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Stock Return Predictability and Model Instability: Evidence from Mainland China and Hong Kong[1]

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Highlights

- This paper examines the predictability of the Shanghai Composite, Shenzhen Composite and the Hang Seng China Enterprise index returns, with emphasis on whether considering structural breaks in model parameters improves the stock return predictability.
- Results are important for investors who are interested in investing in Mainland China and Hong Kong stock markets.
- Results indicate higher linear stock return predictability for the Hong Kong market than for the Chinese markets.
- Results differ when model instability is taken into consideration: the Shenzhen market is detected with structural breaks and its predictability varies across different subsamples defined by the breaks.

Abstract

This study examines the predictability of the Shanghai Composite, Shenzhen Composite and the Hang Seng China Enterprise index returns during the period 1993 to 2010, with emphasis on whether considering structural breaks in model parameters improves the stock return predictability. Results indicate higher linear stock return predictability for the Hong Kong market than for the Chinese markets. However, the results differ when model instability is