CHAPTER 5

CONCLUSION AND RECOMMENDATIONS

Chapter 5 concludes the study by reiterating some of the important empirical findings that substantiate the existence of the holiday effect in the KLSE. Possible causes of the holiday effect will be discussed and trading strategies will be proposed to capture the high pre-holiday returns. The chapter will end with a section on the limitations of the study as well as suggestion for further studies.

5.1   SUMMARY

This study uses three daily stock indices to examine the holiday effect in the Main Board and the Second Board of the KLSE. The period under study is from January 1990 to June 2000 for the KLSE CI, and October 1991 to June 2000 for the KLSE EMI and KLSE SBI. The statistical tests conducted in the study comprise of both parametric tests (ANOVA and t-test) and non-parametric test (χ^2- statistic and K-W test).

5.1.1 The Existence of Holiday Effect in the KLSE

This study empirically confirms the existence of the holiday effect in the KLSE. The results show that high returns predominate only on the single trading day before holidays and not on other days around holidays. All the indices record a significantly high return (KLSE CI: 0.348%; KLSE EMI: 0.428%; KLSE SBI: 0.407%) on the first day prior to holiday as compared to the negative returns for normal trading days. On the other hand, post-holiday returns; particularly the first day after holiday, are insignificantly high. This implies that the holiday effect in the KLSE is essentially

attributed to the pre-holiday effect. In addition, the results of χ^2-statistic which test the frequency of advances show that the pre-holiday fraction of positive return is significantly higher than that of the total trading days' for all three indices; thereby reinforcing the results obtained from the parametric test earlier.

In an examination of the individual holiday, the results for the KLSE CI show significant pre-New Year's Day return (0.984%), post-Chinese New Year return (2.825%), and post-Kongsi Raya return (7.272%). A strong post-Kongsi Raya return of 6.636% is also recorded by the KLSE EMI. Meanwhile, the KLSE SBI displays a peculiar holiday effect which concentrates on the pre- and post-Chinese New Year period. High returns for this Chinese New Year effect are reported significant at the 10% level.

The results for all three indices also indicate that the pre-holiday strength is independent of other anomalies such as the January effect, the day-of-the-week effect, monthly effect, and firm size effect. In addition, the existence of pre-holiday effect in the KLSE also suggests that the stock market is not weak form efficient.

5.1.2 Relationship Between Business Cycles and Pre-holiday Effect for Different Firm Sizes

Empirical findings of this study show that the patterns of pre-holiday return and ordinary day return vary according to the level of economic activities whereby the magnitude of pre-holiday strength is found strongest during expansionary period. In addition, the KLSE EMI reports the largest magnitude of pre-holiday returns. This implies that the large-capitalisation stocks appear to outperform the small-capitalisation stocks in terms of pre-holiday returns during economic boom.

There is no sign of any positive pre-holiday effect reported for all three indices during recession period. Furthermore, the small-capitalisation stocks are worst hit during bad times whereby the magnitude of pre-holiday is -0.325% versus -0.145% for large-capitalisation stocks. These results are however, insignificant.

Although small-sized stocks suffered the greatest loss during economic bust, they recorded a remarkable rebound during recovery period by exhibiting the highest magnitude of pre-holiday strength (0.653% versus 0.273% for large firm size stocks).

5.2 POSSIBLE CAUSES FOR THE EXISTENCE OF HOLIDAY EFFECT

(1) Liquidity is seen as the fundamental reason behind the formation of the holiday effect. This is in view of the fact that the pre-holiday effect only exists during expansionary and recovery periods but not during recession period. Therefore, the reason given here is in line with the general economic condition whereby the stock market is flushed with immense liquidity during good times but is pressured by liquidity crunch during bad times. In addition to the general economic condition, companies usually pay bonuses in the months of December and January; thereby further increasing liquidity which is used to boost the rally from pre-New Year's Day to the post-Chinese New Year.

(2) Another possible reason for the presence of the January seasonal in the KLSE as demonstrated by the significantly high pre-New Year's Day return is the influence of stock market movements in foreign stock markets, in particular the U.S., where the January effect has been found to exist. A study conducted by Yong (1995) has indicated a causal relationship between the U.S. stock market

and the KLSE whereby a uni-directional relationship running from the U.S. to the KLSE is found. This further reinforces the belief of spillover pre-New Year's Day effect from the U.S. stock market to Malaysia.

(3)   Favourable holiday psychology of *"good fellowship and cheer"* as suggested by Watchel (1942). This non-economic reason is supported by the high magnitude of pre-holiday returns, in particular the strong post-Kongsi Raya effect which was experienced by all Malaysians who celebrated these joyous festivals (Hari Raya Puasa and Chinese New Year) together. This high spirit is believed to have contributed positively to investment sentiment which is an important driving force behind the KLSE's performance.

(4)   Some researchers have suggested that the Chinese New Year effect is common in stock markets with high participation rates from the Chinese investors. In this study, it is found that the Second Board counters display a unique pre-holiday effect which is concentrated on the Chinese New Year only. Incidentally, the companies that form the Second Board are largely small and medium-sized industries (SMIs) and many of which are Chinese-operated. This could be the reason that explains the Chinese New Year rally as demonstrated by the significantly high pre- and post-Chinese New Year returns.

5.3 RECOMMENDATIONS

(1) An investor may consider buying all the stocks in the market, which is made possible by taking a long position in the KLSE CI futures or options, at the closing of the day before New Year's Day and sell them (or close position) at the opening of the day after Chinese New Year. This strategy will result in a gain of 3.809% (0.984% + 2.825%) whereby after paying 2% for a round trip transaction, a net gain is still obtainable. Following the same strategy, the trading of the Second Board stocks during the Chinese New Year will gain 1.734% after accounting for transaction cost.

(2) In terms of proper asset allocation, higher weightage should be placed on larger-sized stocks during expansionary period and small-sized stocks during recovery period in order to capture the different magnitude of pre-holiday returns as demonstrated by the KLSE EMI and the KLSE SBI.

Having suggested the above, one important point to stress here is that, the figures reported in the study are in terms of average return; therefore, the holiday effect is true only if one is looking at a considerable length of time. Hence, these trading strategies may work only for long-term investment and not so much for speculative investment.

5.4 LIMITATIONS OF THE STUDY

(1) Although the findings have shown that the pre-holiday effect predominates on the single day immediately prior to holiday, the study has not determined the patterns of intra-day movement which will tell us how the hourly returns are accruing to the stock indices.

(2) The KLSE EMI and the KLSE SBI are used as proxies for large and small firms. Although this is not an uncommon practice for many studies, a comparable statistical evidence could be obtained by examining the size decile portfolios.

5.5   SUGGESTIONS FOR FURTHER STUDIES

(1) In order to add new knowledge to the holiday effect, future studies can look into the intra-day pattern of stock returns around holiday by examining the hourly returns of the stock market indices.

(2) In exploring the relationship between the holiday effect and economic conditions, researcher can use the sectoral indices to examine the magnitude of pre-holiday returns accruing on each segment of the economy. This will help in formulating a more focused investment strategy, which is particularly useful for those investors who pursue selective stocks purchase in different sectors of the economy. For example, the sectoral funds that are now offered by unit trust companies allow investors to select the sectors they want to invest in.

(3) Given that the strong holiday returns are concentrated on a few holidays, such as the New Year's Day, Chinese New Year, and Kongsi Raya; future research that use the Gregorian, Chinese, and Muslim calendars is suggested to examine the holiday effect.