CHAPTER I
INTRODUCTION

1.1 Research Background

Financial market is a market where an individual, group or even corporation, that can do a buy-or-sell transaction in term of financial securities (Ross, Westerfield, & Jordan, 2006). The form of financial securities itself can be in the form of stock or bond. Financial market itself can be divided into two types of market, Capital Market and Money Market. Capital Market deal securities transaction in term of long-term securities transaction, while Money Market deal on the short-term securities transaction.

Investing in financial market mean doing an act or activity of buying securities in the financial market in the hope that in the future it will generate profit or appreciated. In addition, the person that do this kind of activity is called as investor. There are two kind of investor the risk seeker or the risk avoider.

For risk avoider, they are the investor that only want to ‘play safe’ or be in their comfort zone in their investment, they despise investing an investment that had a high chance of risk. They are those who want the outcome of an investment to be realized as what they picture it, which mean they despise uncertainty in an investment. To those who avoid risk in an investment to invest their asset they will choose to invest it in the bank by depositing it.

As for the risk seeker, these are investor that is collectively seeking for a risky investment, because they understand and believe in the philosophy of high risk and high return, if an investment has a high risk it will also followed by a high return rate. This investor will choose to invest their assets in the capital market.

Capital market can be describe as market that deals of buying and selling transaction of equity and debt instrument at a long-term period of time, it include those of primary market where stock and bonds are issued, and secondary market a place where investor can trade existing securities. In a country, capital market is very important not only to provide a buying and selling medium for the securities investor, but it also has a function for the country financial and economy.

Capital market can be seen as a medium where the two party, the buyer and seller, can have a transaction that could benefit both party. Where the buyer can lend some capital to the seller in the hope that their investment will be appreciated in the future, without any worry of managing the company. As for the seller, they can borrow some capital from the investor to fund some of their company or organization activity.

Investor invest their money in the capital market with the goal that in the future their investment will give them profit or generate a return on the capital that they invest. To do that the investor actively try to find a way to "*beat the market*" or to outperform the market, some people even try to find a way or strategy to make the market inefficient for them so they can exploit it weakness and gain more from the market.

Efficiency in the context of capital market have been defined in many ways, but the most common way has been defined in terms of what sort of information is available to market participants, and how they handle that information. From this view, according to Dimson and Mussavian (1998) in Gharaibeh and Al Azmi (2015), an efficient capital market is one where prices of financial assets accurately reflect all information and quickly adjust to new information, which is referred to as informational efficiency. So in some way, to gain more return from the investment the investor will try to gain an upper hand from the market by trying to make it become inefficient or finding a suitable strategy in defeating the market. The study of market efficiency is quite crucial for investors, investment manager, and policy makers, by understanding the market efficiency they can assist in improving their returns (Gharaibeh & Hammadi, 2013).

Even in efficient markets, where security prices securely reflect all relevant and recent information, many well-documented seasonal effects continue to exist in many markets. Conventional wisdom states that the stock market is random, that is, there are no patterns or mechanism, which can be understood and used to consistently predict market movement up or down. The theory of market seasonality states just the opposite. This theory holds that there are real factors operating on the stock market, which cause consistently recurring patterns over decades of market history. These factors can be used as the basic for an improved, less risky investment method (Minimol, Makesh, & Radhika, 2013).

In capital market, sometimes there is a situation where some kind of seasonal anomaly occur in the market, where there is actually a seasonal pattern that occur in the capital market. One of the most discussed anomaly is the day of the week effect, where there is a difference in the average daily return of the market for all days of the weeks.

According to Jaffe and Westerfield (1985), Wong et al. (1992), and Agrawal and Tandon (1994) in Patel and Mallikarjun (2014), day of the week effect is a global phenomenon, and this might be the result of spillover effect of developed stock market. The investor as one of their strategy to gain more return from their investment can use this anomaly, if the day of the week effect is prominent in the stock market, investor can use such opportunities or clues regarding their investment decisions. Another strategy to use the day of the week effect is where the investor can time their investment to where they can buy and sell their securities where it would gain them additional return.

In this research, the anomaly that will be tested is one of the calendar anomalies or seasonal anomalies, which is day of the week effect. According to Patel and Mallikarjun (2014), the term "day of the week effect” in the stock market has been documented in early nineties by Fields (1931) and Kelly (1930), while the testing of the stock market seasonality had been received by considerable attention post nineties with the first by French (1980). Even today, this anomaly is an interesting topic to investigate further of their existence in the market index or even in the company stock itself.

This research is done by targeting the stock index of the LQ45 market index, which consist of 45 companies that have the highest market capitalization and overall performance from other companies in Indonesia Stock Index (IDX). The company stock in the LQ45 market index is chosen as the target of this research based on all the previous research suggestion in term of finding the effect of the day of the week in a more ‘micro’ than ‘macro’ scale.

1.2 Problem Statement

Based on the explanation in the research background, the main problem of this study is “Is there a Day of the Week Effect in the stock return of Indonesia LQ-45 company stock Index?”

1.3 Scope of the Research

There are some limitations of the study, which are :

1. Researcher will use data of LQ-45 stock market index in Indonesia Stock Exchange (IDX). LQ-45 stock market index consists of 45 companies that is considered to have the highest market capitalization,

good financial conditions, has a great growth prospect, high transaction value and frequency.

2. The data that is used in this research are of LQ-45 member that has been a member of LQ45 and has been a public company from the period of January 2008 – December 2016. The company that did not match this criterion will be excluded from this research.
3. Share price reported on public holidays, where no trading had occurred will be removed from the dataset, because it will result in an artificial zero returns for each firms.

1.4 Objective of the Research

The objective of this research is to analyze the day of the week effect on the stock return of LQ-45 stock market index member.

1.5 Benefits of the Research

The researcher hopes this research will be able to bring benefits toward :

a. The Author

This research is expected to make a better knowledge and understanding to the author about the anomaly of the stock market, in term of day of the week effect to the stock market of LQ-45.

b. The Readers

This research is expected to increase the knowledge of the reader in the financial sector. It could also be used as a reference or the reader could even considerate in further studying that is related to the variables in this research.

c. The Investor

This research is expected to give more information regarding the day of the week effect and the researcher expect that it could give some additional input to the investor that is doing some transaction in the stock market, preferably in LQ-45 stock market.

1.6 Originality of the Writing

This research followed the previous research that has been done before in other country's stock market and using different type of data. All of the writing in this research was collected, analyzed, explored and studied thoroughly by the researcher.

1.7 Writing Structure

This research is divided into 5 chapters, which are:

Chapter I : Introduction

This chapter consist of the research background, problem statement, scope of the study, research objectives, benefits of the research, originality of the writing, and writing structure.

Chapter II : Theoretical Background

This chapter consist of concept and theory that is relevant with the problem statement of this research. This chapter will be divided into three part, the first one is about the literature review or its theoretical foundation, the second one is will discuss about the previous study done by other researcher or other related study with the topic that became a reference in this research, and lastly there is also the part that contain the hypothesis development that will represent the findings of the research of the study in detail.

Chapter III : Research Methodology

This chapter contain the description of the research population, sample, research data, data collection method, and the hypothesis proving. In the data collection method it consist of the step in processing the data, it include of calculating the daily percentage return of the share, developing the three portfolio, making descriptive statistic analysis, stationary test, ARCH-LM test, OLS Method and the GARCH (1,1) model.

Chapter IV : Data Analysis

This chapter contain the analysis of the collected data and the interpretation of the result of the data analysis. There are six part in this chapter, the data processing, descriptive statistic, stationary test, ARCH-LM Test, GARCH (1,1) Model and OLS Method analysis, and discussion

Chapter V : Conclusion

The last chapter of this study consist of the conclusion, managerial implication, limitation of the research, and the suggestion for future research.