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# **The Impact of Politics on Stock Return Dynamics in Emerging Markets**

A thesis presented in fulfilment of the requirements for the degree of  
Doctor of Philosophy in Finance at Massey University

**Sireethorn Civilize**

School of Economics and Finance

College of Business

Massey University

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*In dedication to my beloved country and particularly to  
His Majesty King Bhumibol Adulyadej, the King of  
Thailand, in celebration of HM the King's 7<sup>th</sup> Cycle  
(84<sup>th</sup>) birthday anniversary in 2011.*

# ABSTRACT

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It is argued that politics plays a vital role in emerging capital markets. This thesis focuses on three specific political aspects and examines how each of these aspects could impact the stock return dynamics in emerging markets.

Firstly, to examine the relationship between political risk and stock returns, political risk ratings from ICRG observed during the period of 1984 – 2007 is employed for the analysis. This thesis finds the magnitude of political risk change to be larger in emerging markets than in developed ones and the presence of global convergence in political risk between these two markets portfolios after the year 1995. Moreover, the influence of political risk is found to be greatest on the aggregated returns of Pacific Basin markets as opposed to other emerging and developed markets. This essay thus provides important implications for international investors that there are differences in political risk exposures among the different types of market and investing in Pacific Basin emerging markets can increase the level of risk and affect the risk-return characteristic of their investment portfolios.

Secondly, an investigation is made on the differences between the stock returns of ten emerging markets under military and civilian regimes. This thesis provides evidence that there is no significant difference in stock returns between military and civilian governments for eight of the ten markets being examined. However, military rule is found to be a stock price factor for two markets being those of Pakistan and Thailand. Such military returns premiums found in these two countries do not appear to be explained by economic cycle fluctuation, extreme stock market slumps, the error term, or returns volatility. The findings are robust to the control of worldwide stock market movements as well as to the test of spurious regression bias and randomisation-bootstrap. The findings provide important information for investors that the shifts from civilian to military government in Pakistan and Thailand do not increase the risk level of their investment portfolios. However, such findings observed in these two countries are country-specific and cannot be applied to all countries under military governments.

Lastly, the relationship among political connectedness, stock returns, and firm values in Thailand is examined. From a newly hand-collected sample of Thai firms observed over the period 1987 to 2008, this thesis finds that there are differences in the stock returns and financial performance of firms with different levels of political connection. The findings suggest that firms which are connected to higher level politicians are associated with higher stock returns. This is particularly prevalent for firms in tightly regulated industries. Highly connected firms are also associated with better financial performance and earnings prospect than those with lower level of connection. Moreover, this thesis finds the incidence of political connections to be higher for firms with long establishment and listed firms seek political affiliations regardless of where their headquarters are located in Thailand. The evidence strongly suggests that the stock market participants do incorporate factors such as political connection into their investment decisions and the level of corporate political connectedness is a stock price factor in Thailand.

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