

THE IMPACT OF POLLS ON THE
STOCK MARKET:
EMPIRICAL EVIDENCE FROM THE
BURSA MALAYSIA.

by

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ABSTRACT

Historically stocks tend to rally just before an election is announced. However prior research also suggests that there is no single discernable trend that allows one to predict with certainty the behaviour of the stock market during the election fervour. This paper looked at the impact of polls on the politically linked stocks on the main board of Bursa Malaysia in particular to identify whether the market trends following the most recent general election was similar to the trend following previous general elections in Malaysia.

This study was conducted by observing the movements of the market returns within a time frame of thirty-four days, namely ten days pre-event and twenty-four days post-event period beginning 4th March 2004 (election announcement).

The study found that the impact of the polls on the politically linked stock prices between the election announcement and polling day as well as the expected rally in the so called politically linked stocks was consistent with earlier patterns. The only exception to this pattern was our finding in relation to the trend of the cumulative average abnormal returns after the end of the polling day which was not consistent with earlier trends.

CHAPTER ONE

INTRODUCTION

1.0 Introduction

Since its independence in 1957, Malaysia has followed its British colonizer to adopt the constitutional monarchy, in which the Prime minister, not the King, had the real power. Only five changes of premiership have occurred, and the last one, Tun Dr. Mahathir Mohamad stayed in office since 1981. This stability of the government plus the British legacy of a professional bureaucracy allowed the Malaysian state to maintain relative political autonomy and administrative efficiency. Furthermore, the ruling coalition has been able to command a two-thirds majority in the parliament, except for a short period in 1969. (Chengtian Kuo, 2000)

Malaysia practices a form of guided democracy. The political scenario in Malaysia is very much a “*winner take all*” type of situation, which tends to foster a climate of politics of patronage. Hence, it is very important for corporate players on the local Bursa Malaysia (formerly known as Kuala Lumpur Stock Exchange) to identify with the right political masters. Investors with strong political connections could use privatization projects to make large gains in the securities market.

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

This chapter focuses on the literature review. Section 2.1 discusses the theoretical background of the effect of election announcements on stock returns. Section 2.2 discusses the prior studies that have been documented in the finance literature with regards to event studies. Lastly, Section 2.3 concludes the discussion on prior literature with the event of interest in this study.

2.1 Theoretical Background on the Effect of Election Announcements on Stock Returns

The event study has many applications. In accounting and finance, event studies have been applied to a variety of firm specific and economy wide events. Several theories concerning the impact of polls on the stock market have been documented in the finance literature due to the share price maximization goal being the central focus in the discipline of finance.

MacKinlay (1997), notes that the history of event studies had started long ago since 1933 as a result of the published study by James Dolley. However, previous studies conducted by How et al. (1992), Salamudin et al. (1999), Abdullah et al. (2000), Seiler (2000), Schadewitz et al. (2000) and Tan et al. (2000) had referred to the significant contribution by Ball and Brown (1968) and Fama et al. (1969) which