ABSTRACT

This study evaluates the effect of market anomalies in the stock market and the cointegration relationship between macroeconomic variables and stock returns to seek efficient market hypothesis. This study uses five macroeconomic variables as M1, GDP, FDI, market capitalization and stock traded turnover. It employs three unit-root tests (KPSS, ADF and Ng-Perron unit-root tests) to check the stationarity of the variables. Moreover, to evaluate the short and long-run causality Granger causality test and error correction model are used. This study also employs variance decomposition analysis in order to investigate to which extent stock prices are affected by their own variances and due to the variances of other macroeconomic variables.

The results indicate the highest Friday and lowest but not negative Monday returns. These results are consistent with French, 1980; Hess, 1981; and Cornell 1985, Keim and Stambaugh 1984. The study finds no January and April effect in the case of KSE. Contrary to January and April effect, May returns are high. These results are consistent with the results of Raj and Thurston (1994), found no April and January effect in New Zealand.

The appropriate test to evaluate the cointegration used by the study is ARDL. The results show cointegration relationship between stock prices and three macroeconomic variables as FDI, M1 and stock traded turnover. The results of error correction model find short-run cointegration relationship between stock prices and three macroeconomic variables as FDI, M1 and stock traded turnover. The Granger causality results indicate that there are only two casual relationships from CLOSE (stock returns) to GDP and from CLOSE to M1. The results of variance decomposition analysis indicate as time horizon increases, the variance of stock returns explained by GDP also increases. The other macroeconomic variable which affects stock returns is M1. The results show that there is causal relationship between stock prices and other macroeconomic variables at longer horizons.