

The impact of derivatives hedging on stock market: evidence from Taiwan covered warrants market

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Abstract

We examine the derivatives hedging impact on the spot market using the accurate hedge ratios of covered warrants traded in the Taiwan Stock Exchange (TWSE). We find significant positive abnormal returns and trading volumes before the announcement of warrants issuance and the effect is stronger when the hedging demand is larger. Moreover, there exists a significantly positive relationship between stock return volatility and the *price elasticity of hedging demand*. Finally, we observe significantly negative price effect to the underlying stock before (after) the expiration date for call warrants that are expired out-of-the-money (in-the-money) due to the liquidation of hedging portfolios.

Keywords: hedging impact, introduction effect, expiration effect, covered warrants, return volatility, trading volume, price elasticity