The Impact of the United State Presidential Election on Jakarta Islamic Index Stocks: Bid-ask Spread Perspective

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Abstract: The political event which associated with the capital market is one of the interesting phenomena to be investigated. The aim of this study is to explore the impact of the United State Presidential Election against the liquidity of Jakarta Islamic Index. Bid-ask spread with Corwin and Shultz formulation was employed as liquidity proxy. This study conducted an event study and regression methodologies. The results of this study reported that after the event date experienced a higher bid-ask spread on the first and the second day than the previous event date. These findings imply that this event has information content.

JEL Classification: G12, G14, G19

1. INTRODUCTION

International events or news have an effect on countries' internal and external policies and since this effect is reflected on the market, the decisions of domestic and foreign investors are revised continually (Bozkurt and Kaya, 2015). A political event is one of the events that indirectly affected the capital market. Political events do not interfere directly the capital market however these are one of the information absorbed by investors in the capital market and use it to obtain expected returns in the future. Such information influences investor decision making and ultimately the market reacts to that information to achieve a new equilibrium (Haymans, 2006). According to Tzachi Zach (2003) who investigated return patterns of Tel Aviv Stock Exchange index and Israeli firms' stocks traded in the US following announcements of news related to the peace process found that the pattern was not present in Israeli stocks that were traded only in the US. Additionally, the study which investigated political events on Taiwan's stock performance found that price reactions to most of the political events are rather insignificant, implying those events be largely uninformative with only a few exceptions (Chen, Bin, and Chen, 2005). However, according to Amihud and Wohl (2004) who investigated the political event effects which are proxy by the

overthrow of Saddam Hussein from the power against the market stocks found that the connection between the prices of "Saddam contracts" and stocks prices, oil prices and exchange rates are pretty strong. In addition, Bozkurt and Kaya (2015) found that Iran related internationally significant good (bad) news had an impact on both Turkey's political risk and ISE-100 index in a positive (negative) way.

The US presidential election on 8 November 2016 was responded negatively by the investor. A market negative reaction can be seen from the weakening of several indices in the US and the world after the US presidential election. Tribun-Bali.com (2016) reported that stock exchange drops drastically after Donald Trump is appointed as the US elected president in where the stock market registered freefall on 9 November 2016 on Wall Street, the Dow Jones futures market fell 3.2 percent or 489 points at 17,803.00. S and P futures fell 3.1 percent to 2,070.10. In Asia, Hong Kong's Hang Seng slumped 2.0 percent to 22,446.77 and South Korea's Kospi shed 2.3 percent to 1,958.38. The Shanghai Composite Index fell 0.6 percent to 3,128.37 and sank in Australia's ASX S and P / 200, 1.9 percent to 5,156.60. Additionally, the Composite Stock Price Index (IHSG) on the Indonesia Stock Exchange was slipping 1 percent on Wednesday's trade. Even the fall of the IHSG continued until Friday on 11 November 2016, when the index closed

at 5,289, falling 161 points compared to the previous day's closing (Kompas.com, 2016).

Donald Trump's controversial policy which he repeatedly stated when campaigning was to prohibit Muslims from entering the US. His statement is also listed on Trump's official campaign website (Liputan 6, 2016). Regarding his policy plan, it will be influenced on the capital market. And no exception for Indonesia which the society is the largest Muslim in the world, there are Islamic indices in Indonesia capital market, such as Jakarta Islamic Index (JII)[1] and Index Saham Syariah Indonesia (ISSI).

The political events could be a positive or negative effect towards capital market. Due to decreasing the IHSG after Donald Trump won, it can be said that this event was responded negatively by investors at Indonesia capital market.

The objective of this study is to explore the reaction of bid-ask spread as liquidity proxy of JII stock against the political event, namely the US presidential election. This study is interesting because this study employed bid-ask spread for liquidity proxy by using the formulation of Corwin and Schults (2012) which quantify bid-ask spread from the daily high and low prices of stocks in which no prior work conducted on this issue. In addition, the results of the previous studies regarding this issue is varied, therefore this research conducted.

The next section presents the methodology. Literature reviews regarding the political event, and Sharia investment and liquidity in Section 3. The Empirical Results in Section 4, and the Discussion and Conclusion are in Section 5 and Section 6 respectively.

2. METHODOLOGY

This research employed an event study and regression methodologies. November 8th 2016 was

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[1]Jakarta Islamic Index (JII) is sharia compliant index which has thirty sharia stocks. It's based on Islamic principles such as company does not conduct activities: gambling, interest rate based on banking, speculation etc. They also have less debt and high market capitalization and high liquidity. JII stocks will be evaluated every six months which one meets the requirement. The JII screening could be seen in http://www.idx.co.id/en-us/idx-islamic/islamic-product/ and http://www.idx.co.id/en-us/idx-islamic/islamic-stock-index/)

selected as an event date due to that day was the US presidential election. For regression, this study used regression of bid-ask spread.

The data of this study employed JII stocks sample which consists of 30 stocks for a period of June – November 2016. The data used is the daily high and low prices of JII stocks during the US presidential election in 2016. All data retrieved from the Indonesia Stock Exchange.

Additionally, liquidity proxy employed the Corwin and Schultz formulation with the high–low spread estimate (Corwin and Schultz, 2012) to quantify the liquidity surrounding the US presidential election by using daily high and low prices of stocks for the bid-ask spread. The prior study which used the formulation was conducted by Listyaningsih and Krishnamurti (2016). Equation (1) presents its formulation

$$S = \left(\frac{2(e^{\alpha} - 1)}{1 + e^{\alpha}} \right) \quad \text{.....................................} \quad (1)$$

where S is bid-ask spread and e is exponential.

$$\alpha = \frac{\sqrt{2\beta} - \sqrt{\beta}}{3 - 2\sqrt{2}} - \sqrt{\frac{\gamma}{3 - 2\sqrt{2}}} \quad , \quad \beta = \sum_{j=1}^{1} [\ln(\frac{H_{t+1}^0}{L_{t+1}^0})]^2 \quad ,$$

which is the sum of expected squared ratio of high and low prices ratio for two consecutive days.

Gamma (γ) equals $[\ln(\frac{H_{t,t+1}^0}{L_{t,t+1}^0})]^2$ a squared ratio of high and low prices over a range of two days (Listyaningsih and Krishnamurti, 2016).

This study employed t-test by using 21 event window (Krishnamurti, Sawicki and Zhongqi, 2006). The regression of the market model is presented in equation 2.

$$S_{it} = \beta_{0i} + \beta_{1i} S_{mt} + e_t \quad \text{....................................} \quad (2)$$

In where S_{it} indicates Spread on stock i for period t, S_{mt} indicates market spread on IHSG for period t as a proxy of market spread and β_1 and β_2 are the regression coefficient of S_{mt} and e_t is the error term.

3 LITERATURE REVIEW

3.1 Political Event

The capital market could be affected by political events such as elections, reshuffle cabinet, political

instability, and some event-derived factors external economy. There was GDP growth is associated with the prediction of Wall Street, as defined by the change in stock price immediately after the presidential election. This relationship has strengthened over time (Chien, Mayer, and Wang, 2012). However, according to Sudewa and Sari (2015) who investigated the reaction of LQ 45 stocks against Indonesia presidential election in 2014 found that the results obtained indicate that there is no market reaction during the 2014 presidential election and there is no difference in the average abnormal return between before and after the 2014 presidential election. Likewise the study which conducted by Yuniarthi and Sujana (2016) in which the result is the same due to the market reaction will tend to wait and see the certainty of the leader which is selected later.

The other study conducted by Sihotang and Mekel (2014) who investigated the company of construction, infrastructure and utilities listed on the Indonesia Stock Exchange towards Indonesia presidential election in 2014 found that there were no significant differences between abnormal returns before and after the presidential election, however there was a significant difference between trading volume activity before and after the Presidential Election. Additionally, there was an increase in the average volume of stock trading at before and after the presidential elections in 2014 on LQ 45 index (Diniar and Kiryanto, 2015). The result of the other study found that market overreaction was only found in winner stocks in the period after the US presidential election. This research did not find the price reversal on the winner and loser stock due to only one stock sample that experienced market overreaction marked by increasing CAR rank in the extreme, while other stocks did not show it (Sabina, and Sulasmiyati , 2017). In sum, the results of this issue are varied therefore this research is interestingly conducted.

3.2 Sharia Investment and Liquidity

Islamic framework of the stock market is no predetermined interest rate, excess speculative activities and asymmetric information (Kia, 2015). Islamic investment differs from conventional investing in different ways such as the prohibition of gambling, pork, alcohol, entertainment, tobacco, profiting from interest rates etc (Kumar and Sahu, 2017). The screening process applied to Islamic investment (Peillex and Rangau, 2015). Therefore, it can be said that this investment is based on faith.

This study investigated whether the US presidential election has information content, if there is information content therefore, it is expected that the market will react towards this issue. The reaction regarding this issue can be seen from the liquidity, in this term I used the bid-ask spread as liquidity proxy. An interesting aspect of this study is that no previous work which conducted in the bid-ask spread with Corwin and Schultz's formulation regarding this issue.

Based on theoretical background in which the event of the US presidential election was responded negatively by investors, and also due to the characteristics of JII stocks which is including blue chips stocks and sharia-compliant stocks, therefore, I expect that JII stocks experience an increase in bid-ask spread. Therefore, this study posits the following hypothesis:

H1: JII stocks experience an increase in bid-ask spread after the United State Presidential election.

4. EMPIRICAL RESULTS

4.1 Paired Sample t-test

Table 1 shows that on the first day and the second day after the event date, the bid-ask spread is significantly higher than the previous event date. However, on the third day and the fourth day after the event date, the bid-ask spread is significantly lower than the previous event date. From the fifth day up to a ninth day after the event date, the bid-ask spread increases significantly. The results support the hypothesis in which after the event date there was an increase in bid-ask spread

Table 1: Paired sample t-test of the daily bid-ask spread

| Days | Average of bid-ask spread | | t-statistics | p-value |
	Before	After		
1	0.03446	0.04716	-5.578	0.000
2	0.04044	0.05787	-4.510	0.000
3	0.03944	0.01113	5.177	0.000
4	0.03751	0.00697	4.917	0.000
5	0.03242	0.05594	-6.167	0.000
6	0.03156	0.04646	-4.018	0.000
7	0.02599	0.03572	-4.517	0.000
8	0.02595	0.03204	-3.035	0.005

9	0.02507	0.03277	-2.613	0.014
10	0.02224	0.00534	3.704	0.001

** and *** denote significance at 0.05 and 0.01 levels
respectively

4.2 Regression Results

Table 2 reports that the results of a regression of daily bid-ask spread having the adjusted R square value is 73.6%. Additionally, the market bid-ask spread coefficient is significantly positive at 1% level. It suggests that market bid-ask spread affects the JII bid-ask spread. It means that the event of the US presidential election has influence JII stocks liquidity. Additionally, the regression result supports the paired sample t-test in which there is a significant difference in bid-ask spread before and after the event date.

Table 2: The Results of Regression
The daily bid-ask spread regression on JII stocks: 25 October – 22 November 2016.
$$S_{it} = \alpha_i + \beta_{1i} S_{mt} + e_t$$

	Variables	β	t	p-value	Adj R^2
	Constant (α_i)	0.026	14.856***	0.000	
Eq. 1	Market bid-ask spread ($\beta_1 S_{mt}$)	0.825	7.542***	0.000	0.736

*** denotes significance at 0.01 level

5. DISCUSSION

This study found that there was an increase in the bid-ask spread of JII after the event date on the first and the second day due to negative response of investors to this event. So that when the event comes, the JII led higher bid-ask spread. However, an increase in bid-ask spread was not in a long term. Nevertheless, it can be said that this event has information content.

6. CONCLUSION

The result of this study found that there was an impact of the US presidential election on the bid-ask spread of JII stocks. The bid-ask spread runs into an increase after the event date. This result suggests that the event has information content.

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