ABSTRACT

This thesis consists of four separate yet related empirical studies. In chapter 2, the thesis reviews the existing literature on regime shifts and financial contagion in the context of developed as well as emerging markets. In chapter 3, the study investigates the regime shifts and volatility from asset allocation and risk management perspectives in the stock market returns of seven emerging markets using monthly data over February, 1996 to January, 2012. Employing Markov regime switching model, the study finds strong evidence of regime switching in mean as well as variance in the examined emerging markets. By analyzing market synchronization and time-varying Sharpe ratios, the study reports that in case of emerging markets, the stock markets provide better risk diversification and hedging opportunities. One of the important hypotheses that this chapter proposes is to confirm whether emerging markets could be considered as homogenous financial asset class. Based on the results, the study concludes that the emerging markets are not a homogenous financial asset class.

In Chapter 4, the study empirically examines the regime dependent dynamics and asset allocation opportunities in the stock markets of eighteen European economies and stock market of USA as global factor for these markets. Covering the same sample period as mentioned above, the study employs Markov regime switching model on sample European markets. After analyzing the properties of market synchronization and Sharpe ratios, the study reports very limited opportunities in the sample European stock markets. Based on the findings, the study also finds that the European stock markets including the markets of Central and Eastern European countries still provide very limited asset allocation and risk management opportunities as these markets appear to be economically and financially homogenous region.

In Chapter 5, the study empirically investigates the role of cross market correlations in cross country risk management especially during the recent Eurozone crisis by
examining the contagion phenomenon. Considering the seven emerging markets, the study analyzed the dynamic conditional correlations model on daily observations of stock market returns for the period February, 1996 to January, 2012. Based on the empirical results, the study reports strong evidence of contagion of Eurozone crisis on emerging markets, though few sample markets also report only interdependence.

In Chapter 6, the study empirically examines the contagion phenomenon in case of European stock markets. Using the daily data for the same sample period of February, 1996 to January, 2012, the study applies dynamic conditional correlation model to examine the contagion effect of Eurozone crisis on European stock markets. The results of this study exhibit strong evidence of contagion effect of Eurozone crisis on European stock markets.

The overall findings of this study can be divided into two parts. First, the analysis of regime shifts and time-varying volatility provides significant evidence of occurrence of bull and bear regimes in stock market returns of emerging as well as developed markets. In case of emerging markets, the study finds strong evidence of possibility of asset allocation and risk management. While, in case of developed markets, the study reports very limited opportunities of investment. The most striking outcome of this study appears to be its rejection of hypothesis of considering emerging markets as a homogeneous financial asset class and acceptance of hypothesis of considering European stock markets as economically and financially homogenous regions. Second, the analysis of contagion effect of Eurozone crisis on emerging and developed markets also provide valuable policy related inputs with regards to coordinated rescue and regulatory measures undertaken to revive these markets.