

What Shapes Market Prices?

Ion Lucas Saru obtained his PhD from the Vrije Universiteit Amsterdam and is currently Energy Analyst at Northpool. In his research, he uses modern econometric tools to understand how information and trading behavior shape prices in financial markets. In two of his papers, he studies how the interaction between news and value traders affects market outcomes and how trading unrelated to new information can still move prices.

Every day, financial markets process vast amounts of information and translate them into prices. Because prices influence investment and corporate decisions, financial markets play an important role in the broader economy. This information is incorporated into prices through market participants' trading decisions. But what information exactly is incorporated, and by whom? Today's market participants have access to increasingly large and diverse datasets that differ in scope, quality, and informational value. Meanwhile, fundamental research may give traders a superior understanding of a firm and its fundamental outlook. In Menkveld and Saru (2026), we study the interaction between two types of traders: news traders and value traders.

News traders are market participants who react quickly to information about changes

Ion Lucas Saru
Energy Analyst at Northpool



in value. Such information may originate from traditional news, but more broadly includes market news such as order book updates in correlated securities. Because these signals are noisy, the profitability of news trading depends not only on the magnitude of the underlying value change, but also on the precision of the observed information. By contrast, value traders acquire information through costly fundamental research aimed at identifying deviations between prices and fundamental values. They trade strategically on this information, gradually moving prices toward fundamentals, with trading profits covering their research costs.

The distinction between these two types of traders has important implications for markets. News traders rely on signals with a short half-life and therefore need to trade immediately. Value traders, by contrast, can trade on their information more gradually. As a result, they can extract substantially higher profits from the same underlying information. As news signals become more precise, part of the informational advantage of value traders shifts to news traders. Consequently, liquidity providers face less adverse selection risk when trading with news and value traders. This lowers price impact and improves market liquidity. Interestingly, although more precise news reduces value trading activity, overall market efficiency remains largely unchanged.

Empirically, we find that value trading is substantially more profitable than news trading, generating nearly three times higher profits after trading fees. Our estimates suggest that the signals observed by news traders are relatively noisy and capture only about one-third of the underlying value change. In recent years, we find that the price impact associated with liquidity demand has more than doubled. We attribute this to noisier news signals arising from the growing abundance of data, combined with lower levels of noise trading. These findings show how the precision of information shapes market liquidity through its effects on adverse selection and trading behavior.

Even in the absence of information, security prices can react to trading activity as liquidity providers accommodate the trading demand of incoming traders using their own inventory. This results in transitory price movements. In Saru (2026), I study systematic drivers of these transitory price movements, which I refer to as pricing errors.

My findings indicate that these pricing errors are not just noise in stock prices, but vary systematically. If two stocks have a similar exposure to common risk factors, a liquidity provider holding both securities after a trade has a greater risk exposure than one holding securities that hedge each other more effectively. As a result, pricing errors tend to be more correlated among stocks with similar factor exposures. Because these pricing errors affect transaction prices, they matter for investors trading baskets of stocks, such as institutional investors and mutual funds.

References

- Menkveld, Albert J. and Saru, Ion Lucas (2026). Does News Trading Crowd Out Value Trading? Evidence from a Structural Estimation. SSRN Working Paper 6306118
- Saru, Ion Lucas (2026). The Cross-Section of Price Efficiency. SSRN Working Paper 5038403.