Impact of financial development on sentiment-return relationship: Insight from Asia-Pacific markets

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Abstrak

Using investor sentiment created from the first principal component of consumer confidence index, advance/decline ratio, and volatility premium, the paper examines its connection with future stock returns in six Asia-Pacific markets during the period from January 2004 to December 2016. The empirical results suggest that market sentiment can be a valid predictor of stock returns in short-term horizons. Additionally, by decomposing total sentiment in each market into regional and local indices, we find that the market-level results are driven mostly by local sentiment. More importantly, this study detects that the differences in financial development across markets have a significant influence on the sentiment-return relationship.