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The efficiency of the stock market in Serbia

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Abstract

The paper analyzes the application of the hypothesis of the efficiency of financial markets on the financial market in Serbia, i.e. the Belgrade Stock Exchange. The weak form presupposes an impossibility of anticipating a future share price on the basis of available historical pieces of information about the prices, indicating a "random walk" trend with shares. In order to carry out a research into the weak form of efficiency, the BELEX15 Index return daily value of the most liquid shares on the Belgrade Stock Exchange from the beginning of 2006 to the end of 2013 is taken. In order to prove the (un)predictability of the share-price trend, time series stationarity is established by means of the parametric and non-parametric econometric tests, such as the Dickey–Fuller test, the Phillips–Peron (PP) test and the Run Test.
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1. Introduction

Are financial markets efficient and how efficient are they are questions that still remain unclear and unanswered in a complete way. The theory of market efficiency assumes that the prices of securities, as a rule, are in a state of balance and reflect investor expectations on the basis of available information. The position that securities prices fully reflect available information about

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securities is also called the hypothesis of market efficiency (the efficient market hypothesis or EMH), although theory (the theorem) and the hypothesis, as concepts, are not synonyms (Mishkin & Eakins, 2003).

In any case, the hypothesis (a term that is more often used in the literature) on the efficiency of the markets states that it is impossible to achieve a long-term rate of return on the market that exceeds the average rate of return of the market as a whole and thus "beat" the market. However, there are a large number of investors who do not believe that prices in financial markets are in a real equilibrium and therefore follow the daily price movements of securities and analyze them, in order to determine whether there are overvalued securities (that should be sold) or undervalued securities (that should be bought).

The hypothesis about the formation of price expectations was proposed by J. Muth in the early 1960s (Muth, 1961). He suggested that one (and perhaps the only) method of forming expectations that is consistent with general optimizing behavior is to make such expectations on a "rational" basis by incorporating all available information about the market in question. The hypothesis of the efficiency of financial markets is, in fact, believed to be an applied hypothesis of rational expectations on financial markets. Rational expectations correspond to the optimal predictions on the basis of available information. On financial markets, optimal predictions regard the factors that may affect the price of financial instruments, especially securities, and available information relate to the information available to the public, concerning the factors that may affect the price. However, predictions based on rational expectations may not be correct. The reason for this may be that they have not taken into account all available information or that all pieces of information have not covered everything accurately and have been completely defined.

Numerous studies have confirmed the existence of a "weak" form of EMH, and generally supported the existence of the "semi-strong" form of EMH, but not the "strong" form EMH. However, even if it is a "weak" and a "semi-strong" form, the EMH has a number of weaknesses, the listing of which would require a lot of space, and primarily comes from the field of the behavioral economics (loss aversion, anchoring, overconfidence, . . .) (Watson & Head, 2007). The EMH has not offered acceptable answers to some of the specific developments in the financial market, such as a decline in the Dow Jones Industrial Average Index by 23% in just a few hours on the "Black Monday" in October 1987 (a partial explanation is found in the then newly-introduced so-called computerized or "program" trading system), nor in many of the latest developments within the global financial crisis that, with a varying intensity, has existed since 2008. (Pike & Neal, 2006).

Grossman and Stigliz argue that perfectly informationally efficient markets are an impossibility for, if markets are perfectly efficient, there is no profit in gathering information, in which case there would be little reason to trade and markets would eventually collapse (Grossman & Stigliz, 1980). Because information is costly, prices cannot perfectly reflect the information which is available, since if it did, those who spent resources to obtain it would receive no compensation. There is a fundamental conflict between the efficiency with which markets spread information and the incentive to aquire information.

Serbian financial system is bank-oriented system with more than 92% of financial assets concentrated in commercial banks. Thus, development of financial markets, especially stock exchanges, is on the low level of implementing basic functions of transferring, allocation and optimal price determination of borrowing. One of the fundamental problems is very low liquidity, lack of qualitative stocks and bonds and insufficient role of institutional investors. Approximately 95% of trading in Belgrade Stock Exchange is in stock, and 5% in only few bonds. The interest of investors remains closed in traps extremely low liquidity and drastic fragmentation of regional markets of South East Europe's (SEE) countries that with the vast and nonconsensual legal regulations

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