

Chapter I

Introduction

1.1 Background

In doing the Investments, both Investors in the form of buyers and sellers are willing to get high dividend or capital gain. From the buyers' side, The Investors will choose the securities which they are certain, it can generate the cash flow in the value which they expect to receive in the future. While from the sellers' side, in determining the price of the stock the investor set it based on the expected cash flow the investors would like to get in the future. Thus, because of the uncertainty of the future condition and the interdependence between Investment with today's condition , it is rationale for the Investors to gather all the relevant information which is available to assess the intrinsic value of the asset—Intrinsic value is the present value of the cash flow the owner of the security expect to receive. It makes the Information becomes the key Issue in the efficient market theory (EMT), the theory simply stated that, in an efficient market prices fully reflect all the relevant information available.

As the Information is playing an important role in the capital market many studies have been held to examine this theory. One of the most famous ones came from Eugene F. Fama, in his publication of “Efficient Capital Market: A Review of Theory and Empirical Framework” (1970), he divided the Information into three categories: 1) past price changes which is the information of the historical price, 2) public information which is the information available publicly, and 3) public and private Information which is information available both publicly and privately. Furthermore, he also defined three different forms of market efficiency. The first is weak form market efficiency. In this form, the current stock prices reflect all the historical information about the firm in the public, including historical prices, trends of stock prices and old news. Because it only shows the information in the past,

this capital market is efficiently weak. The second is semi-strong form market efficiency. In this form the prices do not only reflect the firm historical market information but it also reflects all other information available in the public such as the content of the financial reports, economic forecasts, firm announcements, and so forth. The last form is known as the strong form market efficiency. This is the highest level of the form market efficiency in which the prices of the stocks does not only reflect the information available in the public but also the information from the inside of the firm.

Although in firstly researches this theory seemed have much evidence which support the market hypothesis, but the more updated research showed that there are abnormal phenomenon which contradicts the efficient market theory. This is the condition which daily stock returns are abnormally high for specific periods. Those abnormal returns in some periods are known as calendar anomalies or calendar effects. Unlike in an efficient market, the existence of those anomalies in the market gives the opportunities for the investors to gain excess returns by exploiting them through strategies. LeRoy (1990) stated that if the markets are truly efficient, then an investor in no way could gain an excess return by investing using strategies to exploit these apparent anomalies. Since the early 80s there are some types of anomalies have been documented in the capital market. Monday effect (French 1980), turn of the month effect, January effect, day-of-the-week effect, turn of the year effect and holiday effect which becomes the main focus on this research.

As one of the oldest anomalies, the holiday effect has been existed for at least 90 years in the market (Lakonishok and Smidt, 1988). They reported that this single effect is responsible for approximately 50 percent of DJIA returns and has existed for at least 90 years. The Holiday effect is the market anomaly in which exists when the abnormal returns appear in the market before holidays (pre-holiday return) or after holidays(post-holiday returns). American finance practitionersMerill (1965) and Fosback (1976) has documented abnormal returns on

the day prior to holidays. Meril (1965) conducted a research by using the trading days data from DJIA in the period of 1897 to 1965, from the research she found a disproportionate advances on the preholiday tradings. Meanwhile, Fosback (1976) reported higher returns on the day prior to holidays in the S&P 500 index.

Thaler (1987) documented that the research was first conducted by Fields in 1934. The research used the days before weekend trading data of DJIA from 1901 to 1932. Then Field found out the trading frequencies was significantly higher on the trading days before the day offs on the weekend. Lankonishok and Smidt(1988) held a comprehensive research about the seasonal anomalies. The research uses the daily returns data from the DJIA in almost 90 years period (1897-1986). Then they test for weekly, monthly, yearly and holiday effect. The holiday effect is analyzing by classifying the trading days into three classifications: pre-holiday, post-holiday, and non-holiday. The research reveals that the stock returns on the pre-holiday is more than 23 times greater than the average non-holiday returns and responsible for 50 percent of DJIA annual returns. The authors also added the holiday anomalies is distinct and is not influenced or independent from other seasonal anomalies.

Furthermore, the research from Ariel (1990) also added more evidence to this phenomenon. Through his comprehensive research for CRSP value-weighted and equally-weighted index returns in the period of 1963 to 1982, he revealed that the returns on the pre-holiday trading are significantly higher than the other days. The returns are ranging between nine to fourteen times greater than the average returns on the other days. Those happen because the investors eager to close their short position before holidays which give the pressure to purchasing activities.

Asian market which consists of many countries with different backgrounds and cultures also affect the regulatory of the holidays. Hence, allowing Asian financial market to

experience the phenomenon of holiday anomalies. Many researches have been conducted to provide the evidence of holiday anomalies existence in the Asian stock market. Chan, Khanthavit, and Thomas (1996) found out there are abnormal preholiday returns in the stock market of four countries. They investigated holiday effect by distinguishing between state holiday and cultural holidays in Malaysia, India, Singapore, and Thailand. The result showed that dominant cultural holidays have more profound effect than the state holidays.

Many studies in Asia has found that the cultural holidays has more pronounced effect to the holiday anomalies compare to state holidays. In some Asia countries Chinese Lunar New Year (CNY) has been the main focus in finding the presence of holiday anomalies, given to big numbers of Chinese population. Wong et al. (1990), Tong (1002), Lee et al. (1992), Yen and Shyy (1993) and Ahmad and Hussain (2001) found strong presence of CNY effect across South East Asia countries. Chan et al. (1996) have investigated the presence of holiday effect in four countries in Asia, those are Thailand, India, Singapore and Malaysia. the research has lead them to find that the dominant cultural holidays have more profound effect than the state holidays. In India where hindunese is the majority population they find no holiday effect except for “other Hindu holidays”, in Thailand the find the Chakri effect, in Singapore there is Chinese New Year effect and in Malaysia there are Chinese New Year Effect, Maal Hijriyah (*Tahun Baru Hijriyah*), and Vesak.

As the country with the biggest number of Muslim population, Eid-al Fitr holiday is the longest one which makes the stock market has longer closed days or extra stock market closing. Although, the official holidays are between 2 or three days but usually closing days will be more than that. That kind of behavior is affected by the cultural pattern in the society which is done during the Eid-al Fitr holidays. Therefore, according to background that is explained above, the author will try to investigate the Holiday effect phenomenon in Indonesia stock exchange (IDX) during the Eid-al Fitr Holiday. In addition, the author will

also try to get the evidence to prove the relationship between the firm size and the holiday effect.

Although many researchers have shown that stock price is a fundamental variable underlying the stock return anomalies according to the holiday anomaly. Nevertheless, some studies have tried to find an explanation to define the relation between firm size and the stock return anomalies. The prior research anomalies have found that there is a relationship between some seasonal anomalies and the firm size. Keim (1983) finds that the January effect is mainly a small-firm effect. Later, Keim and Stambaugh (1984) also find that the weekend effect has a greater influence on small-firm stocks than on large firm stocks. In the relation with the Holiday effect, Keim (1989) explained that the systematic pattern of the holiday anomaly is that an abnormal higher return on the pre-holiday trading. If the closing price on two days before the holiday is recorded at the bid and the closing price before the holiday is recorded at the ask then it would produce high returns on the pre-holiday trading. If it happened, Keim concluded that the small firm will be more likely to experience the holiday effect as the bid-ask spread is larger for the small-firm stocks.

Roll (1983) stated that there are relatively higher returns for small-sized firms on the trading days prior to New Year day. Later, Pettingill (1989) and Ariel (1990) have also studied the relationship between the holiday effect and the firm size. Pettingill (1989) finds that pre-holiday returns are stronger for the smallest capitalization portfolio (0.4607 percent vs. 0.2692 percent for the largest). While on the other hand Ariel (1990) finds that the small firms do not get any higher return after adjusting the day of the week effect and excluding New Year's Day. Furthermore, more updated research has been done by Chan-Wung Kim and Jinwoo Park (1994) to investigate those difference findings. The authors used the size decile portfolios traded on the NYSE and AMEX in the period of 1963-1986. They ranked those stocks into 10 portfolios based on the market value of December 15th 1993. The result

shows that on the pre-holiday returns the effect is more pronounced for large-firm stocks than for small-firm stocks.

Based on the Background that has been addressed above, the author is interested to conduct the research to provide the evidence examine the presence of Eid-al Fitr holiday effect in Indonesia and to identify the relation between Eid al-Fitr Holiday Effect with the firmsize.



1.2 Problem Statement

Based on the background above, there the problem statements of the research are:

1. Is there any presence of Eid-al Fitr holiday effect on JKSE index during 2000-2013?
2. Is there any relation between Eid-al Fitr holiday effect and Firm size?

1.3 Scope of the study

As the scope of the research is wide, the author is narrowing the scope by determining some limitations, such as:

1. The data will be daily data in of JKSE index during 2000 to 2013 and companies which always listed in LQ45 during 2000 to 2013
2. Eid al fitri effect will be compared with other 12 holidays exist in Indonesia, such as New year, Chinese lunar new year, Muslim day of sacrifice, Balinese day of silence, Islamic New year, Good Friday, Vesak, Ascension day of Jesus Christ, The Prophet Muhammad's Birthday, Independence day, Ascension day of the Prophet Muhammad, and Christmas.

1.4 Objective of the Research

The Objectives of the research are:

1. To identify the presence of Eid-al Fitr holiday effect on JKSE index during 2000-2013
2. To identify the relation between Eid-al Fitr holiday effect and Firm size.

1.5 Benefit of the Research

Through this research, the author hopes the findings will give the benefits for:

1. The Investors

The author hopes this research can be a source of useful information for the investors about the price stock behavior which can help them to make trading decisions

2. Other researchers

This research might be source full information for those who do the same or related research. Furthermore this paper might provide a clearer explanation regarding the topic of the research.

3. Others

This research can be a source of literature that can be used as additional information for the further research development.

1.6 Research Report Outline

Below is the outline of the research report:

Chapter I: Introduction

This chapter provides the explanations of background, problem statement, objectives of the research, benefit of the research, and research report outline.

Chapter II: Literature Review

This chapter provides the explanation of theoretical basis and literature review from prior related research. Those theoretical and literature review will be used for problem solving and developing the research hypothesis.

Chapter III: Research Methodology

This chapter explains the research methodology used for this research. This chapter also will address the variables, population and sample of the research, method used for gathering the data, data analysis method and hypothesis model used in the research.

Chapter IV: Data Analysis

This chapter provides the test of classic assumption, hypothesis testing and the explanations about the result of hypothesis testing.

Chapter V: Conclusion

This chapter provides summary of the research results and also provides advices related to the research.