

DO INSIDERS HAVE INSIDE TRACKS: AN EXAMINATION OF WALL STREET JOURNAL'S "INSIDE TRACK" COLUMNS?

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ABSTRACT

This study investigates the stock price responses to the publications of *Wall Street Journal's* Inside Track columns. We find negative (positive) stock returns during the insider purchase (insider sale) trading period and positive (negative) stock returns during the insider-purchase (insider sale) filing period. Our evidence suggests that insiders tend to be contrarian investors; they buy (sell) when stock prices of their firms are falling (rising). The event-day stock return for insider purchase (sale) sample is significantly positive (negative). The significant filing period returns along with significant event-day returns are consistent with gradual price adjustment argument. We find that the post-event stock returns continue to be positive for insider purchase sample and negative for insider sale sample.

INTRODUCTION

Several studies have examined the usefulness of insiders' activities in timing the market and in predicting cross-sectional variations in stock returns. Seyhun (1998) finds that stocks purchased by insiders perform 4.5 percent better than the simultaneous market portfolio over the next 12 months; stocks sold by insiders underperform the simultaneous market portfolio by 2.7 percent over the next 12 months. Lakonishok and Lee (2001) show that insider trading predicts the whole market movement. They find that when insiders are buying markets on average do well, and when they are selling markets do poorly, with an annual spread in returns exceeding about 10 percent. Jeng, Metrick and Zeckhauser (2003) find that insider purchases earn abnormal returns of more than 6 percent per year, and insider sales do not earn significant abnormal returns. Scott and Xu (2004) report that large insider sales that also account for large percentages of insiders' holdings predict significantly negative future abnormal returns. Small insider sales that account for small percentages of shares owned are correlated with significantly positive abnormal returns.

Seyhun (1986) reports that insiders earn about three percent abnormal returns over 300 days following the insider trading days. Yet, in the same study Seyhun (1986) concludes that outsiders who imitate insiders cannot make positive abnormal returns after considering transaction costs. Similarly, Rozeff and Zaman (1988) find that after imposing a transaction cost, insiders can still make abnormal return but the outsiders' profits disappear. A latter study by Bettis, Vickrey and Vickrey (1997), on the contrary, find that outsiders can earn significant transaction-cost adjusted abnormal returns by using publicly available insider-trading data. They explain that the difference between their findings and findings of Seyhun and Rozeff-Zaman is due to a different assumption on reporting-delay time; the longer the assumed reporting delay, the smaller the outsider abnormal returns net of transaction cost. The studies of Seyhun (1986), Rozeff and Zaman (1988) and Bettis et al. (1997) suggest that the identification of dissemination date of insider trading activities is crucial in knowing the market reactions to insider trading activities.

In this study, we use a different data set with precise dates of insider trading information available to the

public with very low costs to investigate the market reaction to insider trading information. We examine the stock price reactions to the publications of insider trading information in the Wall Street Journal's "Inside Track" (IT hereinafter) columns. We designate the publication day of each IT column as the event day and we examine the event day stock market reactions to insider trading activities disclosed in the IT columns.

DATA AND METHODOLOGY

Starting from August 31, 1988, WSJ has published weekly Wednesday reports (IT and Spotlight) on insider trading information filed with SEC in the previous week. In total, 250 weekly IT columns between August 31, 1988 and June 23, 1993 are collected. The final sample consists of 414 companies, of which 163 are insider purchases (Insider Purchase Sample) and 251 are insider sales (Insider Sale Sample). Out of 163 insider purchases, 33 are mentioned in the headlines of the IT columns (Headlined Purchase Sub-Sample), the remaining 133 are classified as Non-Headlined Purchase Sub-Sample. Out of 251 insider sales, 63 are used in the headlines of the IT columns (Headlined Sale Sub-Sample) and the other 188 are put into the Non-Headlined Sale Sub-Sample.

We employ a traditional event study method to analyze the companies with insider trading discussed and reported in the column IT. The daily stock returns are retrieved from the Daily CRSP Database. Stock abnormal returns are estimated using the market model suggested by Brown and Warner (1985). The Z-statistics detailed in Mikkelsen and Partch (1988) are employed to determine the statistical significance of the abnormal returns and cumulative abnormal returns. Cross-sectional regression models are used to further investigate the relationship between the stock price reactions and the information disclosed in the IT columns.

RESULTS

Even Study Analysis

Overall, the empirical results indicate that IT publications have information content. The significantly negative and positive CAAR's in the -60 to -31 period for Insider Purchase and Sale Samples respectively suggest that insiders tend to be contrarian investors. The finding of significant positive and negative CAAR's in the 30-day pre-event period for Insider Purchase and Sale Samples is consistent with Seyhun (1988)'s argument that early gathering of insider trading information is necessary. Lakonishok and Lee (2001) also report that insiders in aggregate are contrarian investors.

We then investigate whether the information content is different when insider trading is only reported in the IT columns from when insider trading is also reported in the Spotlight. The results show that both the insider purchases presented and not presented in Spotlight tables are greeted with significantly positive event-day abnormal returns. Similarly, both the insider sales reported and not reported in Spotlight tables receive significantly negative event-day abnormal returns.

Regression Analysis

We estimate a linear model to investigate the relations between the stock price reactions and the information disclosed in the IT columns. The result indicates that market reacts more positively to insider purchase trades when the cited reason for the trading activities is insiders' confidence in the firm, when there are three or more insiders are buying, and when the chairman of the board is buying. It also appears that investors do

not treat headlined purchase firms significantly different from non-headlined purchase firms. But if the insider sales are also reported in the headlines of the IT columns, the abnormal stock returns are significantly more negative than insider sales not mentioned in the headlines of the IT columns. The negative coefficient for board chair in the insider sale sample is consistent with the positive coefficient of board chair in the insider purchase sample.

SUMMARY AND CONCLUSIONS

This study investigates the information disclosed in the Insider Track (IT) columns by the WSJ and the information content of the publication. A detailed examination of the IT columns shows that the columns report more insider-sale information than insider-purchase information. On the publication day of the IT columns, stocks associated with insider buying activities incur significantly positive abnormal returns, while stocks associated with insider selling activities suffer significantly negative abnormal returns. Insider selling activities which also appear in the headlines of the IT columns experience more negative abnormal returns than insider selling activities merely mentioned in the IT columns. We do not find dual coverage of the insider buying and selling activities in both the IT columns and the Spotlight tables provides additional information content than the information provided in the IT columns. For the time period that insiders are assumed to have engaged in their trading activities, we find significantly negative (positive) abnormal returns in the period of 60 to 31 days prior to the IT publications for the insider purchase (sale) sample. It appears that insiders behave like contrarian investors. They tend to buy when their firms' stock prices are falling and sell when their firms' stock prices are rising. Our regression estimations indicate that if chairman of board participates in the insider trading activities, the event-day abnormal return is more positive (negative) for Insider Purchase (Sale) Sample.

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