Investor sentiment, information uncertainty and initial Public Offering mispricing in China Stock Markets

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Abstract

Using a sample frame of 804 new issues from 1 September 2006 to 31 December 2015 in Shanghai and Shenzhen stock markets, this paper presents new evidence to show that investor sentiment and information uncertainty explain initial public offering mispricing in both stock markets. Specifically, we capture investor sentiment via two separate indices – one that captures market-wide sentiment and another that captures company-specific sentiment. We use IPO underpricing and overpricing as proxies for IPO mispricing on the first trading day in the secondary market. Our results show that market-wide sentiment explains 5% of the IPO underpricing while company-specific sentiment explains 1% of the underpricing seen on the first trading day in the secondary market. Information uncertainty explains 30% of IPO underpricing on the first trading day. In contrast, market-wide sentiment explains 15% of the IPO overpricing while the company-specific sentiment shows a negative 13% relation with IPO overpricing on the first trading day. Conversely, information uncertainty has a weak, negative and not statistically significant relation with IPO overpricing.

The results show an interesting pattern in that prior to first day trading, information uncertainty plays a more dominant role in explaining the magnitude of IPO underpricing than both sentiment indices. However, information uncertainty’s low explanatory power to IPO overpricing seems to suggest that the uncertainty surrounding an IPO fundamental value diminishes significantly once the shares are listed on the market. Additionally, both sentiment indices have stronger relation to IPO overpricing than the underpricing. While the market-wide sentiment has positive relation to both IPO underpricing and overpricing, rising company-specific sentiment leads to declining IPO overpricing. This pattern of behaviour is intuitively plausible considering that post IPO, company-specific sentiment is expected to die out as market forces enhances price discovery. So expectedly, both information uncertainty and company-specific sentiment have low explanatory power for IPO overpricing.