muted (since the predictions for liquidity go in opposite directions).

period (e.g., Hendershott, Jones, and Menkveld (2011), Angel, Harris, and Spatt (2013)), as greater inventory concerns would seem to imply less rather than more liquidity.

The above discussion leads us to speculate that the post-2007 patterns may result from noise traders *interacting* with algorithmic traders. Indeed, technological advances—improvements in both hardware (e.g., computing power, custom-designed chips, ultra-fast communication lines) and software (e.g., pattern recognition algorithms, “Big Data,” artificial intelligence)—and new business practices (e.g., colocation, access to exchanges’ proprietary data feeds) have made it easier to detect and anticipate noise trades. These changes have contributed to the development of two types of algorithmic trading.<sup>38</sup>

The first, *agency algorithms*, are used by buy-side institutions to minimize the price impact of their trades, given a target portfolio. An example of such investors are the activist-shareholders analyzed by Collin-Dufresne and Fos (2015). These shareholders strategically time their informed trades (later disclosed in their SEC Schedule 13D filings) to occur when they anticipate more active noise trading, such as when volume on the S&P 500 market index is abnormally high (see also Dong, Feng, and Sadka (2017)). With the development of these agency algorithms, the decline in noise trading on days of sensational news prompts a more severe reduction in informed trades. The consequence for volume and volatility is an amplification during the later subperiod (since informed trades generate volatility over the short run). For liquidity, in contrast, the consequence is an attenuation because there is less adverse selection. This attenuation is consistent with the empirical evidence presented in Collin-Dufresne and Fos (2015) and Kacperczyk and Pagnotta (2017), who document that adverse selection measures fail to detect the presence of informed trading in the stock market.

The second type of algorithmic trading, *high-frequency trading*, is characterized by the speed (on the order of milliseconds or faster) with which orders are placed and modified. It has been argued that high-frequency traders take advantage of slow traders by front-running their orders, with noise traders presumed to be especially slow. Indeed, high-frequency trading firms pay retail brokers hundreds of millions of dollars each year for the right to execute their customers’ orders—a practice that enables front-running

---

<sup>38</sup> Algorithmic trading is “the use of computer algorithms to automatically make certain trading decisions, submit orders, and manage those orders after submission” (Hendershott, Jones, and Menkveld (2011)).

---

and has drawn scrutiny from the SEC.<sup>39</sup> We speculate that front-running by high-frequency traders (i.e., trading on short-run price changes predicted by information about incoming order flow) has a multiplier effect on trading volume. Hence, when noise trading declines on distraction days, trading volume goes down by more than the forgone noise trades because high-frequency traders scale back their front-running trades.<sup>40</sup> The distraction effect on liquidity may simultaneously be dampened to the extent that high-frequency liquidity providers are quick to adapt to incoming informed orders, thus alleviating adverse selection. Consistent with this conjecture, Van Kervel and Menkveld (2019) document that high-frequency traders rapidly switch from supplying liquidity to front-running when trading alongside informed institutional orders—a practice the authors call “with-wind trading.”

These considerations prompt us to investigate how noise trading interacts with algorithmic trading in the post-2007 period. To this end, we examine distraction effects for stocks—again belonging to the bottom size tercile—sorted on the intensity of algorithmic trading. We measure this intensity using three proxies, each based on a distinct data source. The first proxy, based on TAQ data, is the quote-to-trade ratio, or the number of quote updates divided by the number of trades.<sup>41</sup> A higher ratio indicates more algorithmic trading (see Hendershott, Jones, and Menkveld (2011), Conrad, Wahal, and Xiang (2015), Brogaard, Hendershott, and Riordan (2017)). The second proxy uses (back-filled) data from the SEC’s Market Information Data Analytics System (MIDAS) to construct an index based on four variables that are associated with algorithmic trading

---

<sup>39</sup> While payment for order flow is not new (Easley, Kiefer, and O’Hara (1996b), Battalio(1997)), the rise of high-frequency trading has reinvigorated this practice. Indeed, in 2014 the SEC began to probe brokerage firms about how retail customers’ orders are routed, executed, and filled. This investigation resulted in a number of settlements involving brokers such as Barclays, Credit Suisse, and Deutsche Bank. In 2017, the SEC charged Citadel—a firm responsible for handling approximately 35% of total U.S. retail trading volume—for using an algorithm that executed retail orders at less favorable, “stale” prices while covering these trades at better prices indicated by proprietary data feeds purchased from exchanges—a practice that essentially amounted to front-running.

<sup>40</sup> Although we are not aware of a model that captures front-running of order flow by high frequency traders, Foucault, Hombert and Roşu (2016) make related predictions. These authors develop a dynamic model in which a fast speculator (i.e., a high-frequency trader) has advanced access to incoming public information. In addition to his usual trading on long-term fundamentals, this speculator trades on short-run price changes predicted by his advance knowledge of the news. Foucault, Hombert and Roşu (2016) show that such news-based trading constitutes the bulk of a speculator’s trading activity, which explains why trading volume has soared with the advent of algorithmic trading. We hypothesize that a similar effect may arise when the fast speculator has advance information about imminent noise trades, rather than about imminent news.

<sup>41</sup> We calculate quote-to-trade ratios as described in Roşu, Sojli, and Tham (2018). For each distraction event in the post-2007 period, we then group stocks into terciles based on the trade-to-quote ratio in the year prior to the event.

---

(Weller (2017)).<sup>42</sup> The third proxy is the stock price, orthogonalized with respect to firm size (i.e., the residual from regressing stock price on the logarithm of market capitalization). Weller (2017) shows that this measure is a valid instrument for algorithmic trading activity—because of the minimum tick size of one cent imposed by SEC Rule 612 (the "sub-penny" rule), high-price stocks have a finer price grid, which advantages algorithms over humans for continually updating quotes.

[[ Insert Table IX about here ]]

Table IX presents event study results for the quote-to-trade ratio. Findings based on MIDAS data and the orthogonalized price are similar and relegated to Internet Appendix Sections II.I and II.J, respectively. We find that for the 87 distraction events occurring in the post-2007 period, the distraction effects for trading activity, volatility, and price reversals are more pronounced for stocks with more algorithmic trading (i.e., stocks in the top tercile). The differences across terciles are statistically significant for all but price reversals. In contrast, the distraction effects for liquidity tend to dampen among high-algorithmic trading stocks: the difference across terciles is negative for seven out of eight liquidity measures, significantly so for two. These findings suggest that the heightened distraction effects for volume, volatility, and price reversals and the attenuated liquidity effect that we find for the post-2007 period (See Table VII) are driven mainly by stocks characterized by a high level of algorithmic trading.

In short, far from dissipating with the downtrend in retail ownership, distraction effects have strengthened over time. Our evidence suggests that technological advances play a role in this amplification. The arrival of the Internet first rendered noise traders more overconfident and/or reactive to sensational news. Then came "robot" investors, which interact with noise traders in ways that exacerbate their impact on volume, volatility, and return reversals, while muting their impact on liquidity.

## VII. Conclusion

This paper studies how the limited attention of noise traders affects the stock market. We exploit episodes of sensational news that are exogenous to the stock market and that distract noise traders among retail and institutional investors, to examine how investor distraction affects market outcomes. We find that distraction days are associated with

---

<sup>42</sup> These four variables are: the *oddlot volume* ratio, or the fraction of volume of trades involving fewer than 100 shares; the *trade-to-order volume* ratio, which is equal to the executed trading volume divided by the total order volume; the *cancel-to-trade* ratio, or the number of full or partial cancellations divided by the number of trades; and the *average trade size*, which is the number of shares traded divided by the number of trades. See Internet Appendix Section B.9 for details on the construction of the index.

reduced trading activity, volatility, and liquidity among stocks for which noise trading is expected to be more pronounced, that is, stocks with small market capitalization, a low share price, and/or a low level of institutional ownership. We rationalize these findings in a parsimonious model that extends Kyle (1985) to incorporate market makers' concern for inventory risk.

Our findings have important implications for the literature on liquidity. In particular, our findings confirm that liquidity deteriorates in response to short-lived reductions in the intensity of noise trading—as predicted by theories of adverse selection (e.g., Glosten and Milgrom (1985), Kyle (1985))—and provide countervailing evidence to research documenting a liquidity improvement after a permanent reduction in the intensity of retail (noise) trading (Foucault, Sraer, and Thesmar (2011)). We reconcile these seemingly inconsistent results by noting that adverse selection and inventory risk are affected differently depending on the persistence of shocks to the intensity of noise trading: inventory concerns loom large when such shocks are persistent (as in Foucault, Sraer, and Thesmar (2011)), but adverse selection dominates when they are not (as in the case of our distraction shocks).

Our results highlight that the importance of noise trading has not declined in recent years, despite the downward trend in direct retail ownership. We offer three possible explanations for this observation. First, retail noise traders may simply have been replaced by institutional ones. Second, changes to the information and trading environments, such as those caused by the Internet, may have emboldened noise traders and offered new trading stimuli. Third, noise traders may interact with algorithmic traders in ways that magnify their impact. Indeed, we find that distraction effects for trading activity and volatility (but not for liquidity) have become stronger in recent years among stocks with a large presence of algorithmic traders. Since algorithmic traders are unlikely to be distracted themselves, this finding suggests that such interaction effects could be important. We look forward to seeing more work along these lines.

Initial submission: July 20, 2016; Accepted: December 1, 2018  
Editors: Stefan Nagel, Philip Bond, Amit Seru, and Wei Xiong

## REFERENCES

- Abel, Andrew B., Janice C. Eberly, and Stavros Panageas, 2007, Optimal inattention to the stock market, *American Economic Review* 97, 244–249.
- Abel, Andrew B., Janice C. Eberly, and Stavros Panageas, 2013, Optimal inattention to the stock market with information costs and transactions costs, *Econometrica* 81, 1455–1481.
- Abudy, Menachem, and Avi Wohl, 2018, Corporate bond trading on a limit order book exchange, *Review of Finance* 22, 1413–1440.
- Agarwal, Vikas, Kevin A. Mullally, and Narayan Y. Naik, 2015, The economics and finance of hedge funds: A review of the academic literature, *Foundations and Trends® in Finance* 10(1), 1-111.
- Amihud, Yakov, 2002, Illiquidity and stock returns: Cross-section and time-series effects, *Journal of Financial Markets* 5, 31–56.
- Angel, James J., Lawrence E. Harris, and Chester S. Spatt, 2013, Equity trading in the 21<sup>st</sup> century: An update, (Knight Capital Group, New York, NY)
- Barber, Brad, and Terrance Odean, 2000, Trading is hazardous to your wealth: The common stock investment performance of individual investors, *Journal of Finance* 55, 773–806.
- Barber, Brad, and Terrance Odean, 2001a, Boys will be boys: Gender, overconfidence, and common stock investment, *Quarterly Journal of Economics* 116, 261–292.
- Barber, Brad, and Terrance Odean, 2001b, The internet and the investor, *Journal of Economic Perspectives* 15, 41–54.
- Barber, Brad, and Terrance Odean, 2002, Online investors: Do the slow die first? *Review of Financial Studies* 15, 455–489.
- Barber, Brad, and Terrance Odean, 2008, All that glitters: The effect of attention and news on the buying behavior of individual and institutional investors, *Review of Financial Studies* 21, 785–818.
- Barber, Brad, Terrance Odean, and Ning Zhu, 2009, Do retail trades move markets? *Review of Financial Studies* 22, 151–186.
- Battalio, Robert H., 1997, Third market broker-dealers: Cost competitors or cream skimmers? *Journal of Finance* 52, 341–352.
- Ben-Rephael, Azi, Zhi Da, and Ryan D. Israelsen, 2017, It depends on where you search: Institutional investor attention and underreaction to news, *Review of Financial Studies* 30, 3009–3047.
- Benston, George, and Robert L. Hagerman, 1974, Determinants of bid-asked spreads in the over-the-counter market, *Journal of Financial Economics* 1, 353–364.
- Black, Fischer, 1986, Noise, *Journal of Finance* 41, 528-543.
- Bloomfield, Robert, Maureen O’Hara, and Gideon Saar, 2009, How noise trading affects markets: An experimental analysis, *Review of Financial Studies* 22, 2275–2302.
- Boehmer, Ekkehart, Jim Musumeci, and Annette B. Poulsen, 1991, Event-study methodology under conditions of event-induced variance, *Journal of Financial Economics* 30, 253–272.
- Brandt, Michael W., Alon Brav, John R. Graham, and Alok Kumar, 2010, The idiosyncratic volatility puzzle: Time trend or speculative episodes? *Review of Financial Studies* 23, 863–899.

Brogaard, Jonathan, Terrence Hendershott, and Ryan Riordan, 2017, High-frequency trading and the 2008 short sale ban, *Journal of Financial Economics* 124, 22–42.

Chakrabarty, Bidisha, and Pamela C. Moulton, 2012, Earnings announcements and attention constraints: The role of market design, *Journal of Accounting and Economics* 53, 612–634.

Chakrabarty, Bidisha, Pamela C. Moulton, and Xu Wang, 2018, Attention effects in a high-frequency world, Working paper, available at SSRN 2634621.

Chien, YiLi, Harold Cole, and Hanno N. Lustig, 2012, Is the volatility of the market price of risk due to intermittent portfolio rebalancing? *American Economic Review* 102, 2859–2896.

Choi, Jaewon, Neil D. Pearson, and Shastri Sandy, 2016, A first glimpse into the short side of hedge funds, Working paper, available at SSRN: <https://ssrn.com/abstract=2799423>.

Choi, James J., David Laibson, and Andrew Metrick, 2002, How does the Internet affect trading? Evidence from investor behavior in 401 (k) plans, *Journal of Financial Economics* 64, 397–421.

Chordia, Tarun, Richard Roll, and Avanidhar Subrahmanyam, 2000, Commonality in liquidity, *Journal of Financial Economics* 56, 3–28.

Chordia, Tarun, Richard Roll, and Avanidhar Subrahmanyam, 2011, Recent trends in trading activity and market quality, *Journal of Financial Economics* 101, 243–263.

Cohen, Lauren, and Andrea Frazzini, 2008, Economic links and predictable returns, *Journal of Finance* 63, 1977–2011.

Collin-Dufresne, Pierre, and Vyacheslav Fos, 2015, Do prices reveal the presence of informed trading? *Journal of Finance* 70, 1555–1582.

Conrad, Jennifer, Sunil Wahal, and Jin Xiang, 2015, High-frequency quoting, trading, and the efficiency of prices, *Journal of Financial Economics* 116, 271–291.

Conroy, Robert M., Robert S. Harris, and Bruce A. Benet, 1990, The effects of stock splits on bid-ask spreads, *Journal of Finance* 45, 1285–1295.

Copeland, Thomas E., 1979, Liquidity changes following stock splits, *Journal of Finance* 34, 115–141.

Corwin, Shane A., and Jay F. Coughenour, 2008, Limited attention and the allocation of effort in securities trading, *Journal of Finance* 63, 3031–3067.

Cutler, David M., James M. Poterba, and Lawrence H. Summers, 1989, What moves stock prices? *Journal of Portfolio Management* 15, 4–12.

Da, Zhi, Joseph Engelberg, and Pengjie Gao, 2011, In search of attention, *Journal of Finance* 66, 1461–1499.

DellaVigna, Stefano, and Joshua Pollet, 2009, Investor inattention, firm reaction, and Friday earnings announcements, *Journal of Finance* 64, 709–749.

Dershowitz, Alan M., 2004, *America on Trial: Inside the Legal Battles that Transformed Our Nation* (Grand Central Publishing, New York, NY).

Dong, Xi, Shu Feng, and Ronnie Sadka, 2017, Liquidity risk and mutual fund performance, *Management Science*, 65, 1020-1041.

Dorn, Daniel, and Paul Sengmueller, 2009, Trading as entertainment, *Management Science* 55, 591–603.

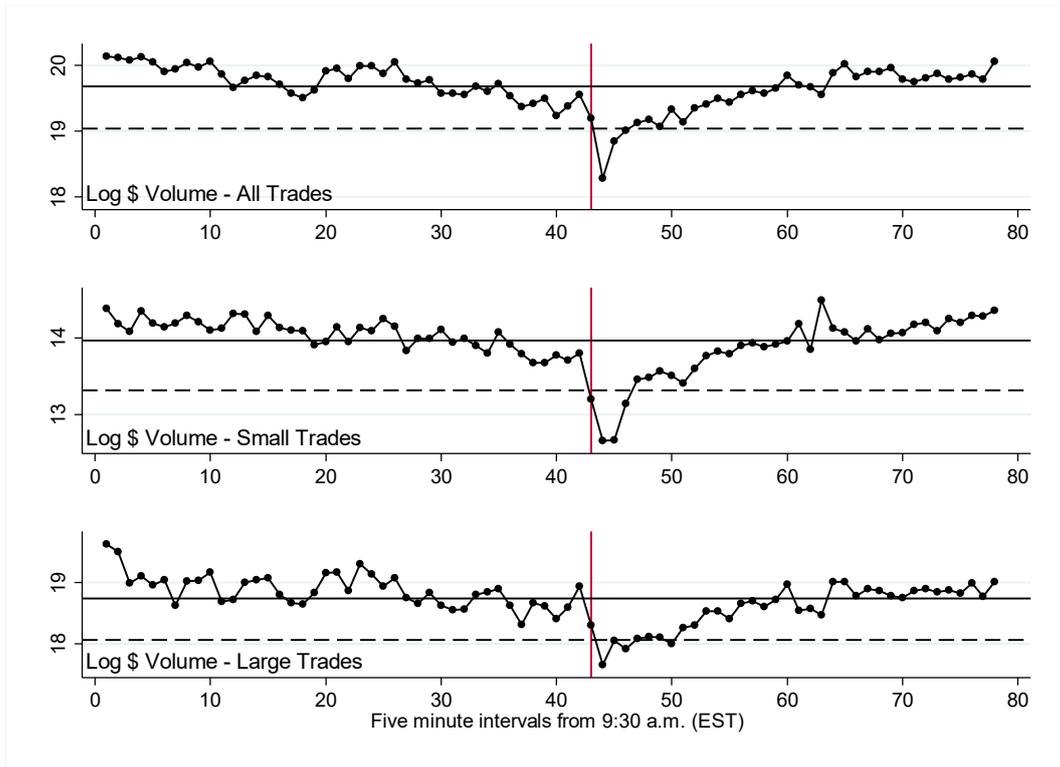
- Easley, David, Robert Engle, Maureen O'Hara, and Liuren Wu, 2008, Time-varying arrival rates of informed and uninformed trades, *Journal of Financial Econometrics* 6, 171–207.
- Easley, David, Søren Hvidkjaer, and Maureen O'Hara, 2002, Is information risk a determinant of asset returns? *Journal of Finance* 57, 2185–2221.
- Easley, David, Nicholas M. Kiefer, and Maureen O'Hara, 1996a, Cream-skimming or profit-sharing? The curious role of purchased order flow, *Journal of Finance* 51, 811–833.
- Easley, David, Nicholas M. Kiefer, Maureen O'Hara, and Joseph B. Paperman, 1996b, Liquidity, information, and infrequently traded stocks, *Journal of Finance* 51, 1405–1436.
- Easley, David, Maureen O'Hara, and Gideon Saar, 2001, How stock splits affect trading: A microstructure approach, *Journal of Financial and Quantitative Analysis* 36, 25–51.
- Ederington, Louis H., and Jae H. Lee, 1993, How markets process information: News releases and volatility, *Journal of Finance* 48, 1161–1191.
- Edmans, Alex, Diego Garcia, and Oyvind Norli, 2007, Sports sentiment and stock returns, *Journal of Finance* 62, 1967–1998.
- Eisensee, Thomas, and David Strömberg, 2007, News droughts, news floods, and U.S. disaster relief, *Quarterly Journal of Economics* 122, 693–728.
- Fang, Lily, Joel Peress, and Lu Zheng, 2014, Does media coverage of stocks affect mutual funds' trading and performance? *Review of Financial Studies*, 27, 3441–3466.
- Foucault, Thierry, Johan Hombert, and Ioanid Roşu, 2016, News trading and speed, *Journal of Finance* 71, 335–382.
- Foucault, Thierry, David Sraer, and David Thesmar, 2011, Individual investors and volatility, *Journal of Finance* 66, 1369–1406.
- Gao, Xiaohui, and Tse-Chun Lin, 2014, Do individual investors treat trading as a fun and exciting gambling activity? Evidence from repeated natural experiments, *Review of Financial Studies* 28, 2128–2166.
- Garcia, Diego, 2013, Sentiment during recessions, *Journal of Finance* 68, 1267–1300.
- Glosten, Lawrence, and Paul R. Milgrom, 1985, Bid, ask and transaction prices in a specialist market with heterogeneously informed traders, *Journal of Financial Economics* 14, 71–100.
- Goetzmann, William N., and Alok Kumar, 2008, Equity portfolio diversification, *Review of Finance* 12, 433–463.
- Goyenko, Ruslan Y., Craig W. Holden, and Charles A. Trzcinka, 2009, Do liquidity measures measure liquidity? *Journal of Financial Economics* 92, 153–181.
- Greene, Jason, and Scott Smart, 1999, Liquidity provision and noise trading: Evidence from the “Investment Dartboard” column, *Journal of Finance* 54, 1885–1899.
- Grinblatt, Mark, and Matti Keloharju, 2009, Sensation seeking, overconfidence, and trading activity, *Journal of Finance* 64, 549–578.
- Grossman, Sanford J., and Merton H. Miller, 1988, Liquidity and market structure, *Journal of Finance* 43, 617–633.
- Grullon, Gustavo, George Kanatas, and James P. Weston, 2004, Advertising, breadth of ownership, and liquidity, *Review of Financial Studies* 17, 439–461.

- Hameed, Allaudeen, Wenjin Kang, and S. Viswanathan, 2010, Stock market declines and liquidity, *Journal of Finance* 65, 257–293.
- Hendershott, Terrance, Charles M. Jones, and Albert J. Menkveld, 2011, Does algorithmic trading improve liquidity? *Journal of Finance* 66, 1–33.
- Hendershott, Terrence, and Albert J. Menkveld, 2014, Price pressures, *Journal of Financial Economics* 114, 405–423.
- Hirshleifer, David, Sonya S. Lim, and Siew Hong Teoh, 2009, Driven to distraction: Extraneous events and underreaction to earnings news, *Journal of Finance* 64, 2289–2235.
- Hirshleifer, David, and Tyler Shumway, 2003, Good day sunshine: Stock returns and the weather, *Journal of Finance* 58, 1009–1023.
- Ho, Thomas, and Hans R. Stoll, 1980, On dealer markets under competition, *Journal of Finance* 35, 259–267.
- Ho, Thomas, and Hans R. Stoll, 1981, Optimal dealer pricing under transactions and return uncertainty, *Journal of Financial Economics* 9, 47–73.
- Holden, Craig W., and Stacey Jacobsen, 2014, Liquidity measurement problems in fast, competitive markets: Expensive and cheap solutions, *Journal of Finance* 69, 1747–1785.
- Hong, Harrison, and Jeremy C. Stein, 2007, Disagreement and the stock market, *Journal of Economic Perspectives* 21, 109–128.
- Hou, Kewei, and Tobias J. Moskowitz, 2005, Market frictions, price delay, and the cross-section of expected returns, *Review of Financial Studies* 18, 981–1020.
- Hvidkjaer, Søren, 2006, A trade-based analysis of momentum, *Review of Financial Studies* 19, 457–491.
- Hvidkjaer, Søren, 2008, Small trades and the cross-section of stock returns, *Review of Financial Studies* 21, 1123–1151.
- Jame, Russell, 2017, Liquidity provision and the cross-section of hedge fund returns, *Management Science*, 64, 3288–3312.
- Kacperczyk, Marcin, and Emiliano Pagnotta, 2017, Chasing private information, Working paper, *Review of Financial Studies*, forthcoming.
- Kamstra, Mark J., Lisa A. Kramer, and Maurice D. Levi, 2003, Winter blues: A SAD stock market cycle, *American Economic Review* 93, 324–343.
- Kaul, Gautam, Qin Lei, and Noah Stoffman, 2008, AIMing at PIN: Order flow, information, and liquidity, Working paper, available at SSRN: <https://ssrn.com/abstract=872945>.
- Kelley, Eric K., and Paul C. Tetlock, 2013, Why do investors trade? Working paper, available at SSRN 2064144.
- Kosowski, Robert, Narayan Y. Naik, and Melvyn Teo, 2007, Do hedge funds deliver alpha? A Bayesian and bootstrap analysis. *Journal of Financial Economics* 84.1, 229–264.
- Kumar, Alok, 2009, Who gambles in the stock market? *Journal of Finance* 64, 1889–1933.
- Kyle, Albert S., 1985, Continuous auctions and insider trading, *Econometrica* 53, 1315–1335.
- Lee, Charles M.C., and Balkrishna Radhakrishna, 2000, Inferring investor behavior: Evidence from TORQ data, *Journal of Financial Markets* 3, 83–111.

- Lee, Charles M.C., and Mark J. Ready, 1991, Inferring trade direction from intraday data, *Journal of Finance* 46, 733–746.
- Lee, Charles M.C., Andrei Shleifer, and Richard Thaler, 1991, Investor sentiment and the closed-end fund puzzle, *Journal of Finance* 46, 75–109.
- Llorente, Guillermo, Roni Michaely, Gideon Saar, and Jiang Wang, 2002, Dynamic volume-return relation of individual stocks, *Review of Financial Studies* 15, 1005–1047.
- Lo, Andrew W., and A. Craig MacKinlay, 1990, When are contrarian profits due to stock market overreaction? *Review of Financial Studies* 3, 175–205.
- Loughran, Tim, and Jay Ritter, 2004, Why has IPO underpricing changed over time? *Financial Management* 33, 5–37.
- McQueen, Grant, Michael Pinegar, and Steven Thorley, 1996, Delayed reaction to good news and the cross-autocorrelation of portfolio returns, *Journal of Finance* 51, 889–919.
- Merton, Robert C., 1987, A simple model of capital market equilibrium with incomplete information, *Journal of Finance* 42, 483–510.
- Odean, Terrance, 1999, Do investors trade too much? *American Economic Review* 89, 1279–1298.
- Patell, James M., 1976, Corporate forecasts of earnings per share and stock price behavior: Empirical tests, *Journal of Accounting Research* 14, 246–276.
- Peng, Lin, and Wei Xiong, 2006, Investor attention, overconfidence and category learning, *Journal of Financial Economics* 80, 563–602.
- Peress, Joel, 2014, The media and the diffusion of information in financial markets: Evidence from newspaper strikes, *Journal of Finance* 69, 2007–2043.
- Puckett, A., and Yan, X., 2011, The interim trading skills of institutional investors. *The Journal of Finance*, 66(2), 601-633.
- Roşu, Ioanid, Elvira Sojli, and Wing Wah Tham, 2018, Quoting activity and the cost of capital, Working paper, available at SSRN: <https://ssrn.com/abstract=3005928>.
- Rydqvist, Kristian, Joshua Spizman, and Ilya Strebulaev, 2014, Government policy and ownership of equity securities, *Journal of Financial Economics* 111, 70–85.
- Saunders, Edward M., 1993, Stock prices and Wall Street weather, *American Economic Review* 83, 1337–1345.
- Schultz, Paul, 2000, Stock splits, tick size, and sponsorship, *Journal of Finance* 55, 429–450.
- SEC, 2010, Concept release on equity market structure, Release No. 34-61358, File No. S7-02-10.
- Stoll, Hans R., 1978, The supply of dealer services in securities markets, *Journal of Finance* 33, 1133–1151.
- Subrahmanyam, Avanidhar, 1991, Risk aversion, market liquidity, and price efficiency, *Review of Financial Studies* 4, 417–441.
- Tetlock, Paul C., 2007, Giving content to investor sentiment: The role of media in the stock market, *Journal of Finance* 62, 1139–1168.
- Van Kervel, Vincent, and Albert J. Menkveld, 2019, High-frequency trading around large institutional orders, *Journal of Finance*, 74, 1091-1137.
- Van Nieuwerburgh, Stijn, and Laura Veldkamp, 2010, Information acquisition and under-diversification, *Review of Economic Studies* 77, 779–805.

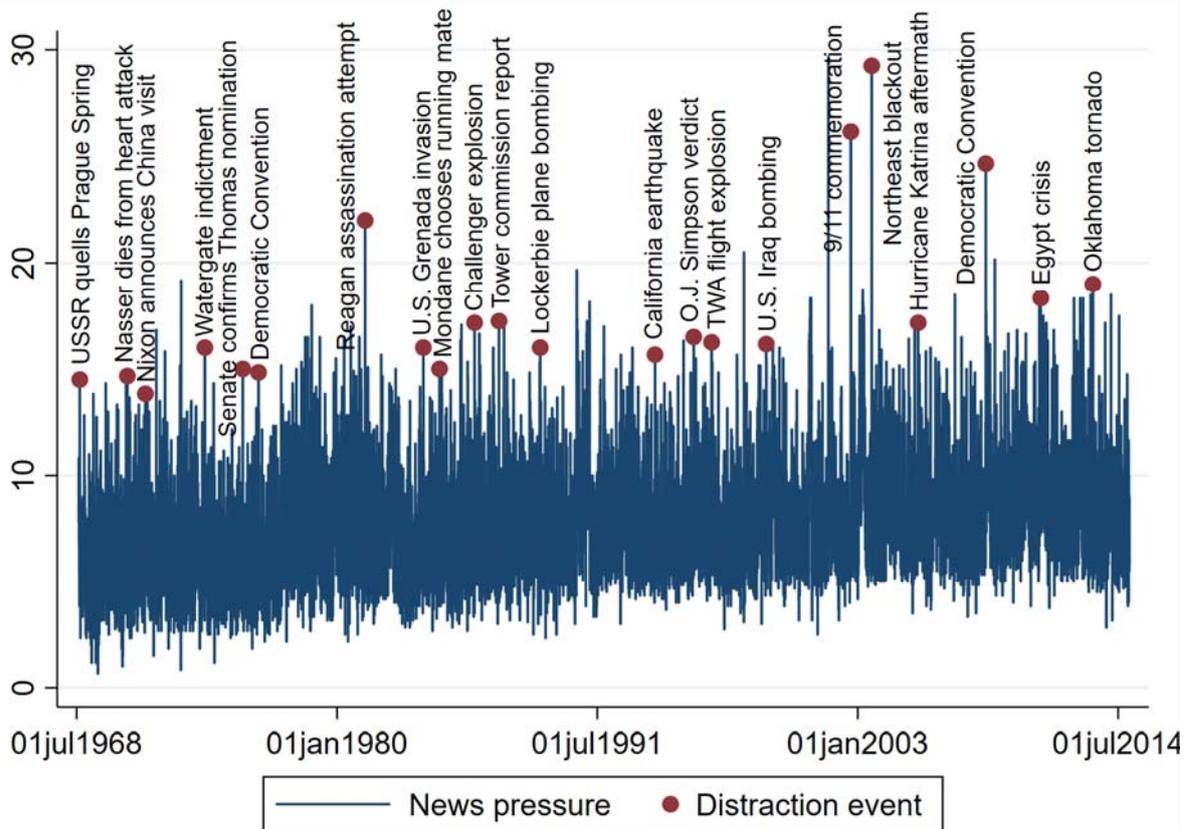
Verrecchia, Robert E., 1982, Information acquisition in a noisy rational expectations economy, *Econometrica* 50, 1415–1430.

Weller, Brian M., 2017, Does algorithmic trading reduce information acquisition? *Review of Financial Studies*, 31, 2184-2226.



**Figure 1. Trading activity during the O.J. Simpson trial verdict.**

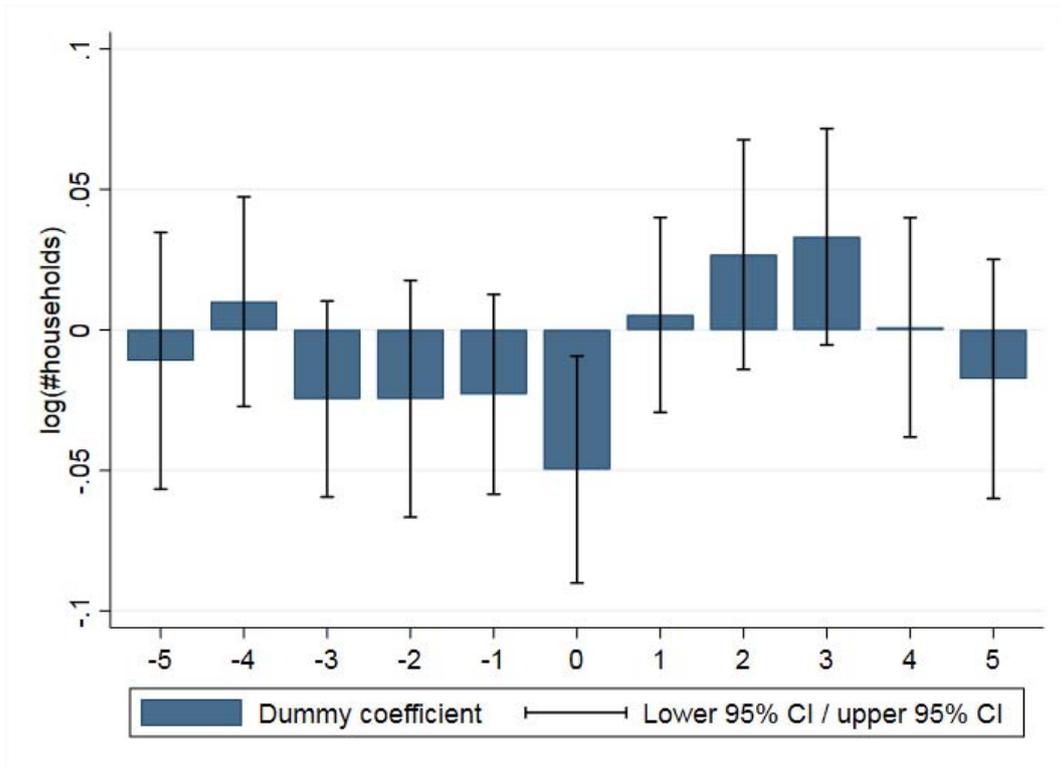
This figure shows the value of aggregate trading volume (in logs) on the New York Stock Exchange on October 3, 1995, the day the verdict of O.J. Simpson's murder trial was announced. The top, middle, and bottom panels display trading volume for, respectively, all, small, and large trades. Trades are sorted into five size groups, where small (large) trades are those in the bottom (top) quintile. The horizontal axis labels five-minute intervals starting from 9:30 a.m. EST. The vertical line marks the announcement time (10 a.m. PST or 1 p.m. EST). The solid horizontal line indicates the average (log) trading volume during that day (excluding the period from 10:00 to 10:10 am) for the trade size category displayed in the panel. The dashed horizontal line indicates the 5% confidence bound (1.96 times the standard deviation of (log) trading volume during the day). Data for this figure come from TAQ.



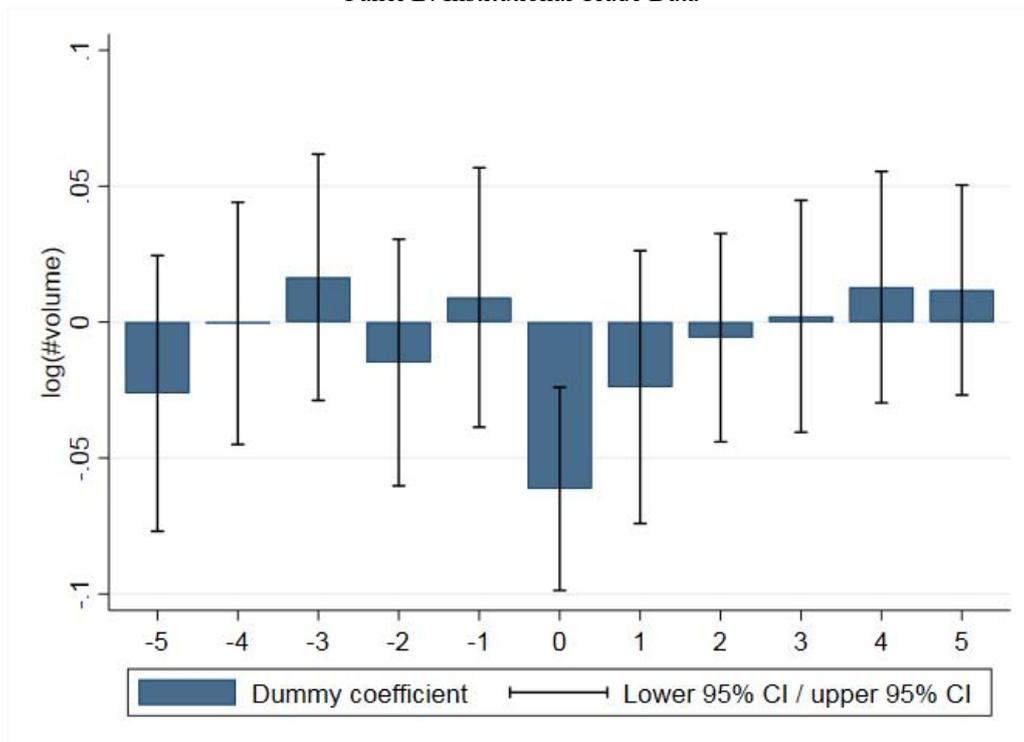
**Figure 2. Daily news pressure and distraction events.**

The blue line shows daily news pressure over the period 1968 to 2014. The red dots mark a subset of the distraction events that we use in this paper. Specifically, they consist of days when news pressure is the highest in a given year and that have survived our filter for excluding potential economic news (see Section II).

Panel A: Retail Brokerage Data



Panel B: Institutional Trade Data



**Figure 3. Distraction effect on retail and institutional trading in event time.**

This graph shows the coefficient estimates and their confidence intervals from regressing measures of (de-seasonalized and de-trended) retail and institutional trading on a set of event-time dummies. In Panel A, the dependent variable is the logarithm of number of households trading in the retail brokerage data. In Panel B, the dependent variable is the logarithm of the aggregated trade volume in the institutional trade data. In both panels, the bar at 0 represents the coefficient estimate on a dummy variable indicating distraction days; the bar at -1 is the coefficient estimate on a dummy variable indicating trading days one day prior to distraction days; etc. Confidence bars are based on standard errors adjusted for autocorrelation up to three lags with the Newey-West method.

**Table I**  
**Distraction Events**

In Panel A, we report event-study results for TV viewership over the period 1991 to 2014 (235 distraction events) using data from Nielsen Research. The estimation period includes all trading days without economic news within a 200-day window centered on the distraction event. Column (1) shows the abnormal value of the logarithm of average daily CNN viewership (scaled by the number of U.S. households). Column (2) shows the abnormal value of the logarithm of average 6:30 to 7:00 p.m. news broadcast viewership for ABC, CBS, and NBC. Below each number, we show the *t*-statistic for the parametric Boehmer, Musumeci, Poulsen (1991) test in parentheses, and the *z*-statistic for the nonparametric rank test in square brackets. Statistical significance at the 1%, 5% and 10% level is indicated by \*\*\*, \*\*, and \*, respectively. In Panel B, we provide a partial list of the distraction events used in this paper. For each year, we show the dates of the two distraction events with the highest news pressure (that survive our economic news filter) together with a short description of the accompanying news story.

Panel A: TV Viewership on Distraction Events

(1)	(2)
CNN viewership (total day)	ABC, CBS, NBC viewership (6:30-7:00pm)
0.327	0.032
(13.190) ***	(6.431) ***
[10.729] ***	[5.265] ***
235	235

Panel B: Two Highest News Pressure Events (without economic keyword in their headline) per Year

Year	Date	Description	Date	Description
1968	Aug 22	USSR invasion of Czechoslovakia	Nov 1	Vietnam bombing halt
1969	Mar 28	Eisenhower death	Nov 20	Apollo 12 color film from moon
1970	Sep 28	Gamal Abdel Nasser death	Sep 9	Dawson's Field hijackings
1971	Jul 16	Nixon announces China visit	Apr 1	William Calley verdict
1972	Mar 6	Senate questions ITT settlement	May 2	Hoover death
1973	Jan 24	Vietnam ceasefire aftermath	Jul 26	Watergate hearings
1974	Mar 1	Watergate indictments	Feb 13	Solzhenitsyn deportation
1975	Nov 3	Rockefeller decides not to run for VP	May 14	South Vietnam evacuation plans
1976	Jul 13	Democratic Convention	Jun 9	Democratic presidential primaries
1977	Oct 18	West German plane hijacking	Mar 11	Hanafi Siege in Washington, DC
1978	Sep 19	Camp David Accords aftermath	Apr 18	Senate passes Panama Canal treaty
1979	Feb 14	U.S. embassy incident in Tehran	Jan 16	Iranian revolution, Shah flees
1980	Dec 26	Iran hostage crisis	Aug 11	Democratic Convention
1981	Mar 30	Reagan assassination attempt	May 13	Pope assassination attempt
1982	Sep 20	Lebanon massacre	Jun 8	Israel Lebanon invasion
1983	Oct 25	Grenada invasion aftermath	Oct 26	Grenada invasion aftermath
1984	Jul 12	Mondale chooses running mate	Aug 16	John DeLorean verdict
1985	Oct 8	Achille Lauro hijacking	Jun 17	TWA847 hijacking
1986	Jan 28	Challenger explosion	Jan 29	Challenger explosion aftermath
1987	Feb 26	Tower commission report	May 18	USS Stark incident in Persian Gulf
1988	Dec 22	Lockerbie plane bombing	Jul 5	Attorney General Meese resigns
1989	Jan 4	Libyan planes downed	Jul 3	Supreme Court abortion ruling
1990	Aug 8	Address on Iraq's invasion of Kuwait	Aug 16	Persian Gulf crisis talks
1991	Oct 15	Senate confirms Thomas nomination	Jan 10	Preparations for Iraq invasion
1992	May 1	Los Angeles riots	Dec 8	U.S. special forces enter Somalia
1993	Apr 20	Waco sect compound fire	Sep 13	Oslo Accords officially signed
1994	Jan 17	Northridge earthquake	Jan 18	Northridge earthquake aftermath
1995	Oct 3	O. J. Simpson verdict	Apr 20	Oklahoma City bombing
1996	Jul 18	TWA flight explosion	Nov 5	Presidential election aftermath
1997	Sep 5	Princess Diana's funeral	Mar 27	Heaven's Gate sect mass suicide
1998	Dec 16	Iraq missile attack	Dec 18	Clinton impeachment house debate
1999	Mar 25	NATO bombing of Yugoslavia	Apr 23	Littleton school shooting
2000	Nov 22	Presidential election aftermath	Dec 11	Florida recount, legal battles
2001	Oct 12	Anthrax letter attacks	Jun 11	Timothy McVeigh execution
2002	Sep 11	9/11 commemoration	Oct 24	Hurricane Lili
2003	Aug 14	Northeast blackout	Oct 27	California wildfires
2004	Apr 7	Iraq Fallujah uprising	Apr 8	9/11 commission hearing
2005	Sep 1	Hurricane Katrina aftermath	Jul 7	London bombing
2006	Jan 4	Sago coal mine explosion	Jul 13	Israel Lebanon conflict
2007	Apr 17	Virginia Tech massacre	Aug 2	Minneapolis bridge collapse
2008	Aug 27	Democratic Convention	Nov 3	Presidential election one day before
2009	Dec 28	Northwest Airlines bombing attempt	Jul 7	Michael Jackson memorial service
2010	Jan 15	Haiti earthquake	Mar 22	Health Care reform passed
2011	Jan 31	Egypt crisis	Jan 10	Tucson Arizona shooting
2012	Dec 14	Connecticut school shooting	Jul 20	Aurora movie theatre massacre
2013	May 20	Oklahoma tornado	May 21	Oklahoma tornado aftermath
2014	Jul 17	MH17 plane crash	Jul 18	MH17 plane crash

**Table II.**  
**Distraction Events and Retail and Institutional Trading**

This table reports event-study results for trading activity on distraction days. Panel A reports results for the discount brokerage data over the period 1991 to 1996 (66 distraction events). Panel B reports results for the institutional trade data over the period 1999 to 2011 (99 distraction events). Panel C reports results for the ISSM/TAQ transaction data over the period 1991 to 2000 (105 distraction events). In Panels A and B,  $\text{Log}\$volume$  is the logarithm of dollar volume aggregated over all sample investors.  $\text{Log}(\text{trade size})$  is the average across stocks and then across investors of the logarithm of dollar trade size.  $\text{Log}(\#stocks)$  is the average across investors of the logarithm of the number of stocks traded.  $\text{Log}(\#investors)$  is the logarithm of the number of investors trading. In Panel C,  $\text{Log}(\$volume)$  is the logarithm of aggregated dollar volume of trade in the respective trade size group. Trades are classified into small trades and large trades based on a procedure described in Hvidkjaer (2006). The estimation period includes all trading days without economic news within a 200-day window centered on the distraction event. In Panels A and B, columns (1) and (2) focus on buys and sells, respectively. Column (3) tests for the difference between buys and sells. Column (4) examines total trades (the sum of buys and sells). In Panel C, columns (1) and (2) show the results for small and large trades, respectively. Column (3) tests for the difference between small and large trades. Below each number, we show the  $t$ -statistic for the parametric Boehmer, Musumeci, and Poulsen (1991) test in parentheses, and the  $z$ -statistic for the nonparametric rank test in square brackets. Statistical significance at the 1%, 5%, and 10% level is indicated by \*\*\*, \*\*, and \*, respectively.

Panel A: Discount Brokerage Data

	(1)	(2)	(3)	(4)
	Buys	Sells	Difference	Total trades
$\text{Log}\$volume$	-0.073 (-2.442) ** [-2.635] ***	-0.056 (-1.649) [-1.134]	-0.018 (-0.912) [-0.476]	-0.065 (-2.221) ** [-2.035] **
$\text{Log}(\text{trade size})$	-0.017 (-1.593) [-1.690] *	-0.025 (-1.526) [-1.255]	0.008 (0.111) [0.789]	-0.019 (-1.868) * [-1.664] *
$\text{Log}(\#stocks)$	-0.010 (-2.480) ** [-2.622] ***	0.003 (0.841) [0.885]	-0.013 (-2.378) ** [-2.405] **	-0.007 (-2.625) ** [-2.782] ***
$\text{Log}(\#investors)$	-0.0539 (-2.857) *** [-2.693] ***	-0.0574 (-2.061) ** [-2.067] **	0.0034 (-0.714) [0.214]	-0.0508 (-2.609) ** [-2.431] **
$N$	66	66	66	66

Panel B: Institutional Trade Data

	(1)	(2)	(3)	(4)
	Buys	Sells	Difference	Total trades
Log(\$volume)	-0.040 (-2.261) ** [-1.832] *	-0.044 (-1.967) * [-1.871] *	0.003 (-0.266) [0.600]	-0.042 (-2.293) ** [-2.049] **
Log(trade size)	-0.019 (-2.014) ** [-1.892] *	-0.012 (-1.211) [-0.880]	-0.007 (-0.572) [-0.848]	-0.017 (-2.066) ** [-1.354]
Log(#stocks)	-0.014 (-1.590) [-1.759] *	-0.004 (-0.458) [-0.789]	-0.009 (-0.858) [-1.044]	-0.014 (-1.360) [-1.532]
Log(#investors)	-0.0026 (-0.385) [0.436]	-0.0144 (-2.796) *** [-2.105] **	0.0118 (2.363) ** [2.171] **	-0.0056 (-1.465) [-0.332]
<i>N</i>	99	99	99	99

Panel C: Aggregated ISSM/TAQ Data

	(1)	(2)	(3)
	Small trades	Large trades	Difference
Log(\$volume)	-0.0203 (-1.822) * [-2.201] **	-0.0072 (-0.451) [-0.321]	0.0132 (2.072) ** [1.680] *
	105	105	105

**Table III**  
**Distracting Events and Noise Traders**

This table reports event-study results for trading activity by different groups of investors. Panel A reports results for the logarithm of the number of households trading in the discount brokerage data over the period 1991 to 1996 (66 distraction events). Panel B reports results for the logarithm of the aggregated dollar volume in the institutional trade data over the period 1999 to 2011 (99 distraction events). For each event, the estimation period includes all trading days without economic news within a 200-day window centered on the event date. Each row in Panels A and B represents a different sample split. In row 1, investors are split into single females (column (1)) and single males (column (2)) (only available for Panel A). In row 2, investors are split into those who never traded online (column (1)) and those who did trade online (column (2)) (only available for Panel A). In the other rows, investors are split in halves based on the variable indicated in the row label. Column (3) tests for the difference between above-median investors (column (2)) and below-median investors (column (1)) (or single males and single females for row 1). *PF concentration* is the average concentration (measured by the Herfindahl index) of monthly portfolio holdings (monthly dollar trading volumes across stocks) for retail (institutional) investors. *PF volume* is the retail or institutional investor's average portfolio volume. *PF losses* is the average monthly portfolio return (post-trade return over the subsequent 12 months) times minus one for retail (institutional) investors. *GK-proxy* is the overconfidence proxy proposed by Goetzmann and Kumar (2008) based on the interaction of inverse profits and portfolio turnover (aggregate trading volume) for retail (institutional) investors. *Media susceptibility* is measured as the retail or institutional investor's average propensity to buy stocks covered in the media. Below each number, we show the *t*-statistic for the parametric Boehmer, Musumeci, and Poulsen (1991) test in parentheses, and the z-statistic for the nonparametric rank test in square brackets. Statistical significance at the 1%, 5%, and 10% level is indicated by \*\*\*, \*\*, and \*, respectively.

Panel A: Discount Brokerage Data

	(1)	(2)	(3)
	Total trades	Total trades	Difference
1) Gender	Single-female	Single-male	Difference
Log(#investors)	0.036 (0.315) [1.384]	-0.093 (-2.790) *** [-1.964] **	-0.119 (-2.532) ** [-1.804] *
2) Online vs. offline	Offline	Online	Difference
Log(#investors)	-0.039 (1.731) * [1.838] *	-0.069 (-2.063) ** [-2.493] **	-0.030 (-1.555) [-1.367]
3) PF concentration	Low	High	Difference
Log(#investors)	-0.034 (-1.778) * [-1.306]	-0.066 (-2.671) *** [-2.258] **	-0.032 (-0.908) [-0.866]
4) PF volume	Low	High	Difference
Log(#investors)	0.001 (0.022) [0.361]	-0.049 (-2.482) ** [-2.047] **	-0.051 (-2.274) ** [-1.313]
5) PF losses	Low	High	Difference
Log(#investors)	-0.036 (-1.935) * [-1.115]	-0.068 (-2.364) ** [-2.380] **	-0.032 (-0.880) [-1.217]
6) GK-proxy	Low	High	Difference
Log(#investors)	0.001 (0.016) [0.533]	-0.053 (-2.196) ** [-1.830] *	-0.054 (-2.294) ** [-1.319]

*(continued on next page)*

	(1)	(2)	(3)
	Total trades	Total trades	Difference

(continued from previous page)

	Low	High	Difference
7) Media susceptibility Log(#investors)	-0.028 (-1.328) [-0.763]	-0.056 (-2.389) ** [-2.003] **	-0.028 (-0.869) [-1.089]
<i>N</i>	66	66	66

Panel B: Institutional Trade Data

	(1) Total trades	(2) Total trades	(3) Difference
1) Gender Log(\$volume)	Single-female N/A	Single-male N/A	Difference N/A
2) Online vs. offline Log(\$volume)	Offline N/A	Online N/A	Difference N/A
3) PF concentration Log(\$volume)	Low -0.042 (-1.447) [-1.358]	High -0.049 (-2.222) ** [-1.860] *	Difference -0.007 (-0.441) [-0.552]
4) PF volume Log(\$volume)	Low 0.017 (0.416) [-0.136]	High -0.043 (-2.309) ** [-2.119] **	Difference -0.059 (-2.147) ** [-1.009]
5) PF losses Log(\$volume)	Low -0.017 (-0.923) [-0.391]	High -0.056 (-2.518) ** [-2.325] **	Difference -0.039 (-1.345) [-1.864] *
6) GK-proxy Log(\$volume)	Low -0.018 (-0.431) [-1.449]	High -0.044 (-2.365) ** [-2.223] **	Difference -0.025 (-1.487) [-0.014]
7) Media susceptibility Log(\$volume)	Low -0.041 (-1.686) * [-1.282]	High -0.062 (-2.350) ** [-2.815] ***	Difference -0.022 (-0.950) [-1.036]
<i>N</i>	99	99	99

**Table IV**  
**Market Wide Event Study**

This table reports (equal-weighted) market-wide event-study results for the 551 distraction events in the period 1968 to 2014. The estimation period includes all trading days without economic news within a 200-day window centered on the event date. All variables are defined in the Appendix. Below each number, we show the *t*-statistic for the parametric Boehmer, Musumeci, and Poulsen (1991) test in parentheses, and the z-statistic for the nonparametric rank test in square brackets. Statistical significance at the 1%, 5%, and 10% level is indicated by \*\*\*, \*\*, and \*, respectively.

(1)	(2)	(3)	
Mkt return	Log(turnover)	Log(\$volume)	
-0.017	-0.008	-0.011	
(-0.798)	(-1.124)	(-1.480)	
[-1.175]	[-0.998]	[-1.390]	
551	551	551	
(4)	(5)	(6)	(7)
Abs return	Price range	Intraday volatility	Intraday autocovariance
0.001	-0.007	-0.006	0.005
(1.213)	(0.781)	(-0.226)	(0.269)
[-1.340]	[-0.521]	[-1.144]	[2.105] **
551	551	225	225
(8)	(9)	(10)	(11)
Closing bid-ask spread	Average bid-ask spread	Effective spread	Realized spread
0.011	0.000	0.009	0.008
(2.258) **	(1.400)	(1.741) *	(1.967) *
[2.051] **	[0.043]	[1.563]	[1.451]
354	225	225	225
(12)	(13)	(14)	(15)
Log(amihud)	Price impact	Absolute trade imbalance	Lambda
0.009	0.002	0.113	0.135
(2.890) ***	(1.002)	(1.637)	(1.943) *
[1.489]	[0.782]	[1.153]	[2.350] **
551	225	225	225

**Table V**  
**Sample Split by Firm Size**

This table reports event-study results for the 551 distraction events in the period 1968 to 2014. The estimation period includes all trading days without economic news within a 200-day window centered on the event date. Stocks are sorted into three terciles based on their market capitalization at the end of the last trading day prior to the event. All variables are defined in the Appendix. Columns (1) to (3) show results for terciles 1 to 3, respectively. Column (4) tests for the difference between tercile 3 and tercile 1. Below each number, we show the *t*-statistic for the parametric Boehmer, Musumeci, and Poulsen (1991) test in parentheses, and the *z*-statistic for the nonparametric rank test in square brackets. Statistical significance at the 1%, 5%, and 10% level is indicated by \*\*\*, \*\*, and \*, respectively.

Panel A: Trading Activity and Volatility

	<i>N</i>	(1) Tercile 1	(2) Tercile 2	(3) Tercile 3	(4) Difference
<i>Trading activity</i>					
Log(turnover)	551	-0.023 (-3.188) *** [-3.803] ***	-0.013 (-1.448) [-1.724] *	0.003 (0.479) [1.080]	0.026 (3.522) *** [4.236] ***
Log(\$volume)	551	-0.027 (-3.601) *** [-4.125] ***	-0.015 (-1.730) * [-2.004] **	0.000 (0.092) [0.673]	0.027 (3.652) *** [4.254] ***
<i>Volatility</i>					
Abs return	551	-0.006 (-0.013) [-1.442]	-0.003 (0.623) [-2.146] **	0.011 (1.849) * [-0.602]	0.017 (2.003) ** [1.149]
Price range	551	-0.060 (-2.449) ** [-3.505] ***	-0.009 (0.410) [-1.224]	0.018 (2.304) ** [1.028]	0.077 (4.526) *** [4.847] ***
Intraday volatility	225	-0.018 (-3.322) *** [-3.877] ***	-0.009 (-0.767) [-2.184] **	0.004 (1.296) [0.545]	0.021 (4.349) *** [3.32] ***
Intraday autocovariance	225	0.008 (2.240) ** [2.962] ***	0.005 (0.269) [2.133] **	0.004 (-0.562) [0.565]	-0.004 (-2.418) ** [-1.862] *

Panel B: Liquidity

	<i>N</i>	(1) Tercile 1	(2) Tercile 2	(3) Tercile 3	(4) Difference
<i>Liquidity - overall</i>					
Closing bid-ask spread	354	0.057 (3.833) *** [3.331] ***	0.011 (1.722) * [1.440]	-0.014 (-0.17) [0.197]	-0.071 (-2.849) *** [-3.265] ***
Average bid-ask spread	225	0.042 (2.607) *** [1.377]	-0.002 (0.943) [-0.500]	-0.021 (-0.952) [-1.906] *	-0.063 (-2.229) ** [-1.891] *
Effective spread	225	0.040 (2.225) ** [1.677] *	0.014 (2.264) ** [2.154] **	-0.011 (0.747) [-0.394]	-0.051 (-1.028) [-2.014] **
<i>Liquidity – adverse selection</i>					
Log(amihud)	551	0.024 (3.157) *** [2.568] **	0.015 (2.913) *** [1.791] *	0.000 (0.680) [-0.496]	-0.024 (-1.879) * [-2.808] ***
Price impact	225	0.010 (1.677) * [1.273]	0.003 (1.086) [0.275]	-0.002 (0.675) [0.568]	-0.011 (-0.626) [-1.427]
Absolute trade imbalance	225	0.348 (2.371) ** [2.301] **	0.213 (1.932) * [1.388]	-0.083 (-0.899) [-1.965] **	-0.431 (-2.895) *** [-2.823] ***
Lambda	225	0.818 (2.787) *** [3.189] ***	0.348 (1.903) * [2.365] **	-0.077 (-0.399) [-0.087]	-0.895 (-2.084) ** [-3.308] ***
<i>Liquidity - inventory costs</i>					
Realized spread	225	0.035 (2.590) ** [2.119] **	0.010 (2.019) ** [1.484]	-0.009 (0.229) [-0.391]	-0.043 (-1.612) [-2.172] **

**Table VI**  
**Cross-sectional Regressions across Distraction Events**

This table reports estimates from cross-sectional regressions of abnormal volatility, return autocovariance, and liquidity measures on abnormal (log) turnover (from CRSP) in the cross-section of distraction events for stocks in the bottom tercile in terms of firm size. For dependent variables from CRSP, we have 551 distraction events in the period 1968 to 2014. For dependent variables from TAQ, we have 225 distraction events in the period 1993 to 2014. Abnormal measures are calculated as described in Section II.C, that is, as the realization of the variable on the event date minus its average in the estimation period (trading days without economic news within a 200-day window centered on the event date). All variables are defined in the Appendix. Each cell shows the regression coefficient obtained for regressing the independent variable on the dependent variable. Below each number, we show the  $t$ -statistic based on Huber-White standard errors corrected for heteroskedasticity. Statistical significance at the 1%, 5%, and 10% level is indicated by \*\*\*, \*\*, and \*, respectively.

Dependent Variable	$N$	Regression coefficient
<i>Volatility</i>		
Abs return	551	0.718*** (6.24)
Price range	551	2.053*** (21.15)
Intraday volatility	225	0.278*** (11.42)
Autocovariance	225	-0.057* (-1.76)
<i>Liquidity - overall</i>		
Closing bid-ask spread	354	-0.556*** (-4.49)
Average bid-ask spread	225	-0.675*** (-4.90)
Effective spread	225	-44.45*** (-3.04)
<i>Liquidity - adverse selection</i>		
Log(amihud)	551	-0.423*** (-7.27)
Price impact	225	-0.055 (-1.28)
Absolute trade imbalance	225	-10.19*** (-7.74)
Lambda	225	-5.788*** (-3.05)
<i>Liquidity - inventory costs</i>		
Realized spread	225	-0.462*** (-2.79)

**Table VII**  
**Subperiod Analysis**

This table reports event-study results carried out for stocks in the bottom tercile in terms of firm size over three subperiods: the “pre-Internet” era spanning 1968 to 1992 (326 distraction events), the “post-Internet” era spanning 1993 to 2006 (138 distraction events), and the “algorithmic trading era” spanning 2007 to 2014 (87 distraction events). The estimation period includes all trading days within a 200-day window centered on the event date. Panel A reports the results for measures of trading activity, return volatility, and return autocovariance; Panel B reports results for liquidity. All variables are defined in the Appendix. Below each number, we show the *t*-statistic for the parametric Boehmer, Musumeci, and Poulsen (1991) test in parentheses, and the *z*-statistic for the nonparametric rank test in square brackets. Statistical significance at the 1%, 5%, and 10% level is indicated by \*\*\*, \*\*, and \*, respectively.

Panel A: Trading Activity and Volatility

	(1) 1968-1992	(2) 1993-2006	(3) 2007-2014
<i>Trading activity</i>			
Log(turnover)	-0.014 (-1.162) [-1.844] * 326	-0.032 (-2.533) ** [-2.792] *** 138	-0.043 (-2.854) *** [-2.573] ** 87
Log(\$volume)	-0.018 (-1.544) [-2.052] ** 326	-0.038 (-2.842) *** [-3.253] *** 138	-0.045 (-2.678) *** [-2.556] ** 87
<i>Volatility</i>			
Abs return	0.007 (0.517) [-0.529] 326	0.002 (0.531) [-0.343] 138	-0.070 (-1.415) [-1.883] * 87
Price range	-0.034 (-1.129) [-1.939] * 326	-0.066 (-1.704) * [-2.19] ** 138	-0.144 (-1.655) [-2.273] ** 87
Intraday volatility		-0.012 (-2.113) ** [-2.354] ** 138	-0.027 (-2.744) *** [-3.162] *** 87
Autocovariance		0.003 (0.914) [1.635] 138	0.015 (2.331) ** [2.692] *** 87

Panel B: Liquidity			
	(1)	(2)	(3)
	1968-1992	1993-2006	2007-2014
<i>Liquidity - overall</i>			
	0.074	0.075	0.004
Closing bid-ask spread	(2.996) ***	(3.389) ***	(-0.082)
	[2.387] **	[3.34] ***	[-0.927]
	129	138	87
		0.086	-0.042
Average bid-ask spread		(3.397) ***	(-0.913)
		[3.27] ***	[-2.404] **
		138	87
Effective spread		0.060	0.008
		(2.489) **	(0.391)
		[2.388] **	[-0.482]
		138	87
<i>Liquidity - adverse selection</i>			
Log(amihud)	0.018	0.036	0.028
	(0.953)	(3.557) ***	(1.575)
	[0.768]	[3.455] ***	[1.354]
	326	138	87
Price impact		0.013	0.003
		(1.954) *	(-0.21)
		[1.657] *	[-0.487]
		138	87
Absolute trade imbalance		0.514	0.085
		(2.594) **	(0.2)
		[2.551] **	[0.347]
		138	87
Lambda		1.140	0.309
		(2.851) ***	(0.789)
		[2.989] ***	[1.134]
		138	87
<i>Liquidity - inventory costs</i>			
Realized spread		0.052	0.008
		(2.798) ***	(0.539)
		[2.632] ***	[-0.174]
		138	87

**Table VIII**  
**Sample Split for Small Stocks by Tech vs. Nontech**

This table reports event-study results for tech versus nontech stocks (classified based on SIC codes as in Loughran and Ritter(2004)) in the bottom size tercile for the 138 distraction events in the 1993 to 2006 period, which is marked by the advent of the Internet. The estimation period includes all trading days without economic news within a 200-day window centered on the event date. All variables are defined in the Appendix. Columns (1) and (2) show the results for nontech and tech stocks, respectively. Column (3) tests for the difference between tech and nontech stocks. Below each number, we show the *t*-statistic for the parametric Boehmer, Musumeci, and Poulsen (1991) test in parentheses, and the *z*-statistic for the nonparametric rank test in square brackets. Statistical significance at the 1%, 5%, and 10% level is indicated by \*\*\*, \*\*, and \*, respectively.

Panel A: Trading Activity and Volatility

	<i>N</i>	(1) Nontech stocks	(2) Tech stocks	(3) Difference
<i>Trading activity</i>				
Log(turnover)	138	-0.031 (-2.614) *** [-2.796] ***	-0.043 (-2.094) ** [-2.108] **	-0.012 (-1.984) ** [-1.773] *
Log(\$volume)	138	-0.033 (-2.618) *** [-3.014] ***	-0.046 (-2.039) ** [-2.071] **	-0.013 (-1.940) * [-1.720] *
<i>Volatility</i>				
Abs return	138	0.003 (0.440) [0.358]	-0.011 (-1.056) [-1.375]	-0.014 (-1.423) [-1.375]
Price range	138	-0.064 (-1.697) * [-2.109] **	-0.072 (-1.408) [-1.790] *	-0.008 (-1.001) [-1.272]
Intraday volatility	138	-0.011 (-2.017) ** [-1.988] **	-0.015 (-1.797) * [-1.730] *	-0.004 (-1.280) [-1.570]
Intraday autocovariance	138	0.003 (0.811) [1.366]	0.004 (1.392) [1.011]	0.001 (0.582) [0.435]

Panel B: Liquidity

	<i>N</i>	(1) Nontech stocks	(2) Tech stocks	(3) Difference
<i>Liquidity - overall</i>				
Closing bid-ask spread	138	0.073 (3.182) *** [3.144] ***	0.080 (2.030) ** [2.274] **	0.007 (1.540) [1.465]
Average bid-ask spread	138	0.085 (3.303) *** [3.231] ***	0.092 (2.644) *** [2.352] **	0.007 (1.793) * [1.684] *
Effective spread	138	0.058 (2.384) ** [2.228] **	0.064 (2.071) ** [2.118] **	0.006 (1.911) * [1.634]
<i>Liquidity - adverse selection</i>				
Log(amihud)	138	0.034 (3.415) *** [3.312] ***	0.043 (2.532) ** [2.334] **	0.009 (1.803) * [0.903]
Price impact	138	0.010 (1.614) [1.451]	0.034 (1.912) * [1.735] *	0.023 (1.173) [1.310]
Absolute trade imbalance	138	0.486 (2.352) ** [2.213] **	0.629 (2.186) ** [1.892] *	0.143 (1.599) [1.455]
Lambda	138	1.002 (2.646) *** [2.698] ***	1.403 (2.241) ** [2.155] **	0.401 (1.856) * [1.862] *
<i>Liquidity - inventory costs</i>				
Realized spread	138	0.050 (2.603) *** [2.479] **	0.059 (2.018) ** [1.920] *	0.009 (1.779) * [1.632]

**Table IX**  
**Sample Split for Small Stocks by Quote-to-trade Ratio**

This table reports event-study results for the tercile of small stocks for the 87 distraction events in the 2007 to 2014 period, which is marked by the advent of algorithmic trading. The estimation period includes all trading days without economic news within a 200-day window centered on the event date. Small stocks are sorted into three terciles based on the average quote-to-trade ratio calculated from TAQ data (see Section VI.C for details). All variables are defined in the Appendix. Columns (1) to (3) show results for terciles 1 to 3, respectively. Column (4) tests for the difference between tercile 3 and tercile 1. Below each number, we show the *t*-statistic for the parametric Boehmer, Musumeci, and Poulsen (1991) test in parentheses, and the z-statistic for the nonparametric rank test in square brackets. Statistical significance at the 1%, 5%, and 10% level is indicated by \*\*\*, \*\*, and \*, respectively.

Panel A: Trading Activity and Volatility

	<i>N</i>	Quote-to-trade Ratio			
		(1) Tercile 1	(2) Tercile 2	(3) Tercile 3	(4) Difference
<i>Trading activity</i>					
Log(turnover)	87	-0.038 (-2.179) ** [-2.013] **	-0.045 (-2.364) ** [-2.175] **	-0.067 (-3.149) *** [-3.047] ***	-0.028 (-2.373) ** [-2.383] **
Log(\$volume)	87	-0.045 (-2.271) ** [-2.111] **	-0.044 (-2.061) ** [-1.972] **	-0.067 (-4.448) *** [-3.843] ***	-0.022 (-2.071) ** [-2.175] **
<i>Volatility</i>					
Abs return	87	-0.063 (-0.925) [-1.503]	-0.095 (-1.931) * [-1.795] *	-0.094 (-2.373) ** [-2.383] **	-0.031 (-1.892) * [-1.375]
Price range	87	-0.102 (-0.851) [-1.710] *	-0.179 (-2.117) ** [-2.239] **	-0.215 (-3.029) *** [-2.810] ***	-0.113 (-2.450) ** [-2.569] **
Intraday volatility	87	-0.020 (-1.631) [-2.341] **	-0.029 (-2.787) *** [-2.620] ***	-0.038 (-4.308) *** [-3.784] ***	-0.018 (-2.316) ** [-2.417] **
Intraday autocovariance	87	0.014 (1.790) * [2.154] **	0.012 (1.225) [1.443]	0.017 (1.861) * [2.434] **	0.003 (0.451) [0.588]

Panel B: Liquidity

	<i>N</i>	Quote-to-trade Ratio			
		(1) Tercile 1	(2) Tercile 2	(3) Tercile 3	(4) Difference
<i>Liquidity - overall</i>					
Closing bid-ask spread	87	0.026 (0.212) [-0.703]	-0.012 (-0.862) [-1.210]	0.003 (-0.180) [-0.491]	-0.023 (-0.366) [-0.063]
Average bid-ask spread	87	0.036 (0.235) [0.263]	-0.053 (-0.800) [-2.446]**	-0.050 (-1.306) [-2.157]**	-0.086 (1.598) [1.760]*
Effective spread	87	0.034 (1.728)* [0.914]	0.005 (-0.152) [-0.690]	0.004 (0.139) [-0.584]	-0.030 (-1.581) [-1.524]
<i>Liquidity – adverse selection</i>					
Log(amihud)	87	0.040 (2.337)** [1.714]*	0.035 (1.533) [1.579]	0.032 (1.911)* [1.811]*	-0.008 (-0.670) [-0.504]
Price impact	87	0.013 (0.219) [0.969]	-0.005 (-0.726) [-1.253]	0.008 (0.816) [0.720]	-0.005 (-0.571) [-0.313]
Absolute trade imbalance	87	0.427 (1.533) [1.464]	0.123 (0.248) [0.042]	0.048 (0.158) [0.106]	-0.379 (-1.098) [-1.215]
Lambda	87	0.247 (0.832) [0.487]	0.211 (0.218) [0.178]	0.592 (0.864) [1.117]	0.344 (-0.071) [0.309]
<i>Liquidity - inventory costs</i>					
Realized spread	87	0.027 (1.721)* [1.257]	0.013 (0.146) [-0.415]	-0.010 (-0.356) [-0.961]	-0.036 (-1.711)* [-2.044]**

## Appendix: Variable Definitions

Variable name	Data source	Explanation
<i>Trading measures</i>		
Log(\$volume)	Discount broker/ANCerno	Natural logarithm of the total dollar volume traded in a given stock by all sample households/inst. Investors.
Log(trade size)	Discount broker/ANCerno	Equal-weighted average across investors and stocks of the natural logarithm of the dollar volume traded in a given stock by a household/inst. investor (conditional on trading at least one stock).
Log(#stocks)	Discount broker/ANCerno	Equal-weighted average across investors of the natural logarithm of the number of distinct stocks traded by a household/inst. investor (conditional on trading at least one stock).
Log(#investors)	Discount broker/ANCerno	Natural logarithm of the total number of households/inst. investors trading at least one stock.
<i>TAQ small versus. large trades</i>		
Log(\$volume)	TAQ	Natural logarithm of the total dollar volume of either small or large trades. The classification into small and large trades follows Hvidkjaer (2006). That is, stocks are first sorted into quintiles based on NYSE/AMEX firm-size cutoff points. The following small- (large-) trade cutoff points are then used within firm-size quintiles: \$3,400 (\$6,800) for the smallest firms, \$4,800 (\$9,600), \$7,300 (\$14,600), \$10,300 (\$20,600), and \$16,400 (32,800) for the largest firms.
<i>Stock market variables</i>		
Mkt return	CRSP	Equal-weighted average return of all sample stocks. Sample stocks are all stocks with CRSP share code 10 or 11 and a stock price above \$1. [Scaled by 100.]
Turnover	CRSP	Equal-weighted average of the ratio of dollar volume over the stock's market capitalization on the previous trading day. [Scaled by 100.]
Log(turnover)	CRSP	Equal-weighted average of the natural logarithm of 0.0000255 (following Llorente et al. (2002)) plus the ratio of dollar volume over the stock's market capitalization on the previous trading day.
\$Volume	CRSP	Equal-weighted average of total dollar volume. [In \$millions.]
Log(\$volume)	CRSP	Equal-weighted average of the natural logarithm of total dollar volume.
Abs return	CRSP	Equal-weighted average of the absolute value of stock return. [Scaled by 100.]
Price range	CRSP	Equal-weighted average of the natural logarithm of the ratio of daily high to low prices. [Scaled by 100.]
Intraday volatility	TAQ	Equal-weighted average of the standard deviation of stock returns over one-hour intervals during the trading day (excluding the opening half hour). [Scaled by 100.]

Intraday autocovariance	TAQ	Equal-weighted average of the standard deviation of stock returns over one-hour intervals during the trading day (excluding the opening half hour). [Scaled by 10,000.]
Closing bid-ask spread	CRSP	Equal-weighted average of the closing bid-ask spread taken from CRSP. The bid-ask spread is defined as $2 * (Ask - Bid) / (Ask + Bid)$ . [Scaled by 100.]
Average bid-ask spread	TAQ	Equal-weighted average of the average bid-ask spread during the trading day (excluding the first half hour). The bid-ask spread is defined as $2 * (Ask - Bid) / (Ask + Bid)$ . [Scaled by 100.]
Effective spread	TAQ	Equal-weighted average of the average effective spread during the trading day (excluding the first half hour). For each transaction, the effective spread is defined as $2 *  TransactionPrice - Midpoint  / Midpoint$ , where $Midpoint = (Ask + Bid) / 2$ valid one second before the transaction. [Scaled by 100.]
Amihud	CRSP	Equal-weighted average of the ratio of the absolute value of stock return over dollar volume. [Scaled by 1,000,000.]
Log(amihud)	CRSP	Equal-weighted average of the natural logarithm of 0.00000001 plus the ratio of the absolute value of stock return over dollar volume.
Price impact	TAQ	Equal-weighted average of the average price impact during the trading day (excluding the first half hour). For each transaction, the price impact is defined as $2 * (Midpoint5 - Midpoint) / Midpoint5$ , where $Midpoint = (Ask + Bid) / 2$ valid one second before the transaction and $Midpoint5 = (Ask + Bid) / 2$ valid five minutes after the transaction. [Scaled by 100.]
Absolute trade imbalance	TAQ	Equal-weighted average of the ratio of the absolute value of trade imbalance, defined as dollar volume of buys minus dollar volume of sells, over total dollar volume. Trades are signed using the Lee and Ready (1991) algorithm. [Scaled by 100.]
Lambda	TAQ	Equal-weighted average of the coefficient obtained from regressing returns over five-minute intervals (calculated from bid-ask midpoints) on $S$ , where $S$ equals the sum over all transactions in that five-minute interval of $I_{Buy/Sell} \sqrt{\$volume}$ and $I_{Buy/Sell} = 1$ for a buy transaction and $I_{Buy/Sell} = -1$ for a sell transaction and $\$volume$ is the dollar volume of the transaction. Trades are signed using the Lee and Ready (1991) algorithm. [Scaled by 10,000.]
Realized spread	TAQ	Equal-weighted average of the average realized spread during the trading day (excluding the first half hour). For each transaction, the realized spread is defined as $2 * I_{Buy/Sell} * (TransactionPrice - Midpoint5) / Midpoint5$ , where $I_{Buy/Sell} = 1$ for a buy transaction and $I_{Buy/Sell} = -1$ for a sell transaction and $Midpoint5 = (Ask + Bid) / 2$ valid five minutes after the transaction. Trades are signed using the Lee and Ready (1991) algorithm. [Scaled by 100.]