CHAPTER 2

NONLINEAR COINTEGRATION RELATIONSHIP BETWEEN STOCK PRICE AND TRADING VOLUME: EVIDENCE FROM BORSA ISTANBUL

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INTRODUCTION

The trading volume, which has a great importance on stock prices and stock price volatility, reflects the cumulative response of investors to new news coming to the market. At the same time, trading volume is an important indicator that measures the information flow that cannot be observed but affects the market (Andersen, 1996; Lamoureux and Lastrapes, 1990). For these reasons, it has a critical importance in the process that creates stock prices and their volatility. The trading volume does not only play an important role on market information, but also reflects information about changes in the investors' expectations in the market (Harris and Raviv, 1993). When there is an increasing information flow to the market, an increasing number of investors are trading at the same time and the ways in which investors interpret the news affecting the stock value are different. In addition to shaping their expectations based on informations including trading volume and prices, investment decisions are also based on many factors such as market structure, quality and quantity of information, investors' experiences, risk preferences and strategies (Puri and Philippatos, 2008).

Karpoff (1987) explains the importance of the relationship between price and trading volume in four reasons: 1) The linkage between price and trading volume provides information about the structure of financial markets. Theoretically, the low trading volume indicates that a market has a non-liquid structure. This means high price volatility. On the other hand, high trading volume means that the market is highly liquid and the result is low price volatility. In general, with the increase in volume, commission income will also increase, so market regulators are

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