

## **The Non-Tradability Premium of Future Contracts**

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### Abstract

In this study we investigated the price of nontradability of future contracts using a unique data sample of nontradable future contracts whose underlying asset is the short-term government bond ("Makam"). The singularity of these data is that identical tradable bonds are traded on the secondary market. This structure of the government bond market in Israel is consistent with the model proposed by Boudoukh and Whitelaw (1993), who assume an economy with identical tradable and nontradable bonds. They argue that an optimal consumer surplus may be achieved by segmenting the market by tradability measures, which allows for discrimination between two types of investors, such as hedgers vs. traders, for example.

The main contribution of this study is the potential to measure the nontradability premium and the factors that affects its size, using a unique data set that allows us to overcome the drawbacks of previous studies. For example, in contrast to the work of Amihud and Mendelson (1989) or Brennan and Sobermanheim (1999)(who estimated the nontradability premium from the residual return, based on a specific asset pricing model, in this study, the returns on the tradable and nontradable bonds are known. Furthermore, unlike other studies of US Treasury bonds by Amihud and Mendelson (1991) and Kamara (1994, 1998). Israeli government Makam bonds in the current study allow us to calculate the nontradability premium in a market that does not permit short sales. Relatedly, we mention that Kamara (1997) found that the return on bonds embodies both the credit risk and the liquidity risk, and both risks are positively correlated to interest rate fluctuations. This concern is nonexistence in the Israeli market, where the short sale market is underdeveloped. Another advantage of the data we use in this study is that, in contrast to Kamara (1988) and others who estimate the nontradability premium by measuring the differences between forward contract prices and similar traded futures contract prices, where futures are marked-to-market daily, all the bonds in the sample of the current study are not subject to the problems related to daily marking-to-market.

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