INTER-RELATEDNESS OF PERFORMANCE BETWEEN KLSE COMPOSITE INDEX AND MAJOR INDICES

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ABSTRACT

The objective of this study is to identify whether there is a significant relationship between KLSE CI and five other indices which are Hang Seng Index (Hong Kong), Australia All Ordinaries Index (Australia), Dow Jones Industrial Average Index (USA), Financial Times-100 Index (UK) and Nikkei-225 (Japan). The study covers the period of 1st January 1990 to 31st May 2002, with special focus on the period before the economic crisis (1st January 1990- 30th June 1997), during the crisis (1st July 1997- 31st January 1998) and after economic crisis (1st February 1998- 31st May 2002). The tests were conducted using the correlation and regression analyses. It was found that there is a relationship between KLSE CI and other indices. Before the economic crisis, the foreign indices have a slight impact on the CI, however, during the economic crisis, only Hang Seng and All Ordinaries indices showed a relationship on Composite Index whilst after the economic crisis apart from those two, Nikkei Index showed a relationship as well. On the whole, it was found that the index that has the most impact is Hang Seng Index. The result also shows that there is no significant difference between the average daily changes in indices of Malaysian market and other foreign markets.

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CHAPTER ONE

INTRODUCTION

1.1 INTRODUCTION

Investment in emerging equity markets and notably in Southeast Asia has risen rapidly over the past decade. The uncertainty surrounding the crisis dramatically increased the transmission of disturbances from one market to another and this transition was clearly global. Links between Asian and non-Asian markets accounted for much of the feedback. Thus, there is an essential feature to know if different stock price follow a common trend and if there is a long run relationship between them.

The issue of common trends and interdependence of financial markets has come under increased scrutiny in recent years. The recent technological advances which effectively eliminate problems of trading due to geographical factors and increase in capital flows across national boundaries such as exchange controls have been abolished. The fact that stock markets move upwards most of the time, attention has focused on to upward trends in stock markets are common across markets. This is to make sure, whether national stock market indices are co integrated. The implication of co integration in this context in highlighted by Taylor and Tonks (1989) and Kasa (1992).

Studies by Izan, Jalleh and Ong (1991) and Roll (1992) have suggested that exchange rate is important in explaining the differences in return volatility and return correlations between countries. The analysis in the paper also includes the potential impact of changes in the exchange rate on the indices being studied.

It is not clear whether financial markets, in general are integrated or not. Previous studies have produced mixed results depending on the methodology, data, time period