Abstract

Abstract of thesis entitled Present-Value Relations and Chinese Stock Price Behavior: The Case of Shenzhen Exchange, Submitted by Luo Ning (M-A46809-7) for the degree of master of Social Sciences in Economics at the University of Macau in June 2006

Recent econometric advances and empirical evidences suggest that financial asset returns are predictable to some degree. According to the present-value model, future stock return has some relations with present dividend. It suggests that we could use some econometric methods to examine the predictability of the stock return with the help of dividend yield. Two common ways of testing are ordinary least square (OLS) estimation and vector autoregressive (VAR) estimation. Most of the estimated results proved dividend yield to be a good regressor in forecasting stock return, with R^2 increasing with the return horizon.

Some economists also examined the relation between stock return and dividend yield, using data of Chinese stock exchange. The stock exchange has a short history in China. Because there are many problems in this market, such as more speculators than investors, low cash dividend and highly volatile index and return, the relation between stock return and dividend yield in Chinese stock exchange may be different from that in other mature stock markets. That relation might not exist in Chinese stock market. It really makes sense to test the data from Chinese stock market. It would be interesting to see whether the stock returns are predictable, and the relation based on present-value model in Chinese stock exchange is similar to other mature ones.

Because of the problem of low cash dividends and lack of data to calculate them, this paper will examine the relation between stock return and earning yield, instead of between stock return and dividend yield. Although earning yield doesn't appear in the model directly, it is an important factor affecting stock return and is highly correlated with dividend yield. Earning yields can be suitable when testing the predictability of stock return.

Both ordinary least square estimation and vector autoregressive procedure are applied to test the relation between stock returns and earning yields in Shenzhen Exchange. The power of ordinary least square estimation in forecasting the relation between stock return and earning yield in Shenzhen Exchange increases with the returns horizon. We find more information about this relation by the vector autoregressive estimation. It shows that the shock to the changes of earning yields could account for about 41% of the variability of stock returns when the returns horizon is larger than 3 months.

The discussions in the thesis imply that the relationship between stock return and earning yield in Shenzhen stock exchange is consistent with the theoretical model. The similarity of the relation to the mature market may suggest the progress gained by Chinese stock exchange through 14 years' development after its establishment.