Print ISSN: 2288-4637 / Online ISSN 2288-4645
doi: 10.13106/jafeb.2016.vol3.no3.17

The Day of the Week Effect in Chinese Stock Market

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Received: April 5, 2016 Revised: April 21, 2016 Accepted: July 18, 2016

Abstract

This study investigates daily stock market anomalies in Chinese stock market, using nine most representative stock indices over an eleven year time period spanning from pre-financial crisis era to six years into the financial crisis. This research is the first to test the presence of the day of the week effect on stock returns in the Chinese stock exchanges during the financial crisis. We find that the day of week effects have been strongly significant in Chinese stock exchanges since 2004. However, unlike the previously found negative Monday effect and positive Friday effect in the U.S., Chinese stock market shows positive returns on Mondays and negative returns on Tuesdays. More importantly, the negative Tuesday effect is only significant after the inception of financial crisis. The results indicate a positive effect on Mondays and a negative effect on Thursdays. More importantly, we find a negative Tuesday effect during the financial crisis, which suggests a spillover of the Monday effect from the U.S. stock market. Our results shed some light on the degree of market efficiency in the largest emerging capital market in the world, and its increasingly close relationship with the U.S. capital market.

Keywords: Day of the week effect, Monday Effect, Weekend Effect, Chinese Stock Market, Financial Crisis.

JEL Classification Codes: C31, G11, G14.

1. Introduction

The day of the week Effect is one of the major calendar anomalies that has been documented extensively in financial markets. This effect has been investigated in different markets. Studies (Cross, 1973; French, 1980; Keim & Stambaugh, 1984; Rogalski, 1984) show that the distribution of stock returns varies according to the day of the week. Monday has been shown to be the "worst" performing day, as the returns on Monday tend to be negative and significantly lower than the average return of other weekdays (Gibbons & Hess, 1981; Jaffe & Westerfield, 1985; Solnik & Bousquet, 1990; Siegel, 1998). Other studies also find higher stock index returns occurring on Friday (Lakonishok & Smidt, 1988). These effects are not limited to the U.S. equity market, but also found in other financial markets including the futures market, Treasury bill market, real estate investment trusts, currency exchange market, and bond market (Cornell, 1985; Dyl & Maberly, 1986; Redman, Manakyan & Liano, 1997; Thatcher & Blenman, 2001).

French (1980) suggests that the weekday effect can be explained by a tendency for firms to delay the announcement of bad news events until the weekend to avoid market disruption. However, Pettengill and Buster (1994) discount this possibility by showing a tendency for weekend announcement to be positive. Some studies suggest that it is caused by the fact that individual investors are usually net sellers on Mondays.

Many studies point to individual investors' behavior. Miller (1998) argues that small investors have time to process information over the weekend and implement trade decisions on Monday. This net sell position may be an adjustment to overbuying securities in the previous weekend driven by the tendency for brokerage recommendations to be primarily positive and to be issued later in the week. Rystrom and Benson (1989) attribute selling activity by individual investors to weekday patterns in psychological well-being, instead of processing time. They argue the lower Monday return is associated with investors being less optimistic on Mondays than on other weekdays. Several studies also find selling activity of individual investors is significantly higher on Monday by examining number of small size trades (Lakonishok & Maberly, 1990; Abraham & Ikenberry, 1994; Brooks & Kim, 1997).

From a different perspective, some studies suggest that

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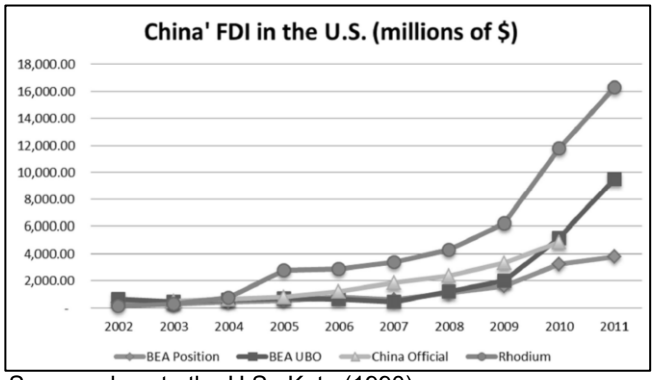
institutional investors avoid buying on Mondays due to the fear of possible private information flows over the weekend (Foster & Viswanathan, 1990; Sias & Starks, 1995; Brooks & Kim, 1997). Wang and Walker (2000) also document a similar finding but argue that less active institutional trading is caused by Monday being a strategic planning day. Chen and Singal (2003) identifies possible trading behavior of short sellers as the possible cause of negative Monday return. They argue that speculative short sellers seek to closely monitor their positions to limit potential losses by closing their open position prior to the weekend. However, short selling should not be impactful in causing the positive Friday returns in the Chinese stock market, since short selling stocks is extremely limited and restricted in both exchanges in China.

Other studies argue that market microstructures, such as settlement procedure, cause this calendar anomaly (Bell & Levin 1998; Draper & Paudyal 2002). Lakonishok and Levi (1982) suggest that stock buyers are willing to pay more for stock purchased on Friday because they have ten days to settle the payment, whereas other trading days require payment in six days. It could also explain low returns on Monday. Clare, Ibrahim and Thomas (1998) also suggest the disappearance of the Monday effect is consistent with a shift in settlement procedures. In Chinese stock market, all index futures settle on Fridays, which usually causes an asymmetric selling pressure in stock market, as short selling is very limited. This concern may cause individual investors to sell stocks prior to the settlement Friday.

For the investors intending to exploit a form of seasonality in the stock price evolution, it is crucial to evaluate its persistence in time. Many anomalies disappeared after their publications. For instance, Dimson and Marsh (1999) showed that the publication of an anomaly could cause its disappearance or reversal. More recent studies have also documented a shift in the weekday pattern of returns. Kamara (1997) finds that the Monday returns of the S&P 500 become positive. He attributes the transaction cost reduction that allows arbitrage against the Monday effect, to this shift. Mehdian and Perry (2001) also find positive average Monday returns over a period from 1964 to 1998. Brusa, Liu and Schulman (2000) find not only positive Monday returns but also negative Friday returns. This reversal is not limited to securities traded in the U.S. market (Board & Sutcliffe 1988; Steeley 2001).

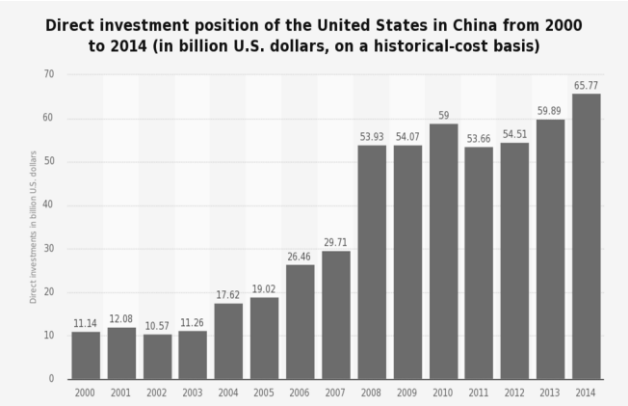
The day of the week effect has also been found significant on other weekdays than Monday and Friday in many other countries (Aggarwal & Rivoli, 1989; Chang, Pinegar & Ravichandran, 1993; Dubois & Louvet, 1996; Tong, 2000). Jaffe and Westerfield (1985) find a similar but not identical effect in Japan, Australia, Canada and the United Kingdom. The key difference is that the lowest mean returns are evident on Tuesday, not Monday, for Japan and Australia. The conventional explanation is a flow-through of the Monday effect from the United States to these markets. Condoyanni, O'Hanlon and Ward (1987) find significantly negative Monday (French index) or Tuesday (the UK index) returns in a study including seven developed markets. They suggest that the negative Tuesday return may be explained by the fact that the French index, unlike the UK index, is compiled before the US market opens. They also find significantly negative Tuesday returns in Australia, Japan, and Singapore. The Japanese market also shows a positive overall Monday return.

This paper is the first to investigate the day of the week effect in China after the inception of the recent financial crisis. Research in the Chinese stock market is important and unique in many aspects. Several studies have described the unique characteristics of the Chinese stock markets (Ma, 1996; Chui & Kowk, 1998; Mookerjee & Yu, 1999; Xu, 2000; Chen, Kwok & Rui, 2001; Chen, Lee & Rui, 2001). The Chinese stock market had previously operated under tight capital controls. In the pre-financial crisis era, even with the implementation of the Qualified Foreign Institutional Investors (QFII) scheme in December 2002, the market was largely insulated and free from foreign influence. This insular nature of the Chinese stock market suggests that price movements may not necessarily be affected by short-term U.S. stock market performance (Ong, 2000). However, this insular nature may have been changed due to the Chinese capital market becoming more related to the U.S. capital market during the financial crisis. Since the inception of financial crisis in 2008, the foreign investments have significantly increased between China and the U.S. (Aoki et al., 2013; Poulsen & Hufbauer, 2011). As <Figure 1> and <Figure 2> show, during the global FDI recession, China has rapidly become an increasingly important host and source of investment for the United States.



Source: close to the U.S., Kato (1990)

<Figure 1> China's FDI in the U.S. (2002 – 2011).



Source: Statista (2016)

<Figure 2> U.S.'s FDI in China (2000 – 2014)**.**

Significantly different day of the week effects found between the class-A and B shares in the Chinese stock market provide supportive evidence to the insular nature before the financial crisis and the possible spillover effect in stocks mostly receiving foreign investment. While individual Chinese residents could only hold domestic currency A-shares, the hard currency B shares are mostly invested by foreign institutional investors. Mitchell and Ong (2006) use the daily stock returns from 1990 to 2002 in China and find that the lowest median and mean returns are on Tuesdays for B shares. The authors suggest that this finding confirms the influence of the U.S. on international markets, as evidenced by its effect on the B share market, which is open to foreign investors. However, the A share market represents more than 99% of the Chinese stock market value and doesn't show a strong negative effect on Tuesdays. Therefore, the strong spillover effects from the U.S. stock market was largely missing before the financial crisis. In a study on a market that is geographically close to China but economically close to the U.S., Kato (1990) finds low Tuesday returns in the Japanese stock market and suggests that it is related to low Monday returns in the U.S.

In this paper, our data sample spanning from 2004 to 2014, enables us to investigate the day of the week effects before and after the inception of global financial crisis. We use daily values of nine most representative indices from major Chinese stock exchanges, in our attempt to identify the day of the week effect. We test two hypotheses in this paper:

<H1> The day of the week effect is significant in Chinese stock exchanges.

<H2> The increased bond between China and the U.S. financial markets causes a Monday effect spillover in Chinese stock exchanges.

The remainder of the paper is organized as follows: Section II describes the data sample and methods. Section III presents and discusses the empirical results. Finally, we summarize the findings in last section.

2. Data and Methodology

Our study includes nine most representative stock indices in China, as shown in the Table I. There are two major stock exchanges in China, Shanghai Security Exchange and Shenzhen Security Exchange. Shenzhen Security Exchange has, other than its main board, two separate markets (Mid-Small Cap Board and ChiNext Board) to accommodate financing needs from smaller companies that may not qualify to be listed in the main market. Our sample

<Table 1> Index Descriptions.

Index	Description	Inception Date in Our Sample
CSI300	Large caps from Shanghai and Shenzhen stock exchanges	Apr. 8th 2005
CSI500	Small caps from Shanghai and Shenzhen stock exchanges	Jan. 1st 2007
SSE180	Large caps from Shanghai	Dec. 31st 2003
SSE380	Mid-Small caps from Shanghai	Jan. 4th 2005
SSE Index	All listed firms from Shanghai	Dec. 31st 2003
Shenzhen Component Index	Large caps from Shenzhen	Dec. 31st 2003
Shenzhen Composite Index	All listed firms from Shenzhen	Dec. 31st 2003
Mid-Small Cap Board Index	All listed firms from Mid-Small Caps Board	Jan. 24th 2006
GEM Index	All listed firms from Growth Enterprise Market Board (ChiNext Board)	Jun. 1st 2010

provides a comprehensive coverage of both stock exchanges. SSE Index and Shenzhen Composite Index cover all listed firms in Shanghai and Shenzhen markets, respectively. We also include the most representative large cap indices for each market, SSE180 for Shanghai, and Shenzhen Component Index for Shenzhen. Small cap companies are also covered by SSE380 for Shanghai, and Mid-Small Cap Board Index and GEM Index (ChiNext Board) for Shenzhen. We also look at the large and small cap indices from both markets combined by including CSI300 and CSI500.

All data are collected from Tongdax in financial database. The sample periods start from the last trading day, Dec. 31st, of 2003, or the inception date of the index, and end on the first trading day, Jan. 5th, of 2015.

Daily market returns of the major stock market indices have been computed and categorized based the occurrence of global financial crisis. The global financial crisis splits the full sample into two groups by Sept. 15th 2008, when the bankruptcy of Lehman Brothers was announced.

We calculate the returns of the indices using the formula:

$$R_t = Ln\ (P_t) - Ln\ (P_{t-1})$$

where

- Rt is the return on the day t;
- Pt is the closing market index price on the day t.

We test the day of the week effects by forming the regression model with dummy variables:

$$R_t = \beta_1 Mon_t + \beta_2 Tue_t + \beta_3 Wed_t + \beta_4 Thu_t + \beta_5 Fri_t + e_t$$

where

-- R_t is the index return on day t;

-- Mon_t is a dummy variable which equals one for Monday and zero otherwise;

-- Tue_t is a dummy variable which equals one for Tuesday and zero otherwise;

-- Wed_t is a dummy variable which equals one for Wednesday and zero otherwise;

-- Thu_t is a dummy variable which equals one for Thursday and zero otherwise;

-- Fri_t is a dummy variable which equals one for Friday and zero otherwise;

If the Chinese stock market exhibits a spillover effect from negative Monday return in the U.S. market, then the estimated coefficient β_2 is expected to be negative and statistically significant.

3. Testing Holiday Effects

<Table 2> presents the descriptive statistics of index returns. The K_W test suggests the presence of seasonality for all indices.

<Table 3> reports the full sample regression results. All nine indices show positive and highest returns. The positive effect is consistent with the statistics in <Table 2>, where all Monday means are positive. More importantly, for all large cap indices and comprehensive indices, the mean returns are all negative on Tuesdays. This finding is consistent with previous studies showing negative Tuesday effect in Japan and Australia. This may indicate a spillover effect from the U.S. stock market, as suggested by many previous studies (Jaffe & Westerfield, 1985; Condoyanni, O'Hanlon & Ward, 1987; Kato, 1990). This effect disappears for middle and small indices. In addition, for all large cap and comprehensive indices, the largest negative effect is on Thursdays. A search for possible explanations of this strong Thursday negative effect points to the Friday settlement effect, which causes investors to sell on Thursdays before index futures' settlement on Fridays. For middle and small cap indices, this effect loses its statistical significance or economic magnitude. There is no consistent significant effect on other weekdays.

In <Table 4>, the most important finding in the pre-financial crisis era is that the negative Tuesday effect disappears for all indices. This is consistent with previous studies on Chinese stock market in the pre- crisis era. Other results are similar with the full sample for Monday and Thursdays.

<Table 5> reports the regression results during the financial crisis. In comparison to the pre-crisis results, the key difference is that the negative Tuesday effect becomes significant during the financial crisis. This effect is also more significant and larger in magnitude than the full sample results. Since the Chinese financial market became more closely related to U.S. financial market during the financial crisis (Aoki et al., 2013; Poulsen & Hufbauer, 2011), it provides further support for the Tuesday effect as the Monday effect spillover from the U.S. Other results in <Table 5> are similar with previous full sample results.

<Table 2> Descriptive Statistics.

Size Group	Index	Return	Mean (Std. Dev.)	K-W Test [p-value]
Large Cap	CSI300	Monday	.0021 (.0217)	16.504 [.0024]***
		Tuesday	-.0011 (.0171)	
		Wednesday	.0016 (.0180)	
		Thursday	-.0013 (.0173)	
		Friday	.0013 (.0160)	
	SSE180	Monday	.0016 (.0210)	15.597 [.0036]***
		Tuesday	-.0010 (.0165)	
		Wednesday	.0014 (.0178)	
		Thursday	-.0014 (.0170)	
		Friday	.0013 (.0157)	
	Shenzhen Component Index	Monday	.0014 (.0220)	14.882 [.005]***
		Tuesday	-.0007 (.0174)	
		Wednesday	.0018 (.0183)	
		Thursday	-.0015 (.0176)	
		Friday	.0011 (.0166)	
Composite	Shenzhen Composite Index	Monday	.0019 (.0214)	25.087 [.000]***
		Tuesday	-.0005 (.0174)	
		Wednesday	.0023 (.0178)	
		Thursday	-.0017 (.0173)	
		Friday	.0005 (.0166)	
	SSE Index	Monday	.0015 (.0197)	17.531 [.002]***
		Tuesday	-.0009 (.0152)	
		Wednesday	.0015 (.0163)	
		Thursday	-.0014 (.0157)	
		Friday	.0008 (.0148)	
Mid-Small Cap	CSI500	Monday	.0026 (.0250)	25.093 [.000]***
		Tuesday	-.0008 (.0212)	
		Wednesday	.0026 (.0202)	
		Thursday	-.0021 (.0204)	
		Friday	.0004 (.0195)	
	SSE380	Monday	.0029 (.0227)	30.651 [.000]***
		Tuesday	-.0004 (.0189)	
		Wednesday	.0025 (.0186)	
		Thursday	-.0018 (.0187)	
		Friday	.0005 (.0178)	
Small Cap	Mid-Small Cap Board Index	Monday	.0025 (.0224)	23.392 [.000]***
		Tuesday	-.0011 (.0193)	
		Wednesday	.0021 (.0186)	
		Thursday	-.0017 (.0186)	
		Friday	.0013 (.0182)	
Extra Small	GEM (ChiNext)	Monday	.0020 (.0217)	16.627 [.002]***
		Tuesday	-.0010 (.0181)	
		Wednesday	.0019 (.0182)	
		Thursday	-.0029 (.0174)	
		Friday	.0019 (.0167)	

*** represents significance at the 1% level.

<Table 3> Full Sample Regression.

Size Group	Index	Return	Coefficient [p-value]
Large Cap	CSI300	Monday (Cons.)	.0033 [.000]***
		Tuesday	-.0017 [.048]**
		Wednesday	
		Thursday	-.0037 [.000]***
		Friday	
	SSE180	Monday (Cons.)	.0025 [.000]***
		Tuesday	-.0019 [.041]**
		Wednesday	
		Thursday	-.0036 [.000]***
		Friday	
	Shenzhen Component Index	Monday (Cons.)	.0024 [.001]***
		Tuesday	-.0018 [.070]*
		Wednesday	
		Thursday	-.0037 [.000]***
		Friday	
Composite	Shenzhen Composite Index	Monday (Cons.)	.0044 [.000]***
		Tuesday	-.0029 [.003]***
		Wednesday	-.0018 [.067]*
		Thursday	-.0053 [.000]***
		Friday	-.0034 [.001]***
	SSE Index	Monday (Cons.)	.0028 [.000]***
		Tuesday	-.0022 [.011]**
		Wednesday	
		Thursday	-.0036 [.000]***
		Friday	-.0021 [.014]**
Mid-Small Cap	CSI500	Monday	.0047 [.000]***
		Tuesday	
		Wednesday	
		Thursday	-.0025 [.054]*
		Friday (Cons.)	.0016 [.070]*
	SSE380	Monday	.0044 [.000]***
		Tuesday	
		Wednesday	
		Thursday	-.0020 [.052]*
		Friday (Cons.)	.0014 [.062]*
Small Cap	Mid-Small Cap Board Index	Monday	.0035 [.003]***
		Tuesday	
		Wednesday	
		Thursday	-.0026 [.024]**
		Friday (Cons.)	.0015 [.079]*
Extra Small	GEM (ChiNext)	Monday	.0043 [.013]**
		Tuesday(Cons.)	
		Wednesday	.0034 [.047]**
		Thursday	
		Friday	.0032 [.060]*

*** represents significance at the 1% level.**represents significance at the 5% level.*represents significance at the 10% level.
Only statistically significant results are reported.

<Table 4> Regression Results: Before Financial Crisis.

Size Group	Index	Return	Coefficient [p-value]
Large Cap	CSI300	Monday	.0051 [.008]***
		Tuesday	
		Wednesday	
		Thursday	
		Friday (Cons.)	
	SSE180	Monday (Cons.)	.0029 [.009]***
		Tuesday	
		Wednesday	
		Thursday	-.0034 [.029]**
		Friday	
	Shenzhen Component Index	Monday (Cons.)	.0026 [.027]**
		Tuesday	
		Wednesday	
		Thursday	-.0032 [.051]*
		Friday	
Composite	Shenzhen Composite Index	Monday (Cons.)	.0037 [.001]***
		Tuesday	
		Wednesday	
		Thursday	-.0041 [.010]**
		Friday	-.0038 [.017]**
	SSE Index	Monday (Cons.)	.0029 [.007]***
		Tuesday	
		Wednesday	
		Thursday	-.0032 [.034]**
		Friday	-.0032 [.031]**
Mid-Small Cap	CSI500	Monday (Cons.)	.0104 [.001]***
		Tuesday	
		Wednesday	
		Thursday	-.0106 [.015]**
		Friday	-.0107 [.015]**
	SSE380	Monday (Cons.)	.0068 [.000]***
		Tuesday	
		Wednesday	
		Thursday	-.0065 [.001]***
		Friday	-.0060 [.002]***
Small Cap	Mid-Small Cap Board Index	Monday (Cons.)	.0063 [.001]***
		Tuesday	
		Wednesday	
		Thursday	-.0066 [.016]**
		Friday	

*** represents significance at the 1% level.**represents significance at the 5% level.*represents significance at the 10% level.
Only statistically significant results are reported.

<Table 5> Regression Results: During Financial Crisis.

Size Group	Index	Return	Coefficient [p-value]
Large Cap	CSI300	Monday (Cons.)	.0025 [.002]***
		Tuesday	-.0028 [.014]**
		Wednesday	
		Thursday	-.0044 [.000]***
		Friday	
	SSE180	Monday (Cons.)	.0021 [.009]***
		Tuesday	-.0024 [.033]**
		Wednesday	
		Thursday	-.0040 [.000]***
		Friday	
	Shenzhen Component Index	Monday (Cons.)	.0023 [.010]***
		Tuesday	-.0025 [.045]**
		Wednesday	
		Thursday	-.0042 [.001]***
		Friday	
Composite	Shenzhen Composite Index	Monday (Cons.)	.0049 [.000]***
		Tuesday	-.0044 [.000]***
		Wednesday	-.0022 [.075]*
		Thursday	-.0063 [.000]***
		Friday	-.0032 [.009]***
	SSE Index	Monday (Cons.)	.0026 [.000]***
		Tuesday	-.0027 [.007]***
		Wednesday	
		Thursday	-.0042 [.000]***
		Friday	
Mid-Small Cap	CSI500	Monday (Cons.)	.0054 [.000]***
		Tuesday	-.0044 [.001]***
		Wednesday	-.0024 [.066]*
		Thursday	-.0068 [.000]***
		Friday	-.0037 [.004]***
	SSE380	Monday (Cons.)	.0053 [.000]***
		Tuesday	-.0044 [.000]***
		Wednesday	-.0026 [.036]**
		Thursday	-.0066 [.000]***
		Friday	-.0037 [.003]***
Small Cap	Mid-Small Cap Board Index	Monday (Cons.)	.0043 [.000]***
		Tuesday	-.0036 [.005]***
		Wednesday	
		Thursday	-.0059 [.000]***
		Friday	-.0030 [.018]**

*** represents significance at the 1% level.**represents significance at the 5% level.*represents significance at the 10% level.
Only statistically significant results are reported.

4. Discussion and Summary

In this research, we intend to find out: first, if weekday effects exists and persists in Chinese stock exchanges; second, how financial crisis impacts the day of the week effect; lastly, if there is a Monday effect spillover from the U.S. stock market in Chinese stock market, like in Japanese and Australian stock markets.

We find that the day of week effects have been strongly significant in Chinese stock exchanges since 2004. However, unlike the previously found negative Monday effect and positive Friday effect in the U.S., Chinese stock market shows positive returns on Mondays and negative returns on Tuesdays. More importantly, the negative Tuesday effect is only significant after the inception of financial crisis. It is consistent with studies on Japan and Australia, suggesting a spillover effect from the U.S. stock market. We also find that the most negative effect is on Thursdays, which may indicate the adjustment to Monday overbids or the Friday settlement effect. The strong negative Thursday effect may be of interest for possible future research.

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