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NAFTA, CAPITAL MARKETS AND STRUCTURAL BREAKS: *MEXICO AND MARKET INTEGRATION*

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Abstract

Mexico eased entry of international portfolio flows by enforcing strong economic reforms at the end of the 1980's and beginning of the 1990s. Liberalization and opening of its economy have been enhanced by NAFTA, which should reinforce long run patterns of integration among Mexico, Canada and U.S. capital markets. Empirical studies are scarce and the evidence about tighter links among NAFTA capital markets is mixed. In this paper we analyze their integration process from 1984:1 to 2002:12. Perron (1989) and Zivot and Andrews (1992) unit root tests allow us to identify structural breaks taking place at the Mexican stock exchange time series index. In order to capture the long run relationships, we test for cointegration in several periods following Johansen, Mosconi and Nielsen methodology (2000) to include structural breaks. The empirical evidence suggests that integration among NAFTA capital markets changes over time, sometimes even decreasing in intensity.

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FIRM SIZE AND THE PRE-HOLIDAY EFFECT IN NEW ZEALAND

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Abstract

Using a sample spanning four decades, we document that the pre-holiday effect, one of the most common of the calendar effect anomalies, still exists in the New Zealand market. Contrary to international evidence, the effect appears to have increased over time. Moreover, we find that this effect is inversely related to firm size with the entire effect limited only to small firms, with no pre-holiday price patterns being observed for medium to large firms. The existence of this pre-holiday effect seems to be mainly driven by factors relevant to New Zealand. A search for possible reasons for the persistence of the effect points primarily towards the illiquidity of smaller stocks and the reluctance of small investors to buy prior to major market closures.

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MACROECONOMIC AND INSTITUTIONAL DETERMINANTS OF STOCK MARKET DEVELOPMENT IN MENA REGION

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Abstract

The paper examines the institutional and macroeconomic determinants of stock market development in MENA (Middle East and North Africa) countries for the period of 1990 to 2007. The paper finds that macroeconomic factors such as income level, saving rate, stock market liquidity and interest rate are important determinant of stock market development. Our results also show that financial intermediary development and stock market development are complement instead of substitutes. Using both panel estimation technique and instrument variables technique, our findings show that institutional environment has no effect on stock market development. In fact the political risk index does not appear a significant determinant of stock market capitalization.

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THE MAGNITUDE EFFECT IN THE OVER- AND UNDER-CORRECTION IN INTERNATIONAL MARKETS

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Abstract

This paper examines the second part of the under reaction and overreaction hypothesis or the magnitude effects of the under reaction and overreaction phenomena in stock market. This hypothesis posits that the more extreme the initial price movement, the greater the subsequent adjustment will be. To do this, we develop three test statistics, including two ordered tests and a rank correlation test and apply the statistics to examine the under- and overreaction hypothesis in the global markets consisting of 25 national market indices. The results of all our tests show evidence consistent with the existence of the magnitude effects in the under- and overreaction. In addition, the results from the two ordered tests support the first part of the under reaction and overreaction hypothesis in De Bondt and Thaler (1985), Jegadeesh and Titman (1993) and others that there exists momentum profits in short periods and contrarian profits in long periods.

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THE PERFORMANCE OF THE CONTRARIAN STRATEGY AND THE MOMENTUM STRATEGY IN THE ASIA PACIFIC REGION

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Abstract

This research investigates the performance of contrarian strategies and momentum strategies implemented in nine sample markets in the Asia Pacific Region between Jan. 1990 and Aug. 2005. We find that the contrarian strategy has a better chance to gain profit than the momentum strategy and that, regardless the durations of the formation and holding periods, a contrarian strategy will produce higher profit.

When markets are separated into developing and developed markets, the empirical result for the developing markets resemble that of the whole markets. However, the momentum strategy has a better chance to gain profit in a developed market. Furthermore, under the momentum strategy, the longer the formation and holding periods, the higher the average cumulative abnormal returns are.

The January effect is not evident in the Asia Pacific region, but the Chinese New Year effect still exists in certain strategies of developed markets. In addition, over-reaction is the major driving force for choosing a contrarian strategy, while over-reaction, under-reaction and the random walk are all possible reasons for choosing a momentum strategy. Thus, investors must be careful in choosing a strategy to protect their profit margins.

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IMPLEMENTATION OF PRE-OPENING SESSION AND MARKET QUALITY: AN EMPIRICAL STUDY ON THE HONG KONG STOCK MARKET

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Abstract

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The Hong Kong Exchanges and Clearing introduced the pre-opening session (POS) on March 25, 2002. We find significant evidence that, subsequent to POS implementation, both quoted and effective spreads narrow and volatility drops for the group of Hang Seng Index constituent stocks. This phenomenon holds for **the** whole trading day and for the respective morning and afternoon trading sessions. Further analysis reveals a very strong endogeneity amongst spread, depth, and volatility. After accounting for this behavior, the reductions in spreads are no longer significant. However, both depth and volatility exhibit significant declines for the whole day and the morning session.

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PERFORMANCE AND PROFITABILITY OF INDIAN BANKS IN THE POST- REFORM PERIOD

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Abstract

This study attempts to examine the efficiency gain by Indian banks in the wake of the financial reform implemented through market and regulatory changes. The reform has indeed initiated the replacement of the government by the private sector as the source of resources for public sector banks, and the infusion of private equity capital has challenged the bureaucratic decision rules. The competitive pressure has also resulted in the switch from the traditional banking based on paper track to electronic banking structure. Here we have an analysis of these changes in one of the fast-developing country in Asia.

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MARKET EXPECTATIONS OF FOREIGN EXCHANGE RATE CHANGES

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Abstract

We use options on Telmex ADRs, and modify approaches developed by Shimko (1993) and Malz (1997) for extracting the implied risk-neutral density (RND) function from those options. to examine whether the U.S. capital markets anticipated the 1994 peso devaluation. We find that implied RND functions were more negatively skewed and leptokurtic than lognormal distributions over the pre-announcement and announcement periods, but resembled lognormal distributions during the post-announcement period. The results suggest that capital markets anticipated changes in the Mexican government's 1994 foreign exchange policy.

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POSITIVE OPTIMAL WEIGHTS ON THE EFFICIENT FRONTIER: CONDITIONS, CAUSES, AND IMPLICATIONS

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Abstract

We study the portfolio optimization conditions that result in all positive portfolio weights. These portfolios are important for theoretical (arbitrage, optimization theory), and practical reasons (no negative weights in stock market indices, legal restrictions on short selling, and so on). Previous analyses of portfolios with positive weights employed mathematical programming tools coupled with no-arbitrage relationships. Our analysis focuses on the optimization itself and uses linear algebra and simultaneous equations systems tools. Concepts of diagonal dominance are used throughout the study to determine the conditions for all-positive weights, as well as their causes, and to identify variable characteristics. Variance-covariance matrices are positive definite, which can be regarded as a weaker form of diagonal dominance. The simplest case of an optimal portfolio with positive weights is uncorrelated securities (strict diagonal dominance) each having positive returns. Normally, with non-zero security correlations, covariance effects do matter. The analysis of diagonal quasi-diagonal dominance leads us to two joint conditions that can generate all positive portfolio weights along the efficient frontier for risky portfolios with positive returns: 1) average returns for individual securities are all positive, and 2) there exists a set of optimal weights that make the variance-covariance diagonally dominant (that is the variance-covariance is quasi-diagonally dominant) when it is needed --negative marginal covariances. Exploration of the ultimate causes for all-positive portfolios leads us to analyze the role of the variance-covariance matrix in identifying relationships at the financial and productive levels of the firm. One implication is that individual (small) investors may want to concentrate on popular indices and their tangent portfolios, or to buy those securities with the highest individual performance ratios (r,/std,) within the indices. Another implication is that mean-variance tools alone may not be sufficient to uniquely identify market index portfolios, which has serious implications for normative pricing theories relying on such identification.

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MONETARY POLICY AND THE SIC INVESTMENT CCMPANIES

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Abstract

This paper examines the impact of the FED's monetary policy actions on returns of the SIC investment companies. The FED employs federal funds rate, discount rate, and their spread as monetary policy tools that depend upon the operating policy regimes that aim at either reserve targeting or federal funds rate targeting. This paper deviates from the traditional approach of establishing a policy-return relationship that has utilized only the *ex post* policy changes. Instead, the focus is on *unanticipated* changes in the federal funds rate that are chiefly responsible for driving the markets. The results indicate an inverse relationship between the returns of investment companies and monetary policy shifts, in which returns respond positively to the expansionary monetary policy actions. and negatively to the contractionary policy actions. Monetary policy actions, both anticipated and unanticipated, have asymmetric effects on returns across different monetary policy environments and different identification schemes of business conditions. In good business conditions, monetary policy significantly impacts returns of investment companies, whereas in bad business conditions they are less so. Investors interpret the surprise monetary expansion in high levels of economic activity as 'bad news', while in low levels of economic activity as 'good news'. Results are robust when announcement-day effects are estimated using daily data. Finally, evidence suggests that the asymmetric effect of monetary policy across different business conditions act through the channels of discount rate rather than expected cash flows.

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LIQUIDITY AND ASSET PRICING MODELS:
A HISTORICAL SKETCH

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LIQUIDITY AND ASSET PRICING MODELS:
A HISTORICAL SKETCH

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Abstract

The goal of this paper is to compile research on the role of liquidity in the asset valuation models. We approach the above issue in three stages. First, we present the debate on the measurement of liquidity under three broad categories, (1) trade based measures and (2) order based measures and (3) price impact measures and also combinations of trade based and order based measures. Second, we present the evidences for and against the illiquidity premium in the literature. In this context, we also present the two dimensions of research such as characteristic (asset specific) liquidity and market liquidity. In this category we also look at the recent developments to correct for an upward bias in the liquidity premium. We conclude with discussions on the implications of liquidity risk for the forever-critical issue in finance, market efficiency

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U.S. STOCK MARKET REACTION TO SEPTEMBER 11, 2001 EVENTS

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Abstract

Studying the impact of important global events on national stock markets has been a popular research topic in finance. Previous studies generally focus on the impact of the events on stock market volatility and the co-movements of national stock markets. The role of firm financial characteristics in explaining the impact of the events on individual stock returns has not received sufficient attention. In this paper, we investigate if the September 11, 2001 events affected individual U.S. stock returns differently based on firm financial characteristics. We find that the stocks of firms with higher betas, larger capitalization, higher debt ratios, higher cumulative returns during -30 to -5 days prior to the event date, and more return volatility during -252 to -5 days prior to the event date incur greater losses during the event period studied.

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MANAGERIAL OWNERSHIP, FIRM SIZE AND EARNINGS MANAGEMENT

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Abstract

This paper proposes a one-period model that is used to predict the association of management proportional ownership of the firm (n), firm size (s) and the intensity of earnings management (e). Managers' compensation is based on their firm's value and firm size. Optimal behavior induces managers to get involved in earnings management. Our model predicts that firm size is negatively correlated with the intensity of earnings management when managers fully control the firm (n > 50%) or when they only own a very small fraction of firm's shares. The effect of substantial managerial ownership on earnings management is more complicated. When the manager owns 50% or more of the firm's shares (i.e., manager completely controls the firm, $0.5 < n < 1$), ceteris paribus, the intensity of earnings management is positively correlated with managerial ownership in the area of only minor level of earnings management and negatively correlated in the area of high level of managed earnings. Managers who own some small fraction of firm shares tend to be less involved in earnings management than managers who own no shares of the firms. We conduct empirical tests using large sample of companies from Vietnamese Enterprise's survey (2003-2004). The results support our theoretical predictions.

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MOTIVATION FOR EQUITY CARVEOUTS

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Abstract

We examine the operating performance of 103 firms that engaged in an equity carveout over an eleven-year period. We find that carveout (parent) firms experience declines in operating performance following the carveout announcement. The post-carveout performance of firms that carveout a subsidiary in a different industry is worse than those that carveout a subsidiary in the same industry. Further, the operating performance of the carved-out subsidiaries deteriorates subsequent to the carveout. Finally, we document an increase in the carved-out subsidiaries' leverage and parent firms' dividends. Overall, our results imply that parent firms prefer to raise capital through equity carveouts when investors are likely to price the subsidiaries' shares higher than management's perceived value.

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IS THERE A FIRM-SIZE EFFECT IN CEO STOCK OPTION GRANTS?

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Abstract

Schaefer (1998) and Baker and Hall (2004) posit a firm size effect for regular executive compensation but not specifically for executive stock option grants. They propose an inverse relation between pay-performance sensitivity and firm size along with a positive relation between the marginal productivity of executive effort and firm size. The product of pay-performance sensitivity and executive productivity is `incentive strength'. They find a weakly positive association between incentive strength and firm size. We substitute Hall and Murphy's (2002) pay-performance sensitivity metric to detect a firm size effect in CEO stock option grants. After adjusting for small-firm risk aversion and private diversification 'clienteles', we document evidence of a residual small-firm effect impacting on incentive strength principally through grant size. Giten lower small-firm deltas, grant size appears to have been increased by compensation committees to ensure small-firm CEOs are not under-compensated relative to their large-firm counterparts. We also find that firm complexity influences pay-performance sensitivity as well, but not labor productivity (proxying for CEO productivity). No evidence is found that firm smallness and complexity impact on labor productivity. However, we empirically confirm a negative relation between pay-performance sensitivity and firm smallness and, by implication, firm complexity.

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INFORMATION SHARING IN REGULAR AND E-MINI FUTURES: AN ANALYSIS OF RUSSELL 2000 SMALL CAP INDEX FUTURES

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Abstract

In recent years, E-mini futures markets have been growing at a rapid pace around the world. These products do not see a fast growth in trading volumes, but still affect the dynamics of the regular futures market. This paper explores the intra-day dynamics of the information transmission processes between Russell 2000 futures (open outcry) and E-mini Russell 2000 (electronically traded and small-sized) through Hasbrouck's (1995) information sharing model. We find that E-mini Russell 2000 possesses the ability to guide price discovery in Russell 2000 futures markets. Thus, E-trading systems have superior information and operational efficiency and help us understand the characteristics of open outcry trading and E-trading, serving as a reference for investing in Russell index futures. Summarily, we provide useful evidence concerning trading mechanisms (open outcry / floor trading vs. E-trading) and contract design (regular futures vs. mini futures). To investors, this information provides a useful reference for investing in Russell 2000 index futures. Concerning global exchanges, this paper's examples can help financial management authorities make adjustments in their own trading mechanism and contract specification design, which will certainly be advantageous in attaining the goal of robust market development.