

Chapter 6

Conclusion

6.1 Summary

The main focus of this empirical study is to assess whether there exists linkages between the Malaysian stock market and other stock markets, and whether international diversification is beneficial among the different stock markets, with emphasis on the period pre- and post the financial crisis of 1997. By using cointegration analysis, which focuses on the analysis of long-run relationships between the series, a relevant framework is built for the study of potential links between different stock markets.

6.1.1 The Entire Sample Period (January 1994 – Jun 2001)

Our results suggest that for most pairwise portfolios there exist potential long-run international portfolio diversification gains to Malaysian investors in the sense that there is no evidence of cointegrating relationships. Three clear exceptions to this appears to be the pairwise portfolios of Malaysia-South Korea, Malaysia-Thailand and Malaysia-Indonesia, which show robust evidence of cointegration over the entire

sample period, hence indicating that diversification in these cases would not be profitable.

Generally, deregulation and liberalization of different markets during the 1980s, encouraged and increased the international activities of multinational corporations inducing the cross-border capital movements. For an example, in the article by Chuppe *et al.* (1989), he explains that the expansion of international trade in both goods and financial services, accompanied by large trade imbalances among the countries induced the long-run relationships between the stock prices of different countries.

Besides that, improvements and development of communication technologies which tie financial centres together via computers and instantaneous communication makes the idea of an integrated international equity market more plausible. With instantaneous communication, disturbances in one market may be transmitted to other markets around the world.

6.1.2 Pre-1997 Financial Crisis Period (January 1994 – Jun 1997)

In depth studies of international comovements among the stock price indices pre- and post the 1997 financial crisis, our results show that Malaysia is pairwise cointegrated with South Korea, Thailand, Indonesia and Philippines. The evidence shows the existence of linkages between the Malaysian market and some of the ASEAN stock markets, namely Thailand, Indonesia and Philippines.

6.1.3 Post-1997 Financial Crisis Period (July 1997 – Jun 2001)

However, the trend changed post-1997 financial crisis, the Malaysian stock market has been found to be cointegrated with the U.S., Hong Kong, Taiwan and Thailand. The results document that the “cointegrating structure” tying the Malaysian stock market with other stock markets has changed after the crisis.

In addition, Granger’s causality tests suggest that the U.S., Hong Kong and Thailand stock markets “cause” the Malaysian stock market after July 1997 which means that a causal effect is running from the U.S. to Malaysia, Hong Kong to Malaysia and Thailand to Malaysia in our sample post-July 1997 financial crisis. The influence of the U.S., Hong Kong and Thailand stock markets has substantially increased since July 1997. Given our results, one can conclude that in the recent financial crisis, the relationship between Malaysia and the U.S. Hong Kong and Thailand seems to be stronger than that within the ASEAN countries. The 1997

financial crisis caused instability, which was transmitted from the major stock markets of the world such as the U.S. and Hong Kong stock market to the Malaysian market.

6.2 Limitations of the Study

This study attempts to examine the linkages between the selected stock markets by using pairwise cointegration test following Kanas's paper (1998). The results do yield useful information in the investors' consideration of portfolios as they demonstrate which series are moving together in the long run. However, the Malaysian investors would also like to consider a wide portfolio which is included a few of the stock markets in making investment decisions. Due to that, the study can be further enhanced using the multivariate cointegration test to determine the linkages among the selected stock markets. We leave this on the agenda for future research.

Another shortcoming of the study is that it only assesses nine stock markets and does not cover all the stock markets in the world. The study of linkages between the Malaysian stock market and other selected stock markets can be further enhanced by analyzing the relationship with other stock markets such as Japan, UK, Australia and European countries like France, Italy and Sweden

6.3 Conclusion

This paper has examined the linkages between the Malaysian and eight selected stock markets, namely those of the US, Hong Kong, Taiwan, South Korea, Singapore, Thailand, Indonesia and Philippines, using cointegration techniques. The analysis examined the period from January 1994 to Jun 2001, as well as the pre- and post-1997 financial crisis periods.

The main finding is that the Malaysian stock market is pairwise cointegrated with the South Korea, Thailand and Indonesia stock markets. The result holds for the entire sample period as well as the pre-1997 financial crisis period, hence indicating that diversification in the selected stock markets would not be profitable.

In depth studies of the linkages between the selected stock markets during pre- and post-1997 financial crisis, the results show that the "cointegrating structure" tying the Malaysian and other selected stock markets has changed after the 1997 financial crisis. The Malaysian stock market is pairwise cointegrated with the US, Hong Kong, Taiwan and Thailand stock market during the post-1997 financial crisis period. The evidence of cointegration has indicated that there do not exist any potential gains in risk reduction from diversifying in the Malaysian stocks and stocks in any of these selected stock markets during the post-1997 period.

However, by acknowledging that the Malaysian stock market is not cointegrated with all the selected stock markets, the Malaysian investors with a long run perspective may benefit from an investment made, in other words, there still exist opportunities for beneficial international portfolio diversification across the selected stock markets, such as Singapore stock market. This result can be valuable to the investors and financial institutions holding long run investment portfolios.