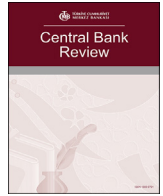


Contents lists available at [ScienceDirect](#)

Central Bank Review

journal homepage: <http://www.journals.elsevier.com/central-bank-review/>

Investor herds and oil prices evidence in the Gulf Cooperation Council (GCC) equity markets

Talat Ulussever ^{a, *}, Rıza Demirer ^b^a King Fahd University of Petroleum & Minerals, Department of Finance & Economics, College of Industrial Management, Saudi Arabia^b Southern Illinois University at Edwardsville, Department of Economics & Finance, School of Business, United States

ARTICLE INFO

Article history:

Received 27 July 2017

Accepted 1 August 2017

Available online xxx

JEL classification:

G14

G15

Keywords:

Investor herds

Equity return dispersion

GCC stock markets

Crude oil

ABSTRACT

This paper scrutinizes the effect of crude oil prices on herd behavior among investors in the Gulf Cooperation Council (GCC) stock markets. Using firm level data from Saudi Arabia, Qatar, Oman, Kuwait, Bahrain, Dubai and Abu Dhabi stock exchanges, we examine equity return dispersions within industry portfolios and test whether investor herds exist in these markets. We then assess whether crude oil price movements have any effect on the investment behavior of traders in the aforementioned markets. Our findings reveal significant evidence supporting herd behavior in all GCC equity markets with the exception of Oman and Qatar, more consistently during periods of market losses. Furthermore, we find significant oil price effects on herd behavior in these markets, particularly during periods of extreme positive changes in the price of oil. Our findings suggest that investors' tendency to act as a herd in the said markets is significantly affected by the developments in the oil market.

© 2017 Central Bank of The Republic of Turkey. Production and hosting by Elsevier B.V. This is an open access article under the CC BY-NC-ND license (<http://creativecommons.org/licenses/by-nc-nd/4.0/>).

1. Introduction

The effect of oil prices on financial markets has been a topic of interest to academics, practitioners as well as policy makers. Throughout the last half century, oil has played a significant role in the economic development of both oil importing and exporting nations, in some cases providing investors clues about the future performance of stock markets in these countries. The bubbles in oil prices and the crash during the second half of 2008 have led researchers as well as market regulators to take a closer look into the behavior of traders in commodity markets. However, the impact of oil market developments on the behavior of traders in stock markets has not yet been fully explored. For this purpose, the stock markets in the Gulf Cooperation Council (GCC) countries provide fertile ground for research as the performance of stock markets in these countries has a strong link with the behavior of oil prices (see Fig. 1).

Studying investor herds in GCC stock markets is particularly interesting for several reasons. First, following the Asian financial

crisis in 1998, the economies of GCC countries experienced extraordinary growth fueled with the boom in oil prices (Fig. 1). Considering the fact that the region possesses about 48% of the world's proved oil reserves, controls one third of world oil production, and 40% of world oil exports,¹ the flow of large sums of petro-dollars into these economies fueled some of the highest GDP growth rates worldwide. In order to move their economies away from their vast oil dependence, the governments in the region have implemented policies to strengthen financial institutions and channeled funds into the real economy through domestic investments that are aimed to modernize the infrastructure in non-oil industries. Moreover, the deregulation of important industries including finance and tourism has attracted a wider spectrum of investors into these countries, creating a great investment opportunity for domestic as well as foreign investors trading in the stock markets of these countries.

Second, in addition to their domestic investments to build up their infrastructure, the GCC countries, flush with petro dollars, emerged as an important FDI investor towards emerging markets as well as western economies. Recycling large sums of petrodollars by investing in foreign economies, either through sovereign

* Corresponding author.

E-mail addresses: talat@kfupm.edu.sa (T. Ulussever), rdemire@siue.edu (R. Demirer).

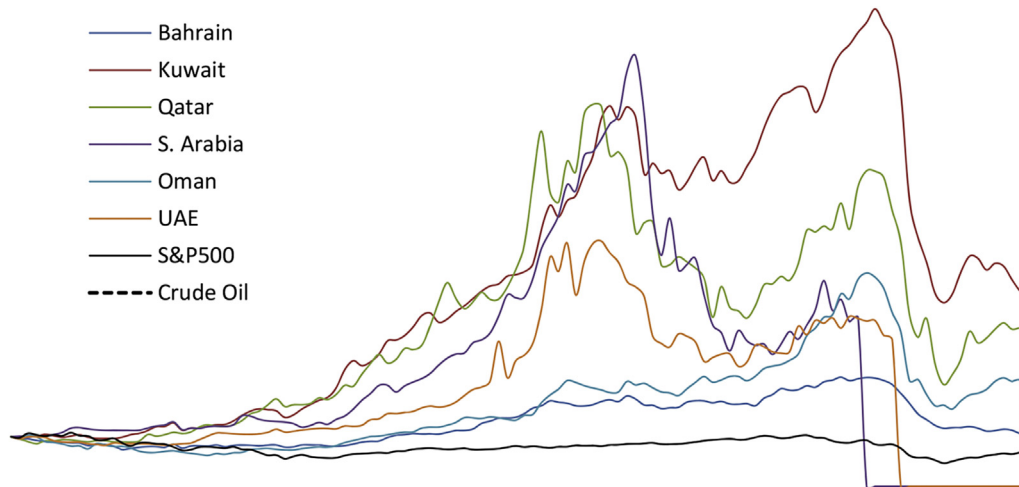
Peer review under responsibility of the Central Bank of the Republic of Turkey.

¹ Rault and Arouri (2009) the BP Statistical Review of World Energy (June 2015, and the CIA World Factbook, 2014).

<http://dx.doi.org/10.1016/j.cbrev.2017.08.001>

1303-0701/© 2017 Central Bank of The Republic of Turkey. Production and hosting by Elsevier B.V. This is an open access article under the CC BY-NC-ND license (<http://creativecommons.org/licenses/by-nc-nd/4.0/>).

Please cite this article in press as: Ulussever, T., Demirer, R., Investor herds and oil prices evidence in the Gulf Cooperation Council (GCC) equity markets, Central Bank Review (2017), <http://dx.doi.org/10.1016/j.cbrev.2017.08.001>



Note: Market index values are rebased at one as of January 2000 for comparison purposes. Returns are calculated using local currency based stock market index values. The second axis represents crude oil prices for the front-month futures contract traded at the New York Mercantile Exchange.

Fig. 1. Nominal stock market index returns for GCC countries, S&P 500 Index and Crude Oil Prices (Jan. 2004–Dec. 2013).

Note: Market index values are rebased at one as of January 2000 for comparison purposes. Returns are calculated using local currency based stock market index values. The second axis represents crude oil prices for the front-month futures contract traded at the New York Mercantile Exchange.

investment funds or private investment funds, bolstered the position of GCC countries in international markets. As a result, the GCC markets have not just become more attractive to foreign investors, and thus, been able to draw high levels of foreign direct investment, but also become more important in the global financial arena and attracted an increasing number of key financial players.

Third, unlike the stock markets in other emerging nations such as Poland or Chile, Gulf exchanges are largely dominated by retail traders who tend to be short term investors moving in and out of markets as they react to news. Institutional investors including insurance companies and pension funds generally provide a stabilizing factor in financial markets; however they are largely underdeveloped in the GCC markets. For example, institutional investors have been accounting around 5 percent of the value traded on the Saudi stock exchange. In such markets dominated by retail investors who, compared to institutional investors, tend to have limited access to information, less professional knowledge and financial culture and a short-term investment strategy, investors might have a greater tendency to watch and follow each other's trades, act on the basis of rumors, moving in and out of markets as a group, resulting in herd behavior in these markets.

Fourth, like any other emerging stock market, the stock markets in GCC countries suffer from a combination of regulatory weaknesses, illiquidity, and a great deal of information asymmetry among institutional and individual investors in the market. Recently, a broad range of legal, regulatory and supervisory policy changes has been implemented in order to enhance the transparency of these markets and diminish structural and regulatory weaknesses; however the informational efficiency of these markets and its impact on asset prices are not yet fully examined. The tremendous potential offered by these economies, the growing interest by foreign investors into their equity markets, the emerging nature of financial institutions, the dominance of retail investors in these markets and increasing participation by domestic investors make it especially interesting to examine whether herd behavior exists in these markets. In this study, we contribute to the

literature on emerging markets by examining investor behavior in GCC stock exchanges.

This study has several contributions. First, we use firm level data from GCC stock markets with unique characteristics as explained earlier and study whether investors in different industries in each country exhibit herd behavior. This is especially important for policy makers as herding might lead asset prices to deviate from fundamentals as prices would reflect investors' tendency to flock in and out of stocks as a herd without researching fundamentals. The result might be a bubble and a subsequent crash which regulators, as well as investors, would like to avoid. The infamous dot-com/tech crash in the U.S. market in early 2000 is an example of the potential costs of avoiding fundamentals when pricing assets. The plot of GCC market index returns shown in Fig. 1 suggests that this might just be the case in these markets as well. The pattern of bubble and crashes that can be clearly seen in Fig. 1 might have been due to herd behavior among traders initially overpricing assets and eventually leading to market crashes. The last column of Table 1a reports the annual returns on each country's general market index; the resulting losses from the crashes were as high as 56% for Saudi Arabia and United Arab Emirates (UAE) respectively in 2008. The second contribution of this study is to examine the effect of oil prices on the behavior of investors in these markets. Clearly, the transmission mechanism of oil price shocks to stock returns in GCC markets should be different from that in net oil-importing countries. Since GCC countries have a rich variety in terms of their dependence on oil exports² and are yet connected through a common political and economic union, the study of investor herds in these markets can provide valuable insight to how oil price shocks are transmitted to equity markets and what factors

² While UAE, Bahrain, and Oman are less oil-dependent, Saudi Arabia, Kuwait, and Qatar are more oil-dependent as the contributions of oil to GDP is 26% in Bahrain, 34% in UAE, 54% in Saudi Arabia, and 62% in Qatar. (Source: Global Investment House, Global Research, GCC January 2008).

Download English Version:

<https://daneshyari.com/en/article/7396105>

Download Persian Version:

<https://daneshyari.com/article/7396105>

[Daneshyari.com](https://daneshyari.com)