University of Zurich

Liquidity Premia on the Swiss Stock Market

Bachelor Thesis

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1 Introduction

Liquidity may be used to describe a variety of different circumstances in an economic world. Therefore, it is easy to find several forms of definitions in the existing literature, but hard to find a precise one for liquidity that would suit for most of its utilization. For this thesis, liquidity will be seen from a financial economic standpoint in the securities industry, where security liquidity refers to "the ability to trade a large number of securities rapidly at low cost and with little impact on market prices" (Brown, Crocker, and Foerster (2009, p. 67)).

For this bachelor thesis, I am going to analyze on how stock liquidity may affect stock return on the Swiss stock market and if an illiquidity premium is identifiable for less liquid shares in case. My motivation for this subject comes initially from Amihud and Mendelson (1986), who studied the effects of liquidity on asset pricing. With help of empirical results, they claim to observe the findings of increased expected return in rising illiquidity for shares.

My main goal is to see if expected market illiquidity causes expected stock excess return to rise over time on the Swiss stock market with a similar approach like Amihud (2002). I am also going to analyze the stock market with the turnover rate measure, similar to Datar, Naik, and Radcliffe (1998), but I will set the main focus to the Amihud (2002) procedure, where I will go deeper into details. With help of an empirical analysis conducted on the Swiss Performance Index (SPI) over a specific timeframe, I hope to find answers and results in defining a premia for illiquidity.

A broad spectrum of literature about increased return in illiquidity emerged in the last 30 years (Ibbotson et al. (2013)). Most of those studies show similar findings among them and support each others results.[1] But the literature is not just limited to those, some studies do show findings that go in the opposite direction.[2] This thesis will try to find out if the Swiss stock market reflects the prediction of an illiquidity premium predicted by the majority of researchers.

This thesis proceeds with Section 2, where the theory behind liquidity is examined. Different dimensions of liquidity are compared and proxies for liquidity are analyzed. In Section 3, important academic works are reviewed and discussed. Section 4 describes the methodology and data sample used for this work. Section 5 follows with the empirical results and Section 6 concludes.

[1] See e.g. Datar, Naik, and Radcliffe (1998) and Amihud et al. (2014).

[2] See e.g. Brown, Crocker, and Foerster (2009).