CHAPTER 6:

CONCLUSION AND RECOMMENDATIONS

6.1 Summary and conclusion

The purpose of this research is to find out whether there is any impact of political and national budget announcements on the stock market. And, if the impact exists, does the market react efficiently to both announcements? Following the objectives, three hypotheses have been formed. The first null hypothesis states that there is no impact of political announcements on the stock market. The second hypothesis is that there is no impact of national budget announcements on the stock market. The third null hypothesis states that there is no difference of market reaction to either political or budget announcement. If either of the first two hypotheses is rejected, we will then ask whether the market is efficient in reacting to the information.

The study examines the impact from general and specific perspectives. From the general perspectives, this study is looking at how the political announcements, as a whole, affect the stock market reaction. The similar concept is applied on the impact of budget announcement on stock market in general. From the specific perspectives, political and budget announcement are being analyzed individually and the impact of individual announcement is examined.

In order to conduct the research, the event study methodology is employed. KLCI was chosen as the proxy of the stock market. 38 political events and 15 national budget

announcement dates were selected and the event windows were formed around the announcement dates. The average abnormal returns and average cumulative abnormal returns were calculated for each period in the event windows and tested for significance.

The test results show that *in general*, the market does react to both political and national budget announcements. Positive political announcement seems to create market momentum for three days after the announcement as the average cumulative return gradually increase over the period. On the contrary, negative political announcements seem to cause market overreaction as the market react negatively for the first two days of the announcement but soon followed by positive abnormal returns after that. In addition, there is also evidence of information leakage five days before a negative political announcement was announced, suggest again that the market is not efficient. However, such leakage was not found for positive political events announcements.

For positive national budget announcements, the significance of abnormal return is limited on the announcement day and no other significant abnormal return was found on other days within the events window, thus supports the efficient market hypothesis at semi-strong level. However, evidence of market inefficiency was found when the test on the cumulative effect of the announcement was carried out. The results show that the average cumulative abnormal returns are all significant after the announcement day. For negative budget announcement, surprisingly none of the abnormal returns or cumulative abnormal return is statistically significant and as a consequence we will have to conclude that such announcements have no impact on the market reaction

This study further explores on market reaction to similar sets of political events. Six categories of political events, namely Cabinet Reshuffles, Changing of Administration Leadership, General Elections, Party Elections, Dissolutions of Parliaments and Extraordinary Events, are tested. It is not surprising to find that while most categories of events do not concern the market participants, the market do respond aggressively to unanticipated extraordinary events through significant ARs and CARs.

Turning to individual study on the impact of each political announcement, results show that not every selected political announcement affects the market reaction. Elections, either at national level or party level, generally do not concern the market as the abnormal return and cumulative return for these events are insignificant most of the time. However, there are also two exceptions where the National Election 1990 and 2008 do give rise to significant results. The probable explanation for this observation might be due to the predictable election outcomes which have been anticipated by the market. Individual political events that concern the market are mostly extraordinary or unexpected. In fact the 2008 national election result announcement can be also categorized as one of the unanticipated events which results in significant market reaction. For those significant events, the market reaction is a mix of overreaction or market momentum.

As compare to political announcements, individual budget announcement that create impact to market is comparatively less. Out of the 15 National Budget announcements,

only budget 2001, 2003, 2009 and 2012 seem to affect the market significantly. Again, the market reaction is a mix of overreaction and market momentum.

As a conclusion, the Malaysian stock market does react to political and budget announcements. However, due to the inefficiency of the market, the impact created by these announcements might be surrounding the actual announcement day, thus results in significant abnormal return or cumulative abnormal return at different period of time. The results also provide evidence that the behavior of market reaction is a mix between overreaction and market momentum which is also a proof of market inefficiency at semi-strong level.

6.2   Implications of the study

Previous studies (DeBondt & Thaler, 1987; Lai et al., 2003; Ali et al., 2010) suggest that it is possible for the investors to earn long term abnormal profit by forming a contrarian strategy to buy winner's portfolio and sell loser portfolio, based on their results of long term studies of market reaction to various announcements. However, their conclusions do not apply in this research study.

Based on the result of this short term study, investors are quite impossible to design short term trading strategies in order to earn consistent abnormal return from the political or budget announcements even though some of the results show significant abnormal returns and cumulative abnormal returns in certain scenarios. The reason is that in the

short run, market behavior is too volatile. Abnormal return can be positive on day 0, but falls to negative the next day and return to positive two days after.

Besides, it is also quite difficult to predict whether an announcement is positive or negative in nature and since market is inefficient most of the time, it takes a few days for the market to reflect the information and conclude whether it carries positive or negative impact to the market itself. Moreover, it is also hard to determine how the market would react based on the mixed results of study. There are three possible types of market reactions that happened on a random basis based on the results of this study: efficient reaction, overreaction and market momentum. Unless an investor can accurately predict the aforementioned situations and does necessary action, he is very unlikely to consistently earn short term above average return by forming any strategies other than speculations.

6.3   Limitations of the study

This study is designed as the way it is in other to examine the market reaction to political and national budget announcements within Malaysian context, which is also intended to contribute to the currently scarce literature in this research area in Malaysia. Due to constraint of resources, this study is only able to cover 38 political announcement and only 15 national budget announcements. For the 38 political events, all of them are related to governmental-based issues and none of them covers news for the opposition parties. Therefore this study is not able to examine if the announcements related to opposition political issues will affect the stock market reaction. As for the 15 budget

announcements, the budgets before 1998 are ignored and as a result, the impact of those budget announcements during the booming phase of Malaysia economy cycle cannot be studied.

In order to further identify positive and negative market reaction to the announcements, the budget announcements are further segregated into seven positive cases and eight negative cases. These eight negative budgets happened to be announced during the 'bad' years where the variance of the stock return is much higher than other years. Therefore, when testing the impact of negative budget announcements, the t-statistics tends to be smaller and insignificant.

Apart from the data constraint, there are some limitations on the methodology. First, there is a dilemma in determining the width of the event windows. If the window chosen is too narrow, one cannot capture the impact of information leakages prior to the announcement and the delayed reaction of the market a few days after the announcement. If it is set too wide, it would allow unforeseen co-existing events (also known as the "confounding factors") to affect the stock reaction and therefore the return of the stock might be biased. In fact, in many other studies, the choice of the event windows is rather arbitrary. Since this is a short term study of the market reaction, the event window is fixed at 5 days before and after the announcements. Any effect from the announcements longer than this event period is not been able to detect.

Secondly, the choice of benchmark model to estimate the expected return will directly affect the magnitude and significance of the abnormal returns. One of the disadvantages of this method is that the benchmark return does not incorporate the market-wide stock price movement (de Jong, 2007). Using the mean-adjusted model might produce upwardly or downwardly biases in abnormal return when the market is bullish or bearish (Sitthipongpanich, 2011). Market model is widely accepted as a better model in estimated normal return. However, due to the data constraint of the current market benchmark, it seems reasonable to use the mean-adjusted model instead.[1] In fact, the adoption of mean-adjusted return model exists in many influential literatures (Brown & Warner, 1980; Copland and Mayers, 1982; Lasfer et al., 2003; Spyrou et al., 2007) and is always found to yield similar results with other complicated models (MacKinlay, 1997).

Thirdly, some of the results inevitably expose to the confounding factors within the event windows. For example, the ouster of Anwar Ibrahim from UMNO on 2 September 1998 happened just one day after Mahathir announced the currency control to counter the attack of the financial crisis. Prior to the announcement, the KLCI recorded at about 320 points and fell to 262.7 on 1 September and rose again to 294.59 on the day Anwar was arrested. Similarly, "Operation Lalang" occurred on 27 October 1987 when the world economic crisis burst out almost the same time and therefore, the effect on the KLCI could be a mixture of these two events.

In summary, this study is true as to my study design.

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[1] The initial thought of using the FTSE Bursa Malaysia Emas Index is abolished due to the fact that there is no comparable data for this index prior to 1996.

6.4   Suggestions for Future Research

Future research in this area can delve into other political events which are not being able to cover in this study, especially events related to the opposition parties. For the analysis of budget announcements, this study is only able to cover budget after 1998. Future studies therefore might want to investigate the effects of budget on stock market even before 1998.

Besides, future researches in this area that opt for event study as methodology can think of using other benchmark models other than the mean-adjusted model so that results from both studies can be compare. Test for confounding effects is not conducted in this study due to constraints in study techniques.

In addition, since this study examine market reaction to an announcement no longer than 5 days before and after announcements, future studies might want to look at how the market reacts to such announcement in a longer term and examine if any possible trading strategies exist to earn abnormal profit opportunity from the announcements.

To analyze market reactions, measures other than abnormal return and cumulative abnormal return such as market volatility and trading volume can also be used in option. However, in order to test on these variables, other analysis techniques such as GARCH model or panel data is more appropriate.