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Weak-Form Efficiency of the Saudi Stock Market

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Abstract

This paper reports the results of a series of tests carried out to examine weak-form efficiency of the Saudi Stock Market (SSM). The paper examines whether SSM follows a martingale process. Both traditional and newer econometric techniques were applied to test the data between 22 January 1994 and 31 December 2007 (inclusive) of eight industry-based indexes and a composite index. The outcomes of the ten different tests indicate mixed results. The unit root tests, Lo and MacKinlay variance ratio, and Chen and Deo multiple variance ratio test largely cannot reject the random walk hypothesis for both daily and weekly data. With the run test, and rank- and sign-based single and multiple variance ratio tests, the random walk hypothesis is mostly rejected for the daily data and some of the weekly indexes. Since the data are highly non-normal, the other tests may have low power, and the rank- and sign-based tests may be most appropriate.

I. Introduction

THE EFFICIENT MARKET hypothesis (EMH) deals with the informational efficiency of the pricing of listed securities. In an efficient market, stock prices are said to 'fully reflect' the available information, (Fama, 1976). If a market is efficient, all available and relevant information content that may affect stock prices should be reflected immediately. Fama posits three forms of efficiency: weak,[1] semi-strong, and strong. It is assumed that the semi-strong version of efficiency reflects only publicly available information, while the strong version reflects both public and private information.

In general, efficient allocation of ownership of the economy across various sectors is the prime objective of a capital market. With this objective in mind, the World Bank is promoting securities markets in Third World countries (Aly, 1993). A well-organized stock exchange, functioning under general equilibrium, is assumed to facilitate the financial growth of a country.

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