

Time frequency of strategy switching by buy-side professionals in the Japanese stock market

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Several agent-based theoretical models demonstrate that strategy switching between fundamental and trend-following predictors is the main generator of price deviation from the fundamental value. However, no research has empirically identified: (1) the type of investors who actually utilize either fundamental or trend-following predictor and switch the rules over time; and (2) the switching frequencies. This paper achieves this goal by examining a monthly panel dataset on order flows distributed by the Tokyo Stock Exchange, covering July 2002 through June 2013. We categorize buy-side professionals in the Japanese stock market into investors, such as those in charge of managing proprietary trading, individual investors, foreign investors, security companies, investment trusts, life or postal life insurance, city or local banks, and trust banks. We find that our buy-side investors utilize either of the fundamental or trend-following (or contrarian) strategy, and significantly switch between the two rules at both monthly and quarterly frequencies. We also demonstrate that the parameter estimates are quite different across the types of investors, indicating timevarying within-group behavioral heterogeneity in the Japanese stock market. However, we observe that the strategy switching is not necessarily related to the investment profits in our sample.