

OVERREACTION BEHAVIOUR OF SYARIAH COMPLIANT STOCKS IN MALAYSIA



**RESEARCH MANAGEMENT INSTITUTE (RMI)
UNIVERSITI TEKNOLOGI MARA
40450 SHAH ALAM, SELANGOR
MALAYSIA**

BY

**NORLI ALI
NORLI ABD TALIB
ANNUAR MD. NASSIR
SAZALI ZAINAL ABIDIN**

OCTOBER 2012

Contents

| | |
|--|-----|
| 1. Letter of Report Submission..... | iii |
| 2. Letter of Offer (Research Grant) | iv |
| 3. Acknowledgements..... | v |
| 4. Enhanced Research Title and Objectives..... | vi |
| 5. Report..... | 1 |
| 5.1 Proposed Executive Summary | 1 |
| 5.2 Enhanced Executive Summary | 2 |
| 5.3 Introduction..... | 3 |
| 5.4 Brief Literature Review..... | 6 |
| 5.5 Methodology | 9 |
| 5.6 Results and Discussion..... | 14 |
| 5.7 Conclusion and Recommendation | 21 |
| 5.8 References/Bibliography | 24 |
| 6. Research Outcomes | 27 |
| 7. Appendix..... | 29 |

Surat kami : 100-RMI/GOV 16/6/2 (72/2010)
Tarikh : 30 Mac 2012



Dr Norli Ali
Fakulti Perakaunan
Universiti Teknologi MARA
40450 Shah Alam

Puan

PERUBAHAN KELULUSAN PROJEK DI BAWAH GERAN PENYELIDIKAN ARI HICoE

Tajuk Projek : Overreaction Behaviour Of Price Bubbles Of Syariah Compliant Stocks
Kategori Projek : Kategori A
Jumlah Peruntukan Asal : RM 12,800.00
Jumlah Peruntukan Baru : RM 45,000.00
Tempoh : 24 bulan (1 Novemberi 2010 – 31 Oktober 2012)
Ketua Projek : Dr Norli Ali

Dengan hormatnya perkara di atas adalah dirujuk.

2. Perbincangan dengan pihak Institut Penyelidikan Perakaunan (ARI) telah memutuskan untuk menyusun semula kewangan projek penyelidikan di bawah dan pengurusan ARI/RMI.

3. Sukacita dimaklumkan bahawa projek penyelidikan puan di bawah dana pengurusan ARI/RMI telah diubah kepada RM 45,000.00. Sehubungan itu, surat ini mengatasi surat kelulusan bertarikh 9 Februari 2011 yang dikeluarkan oleh Institut Pengurusan Penyelidikan (RMI) berkenaan projek penyelidikan.

4. Untuk tujuan mengemaskini, puan adalah diminta untuk menyusun perancangan semula bajet yang baru dan surat setuju terima bajet yang diluluskan sekiranya perlu.

Sekian, harap maklum

“SELAMAT MENJALANKAN PENYELIDIKAN DENGAN JAYANYA”

Yang Benar

PROFESOR DR ABU BAKAR ABDUL MAJEED
Penolong Naib Canselor (Penyelidikan)

Penolong Naib Canselor (Penyelidikan) : 603-5544 2094/2095
Bahagian Penyelidikan : 603-5544 2097/2091/2098/2101/5521 1462/1463
Bahagian Perundangan : 603-5544 2100/2787/2092/2093
Bahagian Inovasi : 603-5544 2750/2747/2748

Bahagian Penerbitan : 603-5544 1425/2785
Bahagian Sokongan ICT : 603-5544 3097/2104/5521 1461
Bahagian Sains : 603-5544 2098/5521 1463
Pejabat Am : 603-5544 2057/5521 1636/5543 7907

Penolong Pendaftar : 603-5544 2090
Fax : 603-5544 2096/2767
Unit Kewangan Zon 17 : 603-5544 3404/2099
Unit Kewangan Zon 18 : 603-5521 1386/3404



5. Report

5.1 Proposed Executive Summary

Studies on overreaction hypothesis on conventional stocks have been vastly documented in previous research (De Bondt and Thaler 1985, 1987; Spyrou et. al 2005; Saleh 2007 and Morad and Salehi 2011, among others). Recently, Morad and Salehi (2011), found that there has been investor's overreaction and it is possible to earn abnormal return by applying the contrarian strategy (inverse investment strategy) in the Tehran stock exchange. In Malaysia, many published works found evidences of overreaction in stock returns such as studied by Hameed and Ting(2000), Ahmad and Hussain (2001) and Lai et al (2003) Norli et al (2009), Norli et. al (2010, 2011).

Although ample evidences have been presented by previous studies mention above, however, there still lack of research in this area on syariah-compliant stocks. It is known that the characteristics of syariah stocks are different from their conventional counterpart in the sense that for firms to be classified as syariah compliant, they need to meet certain regulations or to posses certain features. Questions may arise whether syariah stocks behave like conventional stocks? Do syariah compliant stocks are also the subjects of stock overreaction behavior? Do these stocks able to generate abnormal returns? This study aims to investigate the behavior of syariah compliant stocks with respect to stock overreaction hypothesis.

The purpose of this paper is to study stock overreaction behavior in syariah compliant stocks in Bursa Malaysia. This paper is divided into four sections. Next section reviews the background of syariah compliant stocks in Bursa Malaysia. Section three outlines the methodology used in the paper and section four discusses the findings of the study.

5.3 Introduction

Studies on overreaction hypothesis on conventional stocks have been vastly documented in previous research (De Bondt and Thaler 1985, 1987; Spyrou et. al 2005; Saleh 2007 and Morad and Salehi 2011, among others). Recently, Morad and Salehi (2011) found that there has been investor's overreaction and it is possible to earn abnormal return by applying the contrarian strategy (inverse investment strategy) in the Tehran stock exchange. In Malaysia, many published works found evidences of overreaction in stock returns such as studied by Hameed and Ting(2000), Ahmad and Hussain (2001) and Lai et al (2003) Norli et al (2009). Although ample evidences have been presented by previous studies mention above, however, there still lack of research in this area on syariah-compliant stocks. It is known that the characteristics of syariah stocks are different from their conventional counterpart in the sense that for firms to be classified as syariah compliant, they need to meet certain regulations or to posses certain features. Questions may arise whether syariah stocks behave like conventional stocks? Do syariah compliant stocks are also the subjects of stock overreaction behavior? Do these stocks able to generate abnormal returns? This study aims to investigate the behavior of syariah compliant stocks with respect to stock overreaction hypothesis.

Stock overreaction hypothesis suggests that stocks that are past losers tend to outperform those of past winners. Therefore, the hypothesis point towards a potential profitable strategy known as Contrarian Strategy. This strategy asserts that investors are able to earn abnormal profit by buying past losing stocks and simultaneously selling past winning stocks. This is because, according to stock overreaction hypothesis, stocks that performed poorly in initial period have a tendency to perform better in the successive period and vice versa. This usually due from investors actions who incline to overreact to new information but will correct their behavior once they realize of the misbehavior. For example, investors have a tendency to overly undervalued stocks that showed a series of negative earnings resulting in large drop in the stocks prices. The ensuing undervaluation makes market realize of the overreaction behavior and will correct themselves. Thus those losing stocks will tend to become winner in the following period.

The purpose of this paper is to study stock overreaction behavior in syariah compliant stocks in Bursa Malaysia. This paper is divided into four sections. Next section