

Contents

1 Emerging Markets: Overview and Performance Analysis	1
1.1 Basics of Emerging Markets	1
1.1.1 The Concept of Emerging Markets	2
1.1.2 Dispersions Among Emerging Markets	3
1.1.3 Capital Markets	5
1.2 Risk and Return Characteristics of Emerging Stock Markets	11
1.2.1 Risk and Returns	12
1.2.2 Correlation	14
1.3 The Process of Market Integration and Risk-return Tradeoff	16
1.3.1 The Case of Complete Integration	16
1.3.2 The Case of Partial Market Integration	17
1.4 Specific Risks	18
1.4.1 Political Risk	18
1.4.2 Liquidity Risk	19
1.4.3 Currency Risk	19
1.5 Investing in Emerging Markets: Why and How?	20
1.5.1 Advantages of Emerging Markets	20
1.5.2 Accessibility to Foreign Investors	22
1.5.3 Market Entry Methods	23
1.5.4 The Future of Emerging Market Investments	24
1.6 Summary	26
References	27
2 Dynamic Process of Financial Reforms	29
2.1 Oil Shocks and Economic Recession in the 1970s	29
2.2 Financial Liberalization as a Solution to Economic Development	30
2.3 Liberalization Methods and Indicators	31
2.3.1 Official Versus Effective Liberalizations	31
2.3.2 Liberalization Indicators	32
2.4 Dynamics of Liberalization Process	39
2.4.1 The Gradual Process of Financial Liberalization	39

2.4.2	The Intensity of Liberalization	40
2.4.3	Challenges in Measuring Liberalization Effects.	43
2.5	Financial Impacts of Liberalization	44
2.5.1	Cost of Capital	45
2.5.2	Observed Volatility.	47
2.5.3	Unconditional Cross-Market Correlation	50
2.5.4	Stock Market Development.	53
2.6	Summary	53
	References.	54
3	Asset Pricing Models.	55
3.1	Introduction	55
3.2	The Capital Asset Pricing Model	56
3.2.1	Theoretical Framework of the Model	56
3.2.2	The CAPM	58
3.2.3	Extensions of the Original Model	60
3.2.4	Empirical Test of the CAPM.	62
3.3	Arbitrage Pricing Theory	64
3.3.1	Theoretical Framework of the Model	64
3.3.2	Derivation of the Valuation Relationship.	66
3.3.3	APT and CAPM	67
3.3.4	Extensions of the APT: Towards the Equilibrium APT	68
3.3.5	Empirical Test of the APT	68
3.4	Particularities of Asset Pricing in Emerging Markets	69
3.5	Summary	70
	References.	71
4	Threshold Stock Price Adjustments	73
4.1	Introduction	73
4.2	Economic Justifications of Nonlinearity in Stock Price Dynamics	74
4.2.1	Market Microstructure Approach.	74
4.2.2	Behavioral Finance Approach	75
4.2.3	Nonlinearity and Emerging Stock Markets	76
4.3	Threshold Econometric Modeling	78
4.3.1	Brief Presentation of Threshold Models	78
4.3.2	Mixing Tests.	80
4.4	Empirical Results and Discussions.	81
4.4.1	Data and Preliminary Tests	81
4.4.2	Mixing Test Results	82
4.4.3	Estimation of ESTECMs	82
4.4.4	Essays in Nonlinear Modeling of Oil and Stock Market Linkages	85
4.5	Summary	88
	References.	89

5	Evolving Stock Market Efficiency	91
5.1	Theory of Stock Market Efficiency	91
5.1.1	The Concept	92
5.1.2	Consequences of the Market Efficiency	93
5.1.3	Three Forms of Informational Efficiency	95
5.1.4	Empirical Evidence	96
5.1.5	Anomalies to Market Efficiency	97
5.2	Informational Efficiency in Emerging Stock Markets	98
5.2.1	Challenges to Market Efficiency	99
5.2.2	Usual Tests and Evidence on Market Efficiency	101
5.2.3	Financial Liberalization and Market Efficiency	103
5.3	Structural Reforms and Hypothesis of Evolving Efficiency	105
5.3.1	Rationale of the Evolving Efficiency	105
5.3.2	Econometric Specification	106
5.3.3	Weak Form Efficiency and Transaction Costs	108
5.4	Results and Discussions	109
5.4.1	Summary Statistics	109
5.4.2	The Evidence of Time-Varying Predictability	110
5.4.3	The Effect of Financial Liberalization	115
5.5	Implications of the Results	119
5.6	Summary	119
	References	119
6	Stock Market Volatility	123
6.1	Introduction	123
6.2	Financial Risk and Its Assessment	124
6.2.1	Empirical Approach	124
6.2.2	Probabilistic Approach	125
6.3	Behavior and Sources of Emerging Market Volatility	126
6.4	Time-Varying Volatility Models	127
6.4.1	Linear ARCH Models	128
6.4.2	Nonlinear ARCH Models	130
6.4.3	ARCH-M Models	131
6.4.4	Volatility Modeling and Tests	132
6.4.5	Empirical Evidence on Emerging Market Volatility Using GARCH Modeling Approach	133
6.5	Empirical Applications of GARCH Modeling	134
6.5.1	Data and Preliminary Analysis	134
6.5.2	GARCH-Based Models for Emerging Market Volatility	137
6.6	Summary	142
	References	143
7	Globalization and Market Integration	145
7.1	Introduction	145

7.2	The Notion of Financial Integration	147
7.2.1	The Law of One Price	148
7.2.2	Factors Increasing Financial Integration	150
7.3	Advantages and Disadvantages of Financial Integration	152
7.3.1	Benefits of Financial Integration	152
7.3.2	Disadvantages of Financial Integration	154
7.4	Assessment of the Degree of Financial Integration	155
7.4.1	Qualitative Aspects of Financial Markets Integration	156
7.4.2	Empirical Aspects of Financial Integration	158
7.5	An Empirical Assessment of Financial Integration of Emerging Stock Markets in Latin America	160
7.5.1	Methodology	160
7.5.2	Data and Results	162
7.6	Summary	165
	References	166
8	Dynamics of Market Integration and International Asset Pricing	167
8.1	Introduction	167
8.2	Basic Problems of Asset Pricing in an International Environment	168
8.2.1	The Relationships of the PPP	168
8.2.2	The International Asset Pricing	170
8.3	Equilibrium International Asset Pricing Model (ICAPM)	171
8.4	International Versus Domestic CAPM	173
8.4.1	Assumptions and Notations	173
8.4.2	Pricing Error	174
8.5	The ICAPM: A Tool for Analysis of Portfolio Choice and Market Integration	175
8.6	An Empirical Investigation of the Integration of an Emerging Market into the World Market	177
8.6.1	Methodology	178
8.6.2	Data and Results	180
8.7	Summary	183
	References	184
9	International Financial Crisis and Contagion	185
9.1	Introduction	185
9.2	Financial Crises and Emerging Markets	186
9.2.1	Brief Overview of Past Financial Crises	186
9.2.2	How Does the Current International Financial Crisis Affect Emerging Market Dynamics?	187
9.3	Contagion in Emerging Markets	189
9.3.1	Contagion Definitions and Factors	189
9.3.2	Contagion Effects Within the Current Financial Crisis	190

9.3.3 Contagion Tests and Previous Findings	191
9.4 Empirical Investigation	192
9.4.1 Data Used and Statistical Properties	193
9.4.2 Contagion Tests	194
9.4.3 Contagion Modeling with VAR Model	197
9.5 Summary	200
References	201
Index	203