Faculty of Economics and Business

THE IMPACT OF GENERAL ELECTION ON THE RETURNS OF THE FBMKLCI

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Final Year Project Report	✔
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KESAN PILIHAN RAYA UMUM TERADAP PULANGAN

FBMKLCI

RACQUEL ANAK ROWLAND

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(Kewangan)

Fakulti Ekonomi dan Perniagaan

UNIVERSITY MALAYSIA SARAWAK

2014

THE IMPACT OF GENERAL ELECTION ON

THE RETURNS OF THE FBMKLCI

RACQUEL ANAK ROWLAND

This project if submitted in partial fulfillment of

the requirement for the Degree of Bachelor of Finance with Honours

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Abstract

The impact of general election on the returns of the FBMKLCI

By

Racquel anak Rowland

The paper's main objective is to examine the influence of the Malaysia general election on the returns of the FBMKLCI. This study used daily data from the FBMKLCI in order to seek empirically examine the effect of general election in Malaysia over the sample period of 1995-2013. This study examines the relationship between Malaysia general elections and FBMKLCI by using Ordinary Least Square (OLS) method and Wald test of restrictions. It focuses on pre and post election periods. Daily closing prices of FBMKLCI are used for the period of 248 days or one year period for each election year. The model is regressed for different timeframes. The results show that the 2008 election is negatively affect the stock market for 15 days after the election whereas the FBMKLCI experiences higher returns and positively significant for 30, 45, and 60 days post election in the 1999 election. However, the 2004 election is the only year that is statistically different in returns for the period of 30, 45, 60, 90, and 120 days before and after the election.

Abstrak

Kesan pilihan raya umum terhadap pulangan FBMKLCI

Oleh

Racquel anak Rowland

Kertas kerja ini bertujuan untuk mengkaji pengaruh pilihan raya umum Malaysia pada pulangan FBMKLCI. Kajian ini menggunakan data harian daripada FBMKLCI bagi mengkaji kesan pilihan raya umum di Malaysia sepanjang tempoh 1995-2013. Kajian ini mengkaji hubungan antara pilihan raya umum Malaysia dan FBMKLCI dengan menggunakan "*Ordinary Least Square*" (OLS) kaedah dan ujian "*Wald test of restrictions*". Kertas kerja ini juga memberi tumpuan kepada sebelum dan selepas tempoh pilihan raya. Harga penutup harian FBMKLCI digunakan dan merangkumi tempoh selama 248 hari atau tempoh satu tahun bagi setiap pilihan raya yang dijalankan pada tahun tertentu. Model tersebut diregresskan untuk jangkamasa yang berbeza. Keputusan menunjukkan bahawa pilihan raya pada tahun 2008 adalah memberi kesan negatif kepada pasaran saham selama 15 hari selepas pilihan raya manakala FBMKLCI mengalami pulangan yang lebih tinggi dan kesan positif yang ketara selama 30 , 45, dan 60 hari selepas pilihan raya pada tahun 1999. Walau bagaimanapun , pilihan raya pada tahun 2004 adalah satu-satunya tahun yang berbeza dengan statistik dalam pulangan untuk tempoh 30 , 45, 60 , 90, dan 120 hari sebelum dan selepas pilihan raya dijalankan.

Pengesahan Pelajar

Saya mengakui bahawa Projek Tahun Akhir bertajuk

“**Kesan Pilihan Raya Umum terhadap pulangan FBMKLCI**”

ini adalah hasil kerja saya sendiri kecuali

nukilan, petikan, huraian dan ringkasan yang

tiap-tiap satunya telah saya nyatakan sumbernya.

_____   _____

(Tarikh Serahan)   (Tandatangan Pelajar)

 Racquel anak Rowland

 32641

Statement of Originality

The work described in this Final Year Project, entitled,

"**The Impact of general election on the returns of the FBMKLCI**"

is to the best of the author's knowledge that of the author

except where due reference is made.

_____   _____
(Date Submitted)   (Student's Signature)
                                     Racquel anak Rowland
                                     32641

Acknowledgement

First of all, I am grateful to God for establishing me to complete my Final Year Project as it a part of requirement to achieve a degree of Bachelor of Finance with Honours.

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TABLE OF CONTENTS

CHAPTER 3: RESEARCH METHODOLOGY

CHAPTER 4: EMPIRICAL RESULT AND DISCUSSION

CHAPTER 5: CONCLUSION AND RECOMMENDATIONS

LIST OF TABLES

TABLES OF FIGURES

CHAPTER ONE

INTRODUCTION

1.0   Introduction

This study examines the impact of general election on the returns of FBM KLCI in Malaysia. Ever since Malaysian stock price closed at higher price with 1826.22 points during the 13th general election on May 6, 2013, a lot of local and foreign investors seem to be shocked with the higher return of the stock price. This phenomenon is what we called as market anomaly.

Many research studies have conducted to analyze the effect of general election on stock market behavior around the world. Most of the studies carried out in United States, United Kingdom, Australia and New Zealand. The analysis of stock market movements in days and weeks surrounding US presidential elections was the first research conducted by Niederhoffer, Gibbs and Bullock (1970). Since then, the study of the relationship between politics and the stock market has generated much research of interest. Therefore, a huge number of studies have analyzed several topics such as political cycles in the Australian stock market since Federation, economic policy and the presidential election cycle in stock returns, effects of New Zealand general election on stock market returns and the links between the delay of presidential election on stock returns.

Now, back to the world of theory, we know that the theory of market efficiency is one of the most fundamental theories in financial economics. The concept of market efficiency has been introduced by Louis Bachelier in 1900. Based on the market efficiency theory, all available information will be imbodied in the stock price that the investors cannot earn abnormal returns. Even though market efficiency concept has been commonly known in the real world of stock, there are still several studies have detected the existence of market anomalies found in the market efficiency. In the contrary, investors still can earn abnormal return even though the situation is under market efficiency.

There are several market anomalies that always happen in the real life: calendar effect, P/E ratio effect and size of capitalization effect. The calendar effect such as January effect has higher return in the month of January than in any other month. According to Banz (1981), average annual returns are consistently higher for small cap firm than large cap firm due to the size of capitalization effect. As for the P/E ratio effect, portfolios of low P/E ratio stocks will have higher return than portfolio of high P/E ratio in the statement of Basu (1977).

Besides anomalies that related to time frame and firm's characteristics, it also appeared to be a part of determining the pattern of stock market over the general elections. This evidence has been proved through a number of previous studies by many researchers. For example, in the statement of Allvine and O'Neill (1980) presented strong evidence in support of the relation between stock market returns and the presidential election cycle. They found that stock market had a rising trend

over the two years prior to the Unites State's presidential elections. Also, another finding is taken from a case study in New Zealand. The research proposed that right-centre government or known as National party tends to increase the stock returns than left-centre government (Labor party) during the election period according to Abidin, Old and Martin (2010). Apart from that, economy policy has something to do stock returns as well. Since economy policy has divided into two policies which are fiscal policy and monetary policy. Based on Sturm (2011), fiscal policy is more directly controlled by the president's administration because it carried out through the government's tax laws and its spending policy, thereby forming the government's budget. Thus, this will certainly affect the presidential election and automatically will raise the stock market returns.

The remaining of the section is organized as followings. The sections include Section 1.1 is about the background of study, Section 1.2 explains the motivation of study. Meanwhile, problem statement, objectives of study, and significance of study are contained in Section 1.3 to 1.5 respectively. Section 1.6 is regarding the organization of the study.

1.1   Background of the study

The aim of this study is to examine the effect of general election on returns of FBMKLCI in Malaysia. Before starting the academic analysis, it is essentials to introduce the political background and stock market development of this country.

1.1.1 The Electoral System

Malaysia is a federal state which consists of thirteen states and one federal territory with three components, city of Kuala Lumpur, Labuan and Putrajaya. First and foremost, Malaysia is a constitutional monarchy type of political system. According to Lim (1997), the King or known as "Yang di-Pertuan Agong" is the head of state that has the responsibility to act in accordance with government advice. He also presides over a chamber of nine Malay Sultans and four governors, the "Conference of Rules", which has this discretionary power on matter pertaining to Malay culture and traditional. The tenure is five years and its position is ceremonial. Meanwhile, the head of government is a person that has given obligation to govern the country as well as taking care of the citizen is known as Prime Minister. Malaysia has bicameral parliament that consists of Senate (Dewan Negara, DN) and House of Representatives (Dewan Rakyat, DR). Senate (DN) consists of 69 members which are 29 senators of the DN are appointed by the State Assemblies while the King appoints the remaining 40 senators. The federal parliament presently holds 222 members, which are elected from territorially delimited single-member constituencies with plurality voting.

Federal elections are held at intervals no longer than five years. This means that Malaysia has a total of twelve elections held for the period of 1959-2008. In the world of political, Malaysia has multi-party system. But before that, Malaysia compromises two types of coalitions and they are Ruling coalition and Opposition coalition. The ruling coalition or known as Barisan National (BN) that composed by fourteen parties which included the 3 main parties which are UMNO (United Malay

National Organization), MCA (Malaysian Chinese Association) and MIC (Malaysian Indian Congress). As for the Opposition coalition, technically, they are called People's Alliance (Pakatan Rakyat, PR) that is formed by three parties that consist of the Party Islam se-Malaysia (PAS), the Democratic Action Party (DAP) and the Party Keadilan Rakyat (PKR). There is also one independent party called Sabah Progressive Party (Parti Progresif Sabah, SAPP).

In the House of Representatives, ever since the independence 1957, the Malay-led party UMNO, has been part of ruling coalition which has been in power for more than thirty years. This can be seen that the ruling coalition (BN) has taken dominant position in the world of political for so long.

Table 1 shows the number of seats won in National Parliament between the Ruling coalition and the Opposition from 1959-2008. Based on the table below, it proves that ruling coalition has been in power over a long period of time. In the year of 2004, it was truly a victory for the ruling coalition side. We can see that BN won 198 seats to the opposition with only 20 seats. Unfortunately, during the 12th general election of Malaysia, the ruling coalition has marked the worst electoral outcomes. In 2008, the opposition was able to substantially close the huge difference in parliamentary seats between the ruling coalition and opposition. The ruling party closed its score at 140 seats as against 198 seats obtained in the 2004 elections.

Table 1.1: Number of Seats won in the National Parliament between the Ruling coalition and the Opposition from 1959-2013.

| Year	Ruling coalition (seats)	Opposition (seats)	Total
*1959	74	30	104
*1964	89	15	104
1969	95	49	144
1974	135	19	154
1978	130	24	154
1982	132	22	154
1986	148	29	177
1990	127	53	180
1995	162	30	192
1999	148	45	193
2004	198	20	219
2008	140	82	222
2013	133	89	222

Source: Election Commission of Malaysia (2013)
*With the exception of Sabah and Sarawak

1.1.2 Malaysia Stock Exchange

Kuala Lumpur Composite Index (KLCI) is a capitalization-weighted stock market index. The KLCI was introduced on April 4, 1986 and it is currently known as the FTSE Bursa Malaysia Kuala Lumpur Composite Index (FBM KLCI). Back in 1986, KLCI has 100 listed companies on the Main board. But since Bursa Malaysia regularly making improvements to KLCI, they reduce the 100 listed companies to 30 companies. The FBM KLCI comprises the largest 30 companies listed on the Malaysian Main Market by full market capitalisation that meet the eligibility requirements of the FTSE Bursa Malaysia Index Ground Rules. There two main eligibility requirement are free float and liquidity.

Table 1.2 shows a list of 30 companies with high capitalization volume as at 6 March, 2012. According to the table, Malayan Banking Berhad has a market capitalization of RM 66.99 billion followed by Sime Darby Berhad with RM 66.09 billion of market capitalization and CIMB Group Holdings Bhd came in the third place with market capitalization of RM 55.59 billion in FBM KLCI. In other words, their market capitalizations are the leading companies for year 2012. We can conclude that the banking sector earn the two top spots in FBM KLCI with large volume of market capitalization.

Figure 1.1: List of 30 companies with the highest market capitalization volume

Market Capitalization - Total
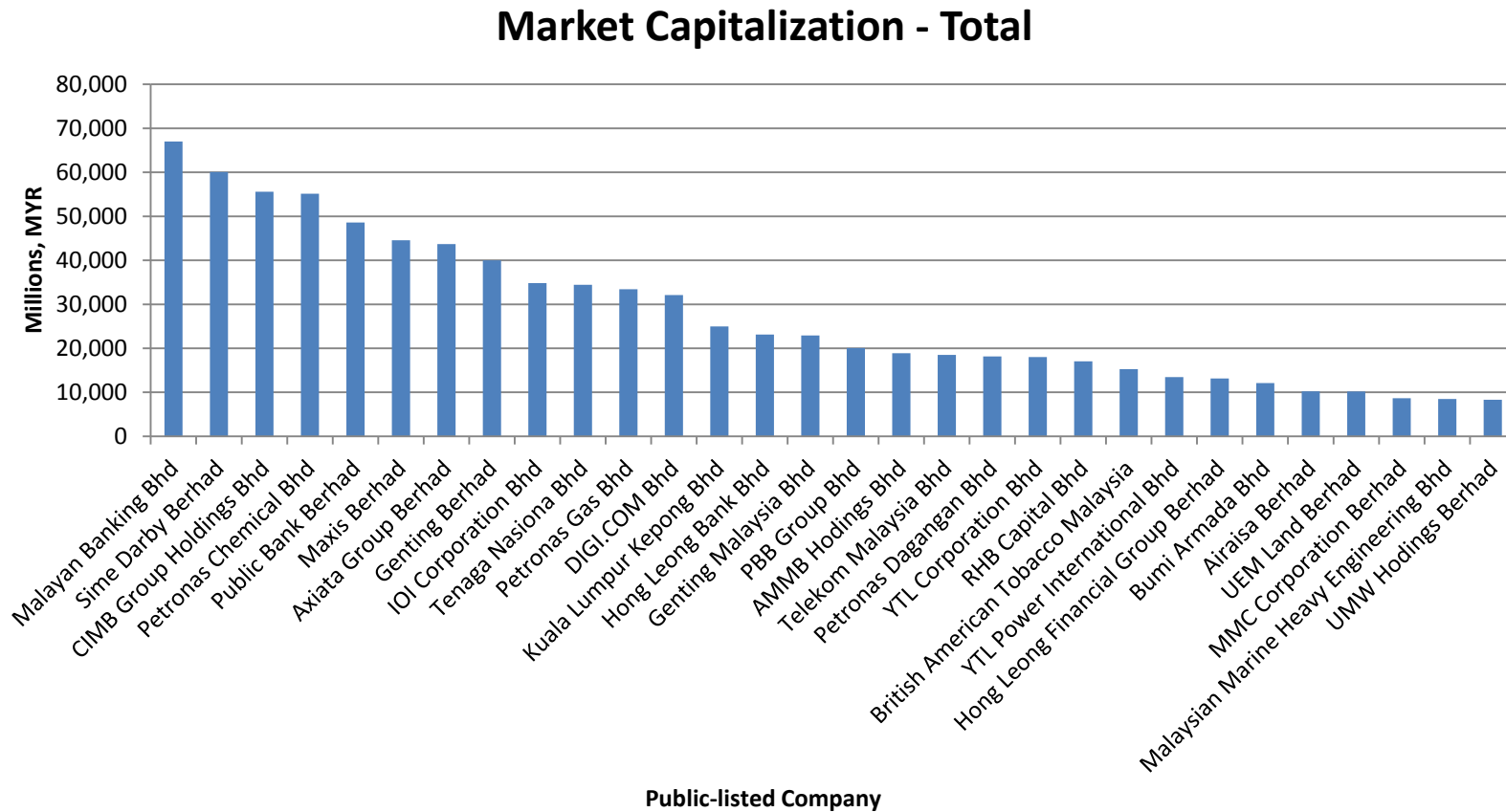
Source: Bursa Malaysia (March, 2012)

The FTSE Bursa Malaysia Kuala Lumpur Composite Index (FBM KLCI) is now the most widely used index. Therefore, FBM KLCI plays an important role both a general indicator of price fluctuations in the stock market and as a sign of economic conditions. In table 3 shows the monthly performance of FBM KLCI during the sample period of 1993 to 2012. From table below, we can compute that FBM KLCI has earned 977.06 points, 754.94 points, 918.95 points, 1242.64 points and 1826.22 points after election date on 25th April 1995, 29th November 1999, 21st March 2004, 8th March 2008 and 6th May, 2013 respectively.

Figure 1.2: FBM KLCI monthly performance from Jan 1994 to Dec 2013.
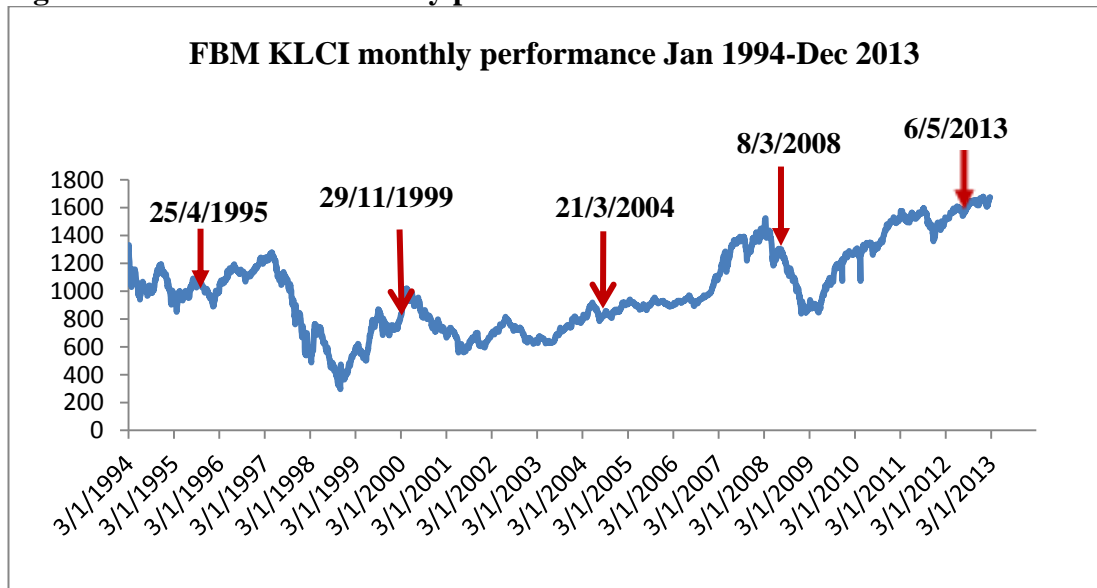
Note: (———▶) shows the election date.
Source: Yahoo Finance (2013)

1.2   Motivation of the study

There are two reasons that motivate me to study the impact of general election on the returns of FBM KLCI. The first reasons that trigger me the most that to the best of my knowledge, there is no research has been done which related to the effect of elections on stock market behavior in Malaysia. Unlike previous studies, most of the findings are obtained from United States, United Kingdom, Australia and New Zealand. There is also case study related to such topic that involved Asian countries but never include Malaysia.

Secondly, the KLCI hits the historical highest peak after the 13th election which held on 5th May 2013. This makes many people think that there is a relationship between general elections and stock market return. This is because investors believe that stock pattern in the past is able to reflect stock price in the future. Through this finding, we are able to observe whether such believe is true for the past election periods. So, it is important to analyze the stock pattern in the past in order to predict stock price especially during the election period.

1.3   Problem Statement

Although a number of studies have been conducted to investigate the effect of elections and stock return in United States, United Kingdom, Australia and New Zealand, such research has never done in Malaysia before. This means that even though a large number of election samples to test the market behavior around the election dates, the general election held by Malaysia are not among the sample pool.