



Testing Uncertainty Information Hypothesis: The Tangency of Presidential Election Postponement

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Abstract

The challenges of the rationality, risk-returns tangles and political information effect in the determination of portfolio investment behaviour using the 2015 Nigeria Presidential Elections postponement as an event that dictates investment direction is the objective of the paper. Market model (MM), Cumulative Abnormal Return (CAR) and t-statistic were used in testing the variance in returns for the pre-postponement, pre-election, pre-swearing-in, post-postponement, post-election as well as the post-swearing-in dates. The results show that uncertainties surrounding the postponement of the presidential elections have an adverse negative relationship with stock prices in the market within the period of study. Based on these, it is recommended to strengthen and professionalize national institutions whose operations determine national deliverables. A more transparent market for efficient prices discovery notwithstanding the fact that too much transparency shrinks liquidity as participant become unenthusiastic in revealing their intents to trade, is also recommended. Traders' advantaged by private information signs prefer anonymous systems while those having liquidity with credible claims and no information prefer greater information disclosure.

Key words: Asymmetric Private Information, Election, Financial Market, Event Study

JEL Classification: D82, D72, D53, G14

Paper Classification: Research Paper

Introduction

Capital market reaction to political economic information and investors apprehension is determined by the unpredictability of elections outcome. This is either due to policy summersault and reversal or market reactions and sentiments (Wing-Keun & McAleer, 2007; Wang, Mei-Yu & Che-Yang, 2008; Valadez & Nickles, 2009; Ro, 2012; Kumar & Jucunda, 2015). Unpredictability in economic activity as a result of external political interference by actors looking for election is called opportunistic business theory. This results in a short-term trade-off between the level of manpower utilization and resources allocation, employment and unemployment swapping, inflation and deliberate alterations in other indexes for measuring aggregate economic performances. Since political officeholders are rational actors as revealed in the ranking of their political objectives, it is, therefore, imperative for other economic agents to deliberately track their actions to undo it if unfavourable.

According to Canes-Wrone and Park (2010), political uncertainty engendered by electoral event buoys up private investors to delay their investments. This they said is not unconnected with challenges associated with reversals on the economy. This challenge results in distortions in aggregate economic performances within the election periods in the economic cycle. They termed this as reverse electoral business cycle (REBC). They further assert that intentional delays in investment-related policies are functions of the extent of policy variations of contending political parties. This increases the prospect of postponing certain investment activities and purchases which in like manners affect corporate earnings and the nation's gross domestic product (GDP).

Uncertain Information Hypothesis (UIH) assumes, in principle, that investors predict with precision stock prices lower than their ultimate values prior to events taking place with a view to hedging against the uncertainty emanating from it. It postulates the likelihood of stock prices overreacting to bad news and underreacting to goods news which discounts investors' expectation of their future earnings. Against these dark spots, the study, therefore, intends to unravel the rationality, risk-returns tangles and information effect in the determination of investment behaviour using the 2015 Nigerian presidential elections postponement as one of the cockroach theories effects. This theory posits that the company revealing one bad news to the public is symbolic of many more connected undesirables yet unrevealed more unpleasant news. It is derived from the belief that sighting one cockroach evidenced much more hidden. This is further demonstrated in the elevation of a specific political party aspirant or political agenda at the expense of other which indicates that the candidate's programme will directly influence market uncertainty that perhaps erodes investors' confidence. Election-related uncertainty foresees undesirable inverse relationship between stock price volatility and uncertainty of the winner in the short run coordinated by prevailing macroeconomic variables (Graham, Nikkinen & Sahlstrom, 2003). Political uncertainty hypothesis posits that election winners-related information reflects evidence of yet to come macroeconomic policy. This shares the ideological belief of partisanship political business cycle. Asserting further that party-political uncertainty stimulates general macroeconomic uncertainty, inclusive of stock market volatility (Krause, 2005; Malley, Philippopoulos & Woitek, 2007; Diebold & Yilmaz 2009; Arnold & Vrugt 2010). Economic prosperity on the eve of election driven by political players to win an election suggests voters decomposing memory.

Since political officeholders are rational actors as revealed in the ranking of their political objectives, it is, therefore, imperative for other economic agents to deliberately track their actions to undo it if unfavourable. Based on these, it is hypothesized that:

Election postponement deepens market volatility and uncertainty hence showing a significant negative relationship with stock prices.

Review of Related Literature

Brown, Harlow and Tinic (1988) and Brown, Harlow and Tinic (1993) in their revolutionary work with a follow-up of Vuchelen (2003), assumes that investors set stock prices below their fundamental values determined by economic, industry and company's specific factors prior to event taking place with a view to hedging against uncertainty emanating therefrom. It suggests the likelihood of stock prices overreacting to bad news and underreacting to good news by discounting investors expected future earnings. The volatility signalling the unpredictability in stock price surging resulting from overreaction and underreaction to market information is a key component of the efficient market hypothesis (Fama & French 2015).

By rule of the thumb, a rising trend in such prices follows as events become more certain. As uncertainties driven by electoral activities diminish, normal returns fall with price decrease. But the reverse was the case with the 2013 election declaration of Malaysia results. This led to a remarkable increase rather than the expected price nose-diving in the financial market. This, some researchers opine is the result of delay, unstable political environment and structure of the countries as well as lack of institutional independence (Pantzalis, Strangeland & Turtle, 2000; Nippani & Medlin, 2002; Fehle & Zdorovtsov, 2003; Nippani & Arize, 2005; He et al 2009; Vahamaa & Aijo 2011; Eriki & Eboigbe, 2012). They find progressively positive returns weeks before elections which were abnormal in size and therefore recommend that investors and other stakeholders should develop financial skills for interpreting the interplay between political events and the economy. This is to enable them to know when to buy, hold and divest their holdings in a highly uncertain economy. Interestingly, some studies (Li & Born, 2006; Ali, Nassir, Hassan & Abidin, 2010; Akkoc & Ozkan, 2013) conclude there is the absence of proof of stock market overreaction in the direction of general polls and other electoral events. Furio, and Pardo (2012) see the stock market performance and volatility around election dates as significantly bearish in the last three trading days and statistically bullish on the day following national elections. Li and Born (2006) find prices surging at a pre-election time with high uncertainty. Interestingly, Goodell and Bodey (2012) reveal a negative relationship with decreasing electoral uncertainty around U.S. presidential elections and price-earnings ratios. This implies that as events uncertainty lessens, the stock market tends towards normality.

The reaction of stakeholders to the coming of key political and economic news is termed reaction hypothesis. This to a very high degree of precision could manifest in overreacting or underreacting depending on the potency and investors' interest in the market. Investors are either liquidity traders or information traders. Rational investor assumption suggests that financial assets values completely replicate all material information and prospect as every fresh information remains assimilated into the current prices as such information is revealed. Available evidence from studies shows that prices do not mainstream existing sets of information but consist of insiders' information as well. These inconsistencies lead to the development of Overreaction Hypothesis-OH as a field of study in behavioural finance (De Bondt & Thaler, 1985; De Bondt & Thaler, 1987) and the Uncertain Information Hypothesis-UIH (Brown, Harlow & Tinic, 1993; Brown, Hallow & Tinic, 1988; Mehdiian, Perry & Nas, 2008).

The Overreaction postulation asserts that prices move downward in reaction to unfavourable news and upward to favourable news (Bloomfield et al., 2000; De Bondt and Thaler, 1985; De Bondt & Thaler, 1987) OH suggests further that stock prices tend to fall after an extreme reaction to favourable news and rise after extreme reaction to unfavourable news which is alternatively termed market correction (Eboigbe & Osamwonyi, 2018). This surging and plummeting in stock prices will result in the prices coming to the initial prices before movements. Under the Overreaction Hypothesis, the underdogs' portfolios steadily outperformed the market index, while the frontrunners' portfolio regularly disappointed in the U.S. (De Bondt & Thaler, 1985; Akkoc, 2003 and Sevim, Yildiz & Akkoc, 2007). Sevim, Yildiz and Akkoc, (2007) submit a trade-off approach of purchasing past underdogs and disposal of past outperformers to succeed in abnormal returns. UIH avows further that uncertainty and risk surge in returns as a result of the announcement of unanticipated news. Perhaps with this, stockholders may not be able to correctly react to startling news with a view to setting new prices lower than their fundamental prices. Therefore, the study submits that UIH is a positive market correction theory using favourable and unfavourable events (Ajayi, Mehdiian, & Perry, 2006; Mehdiian, Perry & Nas, 2008). Shacmurove (2002) observes stockholder responses in thirteen stock markets in Europe with a view to arriving at a consensus

for global support for the hypothesis. The result reveals that UIH is buttressed by four using return variances to unfavourable and the remaining nine are smaller than the return variances of favourable news thereby resulting in a zero summed game. The study also avers that the arrival of surprising information has a negligible impact on European market's instability. Thus, investors in Europe's smaller exchanges respond to uncertain news in an efficient and rational manner. In contrast to the findings of Shacmurove (2002), it has been shown by Sevim, Yildiz, and Akkoc, (2007) and De Medeiros (2005) that Brazil investor reacts differently. The study concludes subsequent to positive news and events, prices surge and a negative event, decreases stock prices immediately with a reversal in five days confirming overreaction. Mehdian, Perry and Nas (2008) confirm no statistical significance supporting reversals in Turkey market though confirm robust evidence of positive increasing abnormal returns to positive news as well as negative news.

Erzurumlu (2011) submits that OH are real for Borsa Istanbul and EMH are real for her Market companies and Derivatives stock but not applicable to investment trusts following unfavourable events. The study opines it was as a result of high liquidity and information efficiency in the Turkey market. Rezvanian, Turk and Mehdian (2011) find consistency in their study of UIH, using Chinese equity prices where returns fall below fundamental values in reaction to sudden information. The paper is arguing that these actions could have been as a result of technical analysis over time to see how trends of events are likely to repeat it. Researchers opine that where well-known information is integrated into efficient market prices with certainty, the anonymous influences will not be termed market risk rather they should be called market uncertainty (Sevim, Yildiz & Akkoc, 2007; Pham, Nguyen, & To, 2008; Slovik, 2011; Rezvanian, Turk & Mehdian, 2011).

Efficiency in market prices is a truism with respect to revealed factors. Consequently, using the perception of market stability, the degree of market uncertainty of different assets and business models are more reliable indicators than market risk. The assertion made by the efficient market theories is that markets integrate all acknowledged information with instant changes that reveal these new events. These unknown events and information expand and contract due to constantly changing socio-economic system which makes the initially available and knowledgeable information become out-dated and shrink with time. Whenever new information becomes available, efficient markets and prices adjust to it (Eboigbe & Osamwonyi, 2018). This is done with a slow speed of corrections as new information, knowledge, and experience come into the well-known information to the liquidity and information traders (De Medeiros, 2005; Eboigbe & Osamwonyi, 2018).

On the other hand, this paper argues that researchers cannot discount the fact that some new information, different realities, or first-hand knowledge are substantially important to the extent of changing previous beliefs. There adjustments of market prices occasioned by changes in sets of information and knowledge sometimes take place slowly over a period and precipitously. It is, therefore, a maxim that the bigger the public surprise relating to this tripod (new information, first-hand knowledge and different realities) the more effectual is the readjustment and integration of these information into the asset prices (Bloomfield, Libby & Nelson, 2000; Ajayi, Mehdian, & Perry, 2006; Bush, Mehdian & Perry, 2010; Erzurumlu, 2011).

Model Specification

In line with the study objective of determining the connection between political events and returns from the capital market using the postponed 2015 general election, the market model analytical approach was preferred. This model does not assume random walk theory in market portfolio returns coupled with its robust certainty in joint returns normality (see Campbell &

Wasly, 1997 & Mackinlay, 1997). To estimate normal market performance, this econometric expression comes to the fore.

$$R_{it} = \alpha_i + \beta_{im}R_{mt} + \varepsilon_{it} \quad (1)$$

Wherein R_{it} = returns of i in time t .

R_m = market returns in time t .

α_i, β_i = regression coefficients

ε_{it} = error terms for stock i in time t .

Mathematically decomposed thus:

$$R_{it} = \alpha_i + \beta_i R_{mt} \quad (2)$$

Changes in prices/returns for each stock is determined as follows:

$$R_t = \ln\left(\frac{SP_t}{SP_{t-1}}\right) * 100 \quad (3)$$

Where R_t = returns in time t

SP_t = price in time t

SP_{t-1} = prior period price

\ln = logarithm of the relation

Abnormality of returns will be computed. This is the variation between actual return and expected returns on the event window using the enhanced form of equation 1 above, where the residual term is the abnormal return (see also Eboigbe, 2016). For any particular time period (Eriki & Eboigbe, 2012), the relationship of the excess return is as expressed below:

$$AR_{it} = R_{it} - (\alpha_i + \beta_{im} R_{mt}) \quad (4)$$

Testing is on the basis of the needs to define the nullity of the hypothesis and techniques for summing up the results of the firms within the study period. Interestingly, the average abnormal return (AAR) which represents the aggregate of the returns for each period within the testing circle divided by the number of days therein and summed together, result in cumulative abnormal returns. This is computed using this formula: $CAR_i = \sum AR_{it}$ (5)

Where AR_{it} is abnormal returns on i assets in time t .

The a priori expectation is given where the returns are zero, denoting no impact. Interpretations, therefore, is reached using the t -statistic as stated below:

$$t = CAR_i / (\sigma_i / \sqrt{n}) \quad (6)$$

Where σ_i is an error term

n is the number of days within the study circle or period.

To incorporate election-driven information impact, the variance in stock prices and associated returns for the pre-, post and days without elections (that is postponement) were computed using this formula.

$$Var = \frac{1}{N_j - 1} \sum_{t=1}^{N_j} (R_{it} - \bar{R}_{ij})^2 \quad (7)$$

Where N_j = No of days (before, after and without an election),

R_{it} = returns of i in day t ,

\bar{R}_{ij} Denotes the mean/average return for N_i in order to test for the UIH, F-test is performed to match the volatility of pre-election window with that of post-election. The argument here in the paper is that election postponement tends to deepen market instability. Therefore, the changes in returns during the election period are considerably higher than that of the non-election period (Bush et al., 2010; Akkoc & Ozkan, 2013). And using panel data estimation technique, economic variables from diverse industries over the specified time are used in the estimation (Greene, 2002; Woodridge, 2001). Morgan Stanley Capital International (MSCI) daily stock market data for 2013Q1-2016Q3 were used.

Analysis

The test of uncertainty information hypothesis is performed based on the effects of election postponement in 2015 on the nation's capital market prices and the associated returns as shown in Table 1.

Table 1: Election Postponement and Stock Returns in Nigeria

Variable	Coefficient	t-Statistic	Probability
Constant	394.6**	148.8	0.0
pre postponement	-0.118**	-7.93	0.0
pre-election	-0.118**	-7.88	0.0
pre-swearing-in	-0.092**	-6.31	0.0
post-postponement	0.063**	5.01	0.0
post-election	0.054**	4.29	0.0
post-swearing-in	0.022	1.63	0.10
Lag	0.908**	28.5	0.0
R-sq.	0.958	F-statistic	43.9
Adj. R-sq.	0.955		

** denotes significance at 5% level

Source: Authors' computations 2018

In the result above, only the coefficient of the post-swearing-in event was not significant at the 5 per cent level. Coefficients pass 1 per cent level significance, thus suggesting that each of these events had a substantial effect on stock prices and associated returns.

In particular, the coefficient of pre-election postponement (which shows the effect of the election postponement news before the election date) is significant and negative. This shows that election postponement had negative impact on the stock returns in Nigeria. It led to 11.8 percentage points drop in market returns. Stock returns also fell meaningfully before the elections, perhaps due to the uncertainties surrounding the event of the election itself. The pre-swearing-in event also had a significant negative impact on stock returns in the market. Interestingly, all the

post-event coefficients are positive. This indicates that after the elections, the stock market tends to normalize and improve its performance.

Summarily, the regression analysis herewith shows the investigation of the variance of stock returns for the period before and after the postponement, election events and swearing-in periods in Table 2.

Table 2: Variance Difference Results

Period	Variance		Bartlett	Levene	Brown-Forsythe
	Pre	Post			
Pre-post-election	177.3	345.3	34.3	55.69	15.3
Pre-post- postponement	542.9	261.8	50.03	76.1	18.4
Pre-post- swearing-in	16.12	9.35	27.11	50.1	14.5
Non-event period	14.7		-		

Source: Authors' computations 2018

It can be seen that the variances were higher for the pre-postponement period compared with the post-postponement period. The test of significance also shows that the differences are significantly different from zero. This implies that the variability of the stock returns shot up during the period when the election postponement was announced.

Conclusion, Policy Implication and Recommendations

The study revealed a strong linkage background for evaluating politics and stock market effects. The issue of volatility in stock prices and its relationship with the country's exchange rates empirically investigated manifests the nexus of politics and key macroeconomics fundamentals (Eboigbe, 2016). Nigeria election postponement has impacted stock returns adversely. Eboigbe and Okwuosa (2018), where trends in elections cycle sometimes yield recurring fluctuation in national economic activity due to the interplay of deliberate and unnecessary government incentive and the restriction is further confirmed by this study. This is particularly possible where policy reversals in the cutting of public expenditures, manipulation of money supply and interest rates manifests. This is done to correct the artificial prosperity driven by electoral manipulation. These political distortions of the equilibrium rate of variables such as employment, inflation and interest rates, trade balances as well as productivity are corrected through the restoration of previously collapsed restraints and incentives.

Apparently, issues of politics as it relates to either the financial markets or overall economic performance is an emerging behavioural finance issue. The Uncertainty Information Hypothesis appears to be operational in the Nigerian Stock market with respect to election postponement. The results show that uncertainties surrounding presidential elections postponement in 2015 in Nigeria had strong adverse properties on the firmness of stock prices in the market. Arguably, the more transparent a market is the more efficient the prices discovery will be notwithstanding the fact that too much transparency shrinks liquidity as participant becomes unenthusiastic in revealing their intents to trade. Traders' advantaged by private information signs prefer anonymous systems while those for liquidity with a credible claim and no information-inspired prefer greater information disclosure. Here portfolio rebalancing which means changing the portfolio composition by investors to diversify portfolio risk seldom results from markets imperfections occasioned by various frictions such as politics (Eboigbe, 2016).

Conclusively, since volatility in capital asset pricing denotes instability and unpredictability of market direction and size, it is, therefore, a truism that a flaw from market microstructure regulation will result in a hostile effect on price, liquidity and market volatility. Hence, it is intuitively recommended to strengthen and professionalize nation's institutions whose functional impact determines national deliverables.

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