In an Efficient Market hypotheses, prices adjust instantaneously toward their fundamental values, and trading volume contains no information about future price developments. However, the sequential arrival of information model implies a positive causal relation between absolute stock returns and trading volume in either direction, and the mixture model suggests a positive causal relation running from volume to absolute returns. Empirical evidence supports these theories, since large movements in stock prices typically take place on days with high trading volume. Here, we consider the relationship between stock return and trading volume using a nonlinear framework. First, nonlinearity in the Helsinki Stock Exchange data is tested using a STAR-model. Next, we compute nonlinear impulse responses; first to check the stability of the models, and second to scrutinize the persistence of shocks in return and volume series. Linear Granger causality tests indicate bidirectional causality between returns and volume. By contrast, the nonlinear causality tests suggest that only in a few cases can volume be used to forecast returns. Thus, the empirical findings give only slight support to the mixture model. Finally, we exploit the outcome of causality tests to specify a STVEC model in order to take into account the influence of the composition effect and common persistence on the results. We conclude that causality runs mainly from returns to trading volume, corroborating the positive feedback trading hypothesis.

There is a large body of empirical evidence that stock markets perform poorly during inflationary periods. Several explanations have been offered for this so-called "anomaly." Here, we test the claim that the "spurious" negative correlation between stock returns and inflation is due to counter-cyclical monetary policy. We identify various regimes in the Finnish data using the Markov-switching vector autoregressive model. When necessary, the existing long run relationship between the model variables are incorporated using the MS-VEC model. Using alternative sets of explanatory variables including measures for monetary policy stringency, we conclude that the sign of the relation between returns and inflation depends especially on the time horizon chosen. In monthly models the statistically significant contemporaneous correlations between returns and inflation are always negative, but positive in the case of quarterly data. Stocks thus seem to be a good hedge against inflation in the long run. To be more specific, stocks seem to maintain protection against purely monetary inflation but fail to provide a hedge against inflation arising from real output shocks. Last, this is tested using the regime-dependent impulse response function.