BEHAVIOR OF MALAYSIAN INVESTORS TOWARDS STOCK MARKET AND INVESTMENT ACTIVITIES

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Statement of Originality

The work described in this Final Year Project, entitled "Behavior of Malaysian Investors towards Stock Market and Investment Activities" is to the best of the author's knowledge that of the author except where due reference is made.

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ABSTRACT

BEHAVIOR OF MALAYSIAN INVESTORS TOWARDS STOCK MARKET AND INVESTMENT ACTIVITIES

By

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This study aims to examine the Malaysian investors' behavior towards stock market and their trading behavior. In particular, we examine the factors that may influence the behavior of investors and how they behave in their investment decision making. The whole analysis is carried out through a system of simultaneous equation - Two Stages Least Square (2SLS) method. The results show that Malaysian investors are mostly driven by herding behavior. Their trading behavior also influenced by the risks. Besides that, emotional and speculative behavior among Malaysian investors also can be explained in this study.
ABSTRAK

TINGKAH LAKU PELABUR-PELABUR MALAYSIA TERHADAP
PASARAN SAHAM DAN AKTIVITI PELABURAN

Oleh

Ung Wei Wei

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CHAPTER ONE
INTRODUCTION

1.0 Introduction

As an investor, one's investment decision making generally influenced by different types of behavior and psychological (Ricciardi & Simon, 2000). In order to achieve their financial goal in investment activities, investors may need to have a good investment planning. A good investment planning involves good decision making among investors. They have to choose the right investment and manage the resources for different types of investments to gain profit, and at the same time, investment risks can be avoided. Malaysian capital market, which is also known as Bursa Malaysia has, provides a variety of investment products such as stocks, bonds, warrants, mutual funds, etc.

According to Muhammad and Abdullah (2009), every individual develops own tactic when they choose the investment products, even some may invest without taking any consideration into account. Mostly, investor's choices depend on his or her financial goals, resources availability and time frame. Nevertheless, some investors, particularly individual investors often make an irrational decision making when they are choosing right stocks to invest.

Based on research done by Chandra (2008), individual investors are influenced by psychological and emotional biases, thus, causing them to make an irrational decision in their investment activities. Hence, psychological and emotional biases
play a significant role in behavioral finance. To make a good decision in stock investment, investors or traders must consider some factors that might affect their decision making process. Investors often rely on two factors, which are personal resources or factors and technical factors when they are making decisions on stocks to invest in.

However, an investor is advised to consider deeply on other factors such as situational and environment factors when they come to decision making in investment, and not only depend upon the personal factors and technical factors. To reach their investment goal, one may need to have a precise decision making while considering other factors in stock market where the risk is not too high. In order to be successful in investment activities, it is important for them to have a positive thinking, good prediction, persistent determination and good intention when decisions are to be made (Chandra, 2008).

From the view of financial theory, investors are behave rationally when they are making investment decision, and also when the information that is available in the market are fully used by them (Ritter, 2003). This means investors are able to make decision whether to buy or sell the stocks when they have enough information to generate some profit from the investment. According to Maditinos, Sevic and Theriou (2007), investors try to reduce their investment risk in order to obtain high return from their investment activities.
However, this is just a view from financial theory. In reality, most of the investors do not really follow the financial rules when making decision. Their willingness to take the risk is different because every individual has their own behavior and perceptions in investment allocation (Maditinos, Sevic & Theriou, 2007). Meanwhile, Toh and Zamri Ahmad (2010) claimed that investor’s decision making does not depending on the true value of stocks, but it is based on investor’s subjective feelings towards stock market investment.

Basically, this paper has some connection to the behavioral finance theory. Research in behavioral finance nowadays is widening in the world of economy. This field started to appear in some other publications since 1990s where its purpose is to investigate the pattern of investors (individual, group, and organization) in their decision making process (Ricciardi & Simon, 2000). The scope of behavioral finance is broad, where it attempts to explain the reason of what, why and how of investors invest in some projects. It also investigates the psychological and sociological factors that influence the financial decision making process of investors (Ricciardi & Simon, 2000).

Based on the research done by Olsen (1998) which is related to the behavioral finance and implications of stock market volatility, investors are risk averse which they try to avoid any kind of risk compared to dealing with it. According to Olsen (1998), investors will rather take only small amount of return against high risk with unknown profit from their investment activities. In addition, people’s attitude when they are entering into investment decisions changes over time due to the past
experiences in investment decisions, plus the investment environment in Malaysia is also changing frequently and the number of investors are growing substantially (Muhammad & Abdullah, 2009).

Investors' behavior also has an interrelationship with the prospect theory. Prospect theory is an important part in behavioral finance where it links to the investors’ perception and valuation of gains and losses (Frank & Lars, 2010). According to Kahneman and Tversky (1979), prospect theory explains how human behave when dealing with the risk and uncertainty. Based on judgement of Kahneman and Tversky (1979), investors will rather invest more in the outcomes that are more certain and higher probability of winning which this situation also called as certainty effect.

1.1 Economic Performance in Malaysia

Recall back the objective in this paper is to determine the investors’ behavior towards stock investments in Malaysia. According to Lucarelli and Palomba (2007), the growth of economy has positive relationship with financial (stock index performance). As the economy of Malaysia is growing, more company are being listed which has contribution to such growth would increase their market value (Lucarelli & Palomba, 2007). For the first quarter in year 2011, Malaysia had recorded with 4.6 percent of Gross Domestic Production (GDP) growth. Two main activities which brought to the economic growth in Malaysia were services and manufacturing sectors with 5.9 percent and 5.4 percent, respectively. With the good
condition economy, it will generate and attract more investors either local or foreign to invest in Malaysia economy.

1.1.1 Types of Investors

It is important to study the types of investor in stock market because every investor has their own characteristics. Thus, every investor has different perceptions in making different decision in stock investment. They have their own perception of investment purposes, level of risk, limited capital and other barriers. For example, institutional investors such as banks, brokerages, finance companies, mutual funds and unit trusts have to estimate the output mean-variance optimization as well. While for the individual investors, they are mostly driven by psychology biases when they enter into investment decision making process (Chandra, 2008).

1.1.2 Definition of Stock Market

A stock market is also known as equity market where companies can trade their stock and derivatives at a certain price. Stock and derivatives are also considered as securities that are listed in the stock exchange market and also privately traded. According to Preda and Alex (2009), the estimation of world stock market size in year 2008 was around $36.6 trillion. The estimation for the total world derivatives market was around $791 trillion nominal value where it is 11 times the size of the entire world economy (Hamilton, 1922).
Stock market plays a significant role in raising money for the companies because their businesses are publicly traded by selling equity to the public. The liquidity of an exchange where investors can easily sell their securities is a captivating reason for companies to invest their stocks.

1.1.3 Performance of Stock Market in Malaysia

In 2010, Bursa Malaysia was performing better where the FBMKLCI index increased 20.44 percent from 1272 points in 1st January 2010 to 1532 points in 10th November 2010. However, the FBMKLCI is just an indication of what is truly happening with the stocks listed in the stock market (Financial Sith Lord, 2010). The main drivers for the higher turnover and prices such as strengthen of ringgit Malaysia (RM) had led to the increasing number of foreign institutional participant in Malaysia stock market (Securities Commission Malaysia, 2010).

In the global financial markets, the reflection for the global trends was the high price of stock and high bond prices in the Malaysian capital market. Domestic financing proposals have grown condition in year 2010 which has improved the economic conditions. In 2010, there was a total of 26 IPO which 22 are from local and 4 are from foreign country were issued. In the end of year 2010, 29 of new listings listed in Bursa Malaysia. Besides that, the listing of Chemical Group Bhd where it was the top Shariah-compliant stocks in Bursa Malaysia and the largest IPO had open good investment choice for investors to invest in Malaysian stocks.
At the same time, the stress level in Malaysian stock market declined in 2010 compared to the past three years. Market stress is a situation where stock market is unable to perform well and efficiently. Overall, the stress level had risen in May includes the global unease over Greece’s sovereign debt crisis, but declined soon after.

Bursa Malaysia also listed as a member of World Federal of Exchange (WFE). The World Federal of Exchanges is a formal affiliation where 52 publicly regulated stock, futures and options exchanges are traded. In World Federal of Exchange (WFE), the total number of listed companies for Bursa Malaysia in 2009 is 959, where 952 are domestic companies and 7 are foreign companies. For the year of 2010, the total of listed companies in Bursa Malaysia decreases to 956 (948 of domestic companies and 8 of foreign companies), compared to the year of 2009.

Market capitalization also called as “market cap” or in simplest form is “MCAP”, can be defined as the total value of a company or equity. Its function is to measure the size of the firm by multiplying the shares outstanding with the price of company’s share. In Bursa Malaysia, domestic market capitalization seemed to increase by 27.3% (in term of local currency) in the end of 2010. The domestic market capitalization for 2009 were RM990, 287.20 million has been raised to RM1, 260,192.90 million in year 2010. In addition, the market capitalization of new listings in Bursa Malaysia also seems to be rising at the end of 2010 which there were RM62, 531.30 million of domestic shares newly listed. In opposite, the market
capitalization of domestic shares that are delisted also increased in the end of 2010, which RM26, 900.00 million shares are delisted.

The table below shows the stock market index for KLCI in Bursa Malaysia from year 2000 to 2010.

Table 1: Stock market index for KLCI in Bursa Malaysia

<table>
<thead>
<tr>
<th>Year</th>
<th>Bursa Malaysia (Kuala Lumpur Composite Index – KLCI)</th>
</tr>
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<tbody>
<tr>
<td>2000</td>
<td>679.64</td>
</tr>
<tr>
<td>2001</td>
<td>696.09</td>
</tr>
<tr>
<td>2002</td>
<td>646.32</td>
</tr>
<tr>
<td>2003</td>
<td>793.94</td>
</tr>
<tr>
<td>2004</td>
<td>907.43</td>
</tr>
<tr>
<td>2005</td>
<td>899.79</td>
</tr>
<tr>
<td>2006</td>
<td>1,096.24</td>
</tr>
<tr>
<td>2007</td>
<td>1,445.03</td>
</tr>
<tr>
<td>2008</td>
<td>876.75</td>
</tr>
<tr>
<td>2009</td>
<td>1,271.12</td>
</tr>
<tr>
<td>2010</td>
<td>1,518.91</td>
</tr>
</tbody>
</table>

(Source: Adapted from World Federation of Exchange (2011), retrieved from http://www.world-exchanges.org/statistics/time-series/indexes.)
Based on the diagram and table above, we can see that index from year 2000 with 679.64 points kept on increased until peak at year 2007 with 1445.03 points. The KLCI index was then dropped sharply to 876.75 points in year 2008 and rose back again to 1271.12 points in year 2009. In year 2010, the index increased by 19.49% to 1518.91 from previous year.
1.2 Problem Statement

Based on finance theory, high risk generates high return. Therefore, investors with rational behavior all over the world will invest in the markets which can generate high profits to them, with the existence of high risk. However, in the real world, not all investors really practice it. Investors have their own attitude regarding to their investment decision and not all investors are willing to take high risk in their investment. It depends on their personal behavior. Same as Malaysia, Malaysia has various types of investors with their different kind of attitudes. Every decision that is made by investors towards investment activities are influenced by their own personal behavior. Even though high risk investment generates high income, but some investors are afraid to invest in high risk project because they fear of loss from their investment projects. All these situations related to the behavioral finance.

Behavioral finance considered as a new field in the financial world where it objective is to study and investigates the irrational nature of investors (Hayat, Bukhari & Ghurfan, 2011). Behavioral finance focuses on irrational behavior that influence investment decisions and market prices and attempts to figure out how emotions and cognitive errors affect investors’ behavior and their decision making process. Researchers argued that the study of psychology and social sciences in financial markets are able to help explain stock market volatility and other anomalies.

In Malaysia, research in behavioral finance is still limited. Some studies have been carried out and explained the investors’ overconfidence in trading behavior in the Asian stock markets including Malaysia. Toh and Zamri Ahmad (2010) in their
research paper had found that Malaysian investors are attention-driven and reference-dependent. Reference-dependent can be defined as trading behavior of investors by judging each stock with the available information. The emergence of behavioral finance in Malaysia continues as it can assists people, notably investors when they are enter into decision making on stock investments. Therefore the question arouse, do Malaysian investors exhibit certain irrational behaviors in stock investment decision? Therefore, this study attempts to investigate and discover more about behavior of investors in Malaysia (particularly in Bursa Malaysia) and at the same time to fill the gap of previous studies.

1.3 Objectives of the Study

There are two kinds of objectives in this study which is general and specific objective.

1.3.1 General Objective

The general objective of this paper is to examine the investors' behavior towards stock market and their trading behavior.

1.3.2 Specific Objectives

i. To determine the factors that may affect the behavior of investors in stock market returns.

ii. To determine the factors that may affect the behavior of investors in trading volume.
1.4 Significance of the Study

Study on investors' behavior has become a famous term in the financial system, because human attitudes change over time and sometimes unpredictable. Therefore, it is important for this paper to investigate more about the various types of attitudes that underlined on Malaysian investors. This paper gives some implications and will be beneficial for researchers to gain more knowledge and information related to the behavioral finance. Researchers can get more resources from the journals and articles and apply the related theories into their current study. In addition, they can continue their research and findings which is related to the behavioral finance.

Besides that, this study also contributes to the investors some significant implications. Study on behavioral finance helps Malaysian investors to control over their feeling when there are make decision on stock investments. Investors can learn a lesson about their bad investment or financial decision in the past. Investors are advised not only invest only in one stock, but they are also advised to follow the crowd so that they can reduce their emotional feelings when the stock decrease. This is because other investors also share the same losses on that particular stock. In additions, this paper will also help investors to choose a better investment and improve their performance. At the same time, they can reduce making wrong judgment in the future.

Furthermore, this study also has some contributions to the policy makers. Study of investors' behavior help to reshape the financial decisions and figure out the financial problem. Behavioral finance also has interconnection with the
retirement matters. The poor investment decision brings to the loss of money in their retirement accounts. Therefore, it is important for policy makers such as financial advisors to seek the solution and help them make a better decision and policy so that they can avoid any problem from retirement crisis.

1.5 The Scope of Study

This study will only cover the data from Malaysia. The study will apply monthly data from 1996 to 2002. The data will be obtained from DataStream. The variables that included in this study consist of following items: trading volume, index returns, P/E ratio, market value, dividend yields and S&P composite index.

1.6 Conclusion

This paper organized as followed: chapter two where theoretical framework and literature reviews will be discussed; the methodology of the research will be discussed in chapter three; chapter four will discuss the empirical result and the last chapter will be the conclusion and recommendations of the study.