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## **FOREIGN EQUITY FLOWS AND MARKET RETURN VOLATILITY: EVIDENCE FROM AN EMERGING EQUITY MARKET**

### **Abstract:**

This study examines the impact of foreign equity flows on market return volatility using a unique data set comprising of an aggregate daily trades data by two classes of foreign investors namely institutional and retail investors in an emerging market equity exchange, Bursa Malaysia between October 2009 and February 2015. Specifically, the aims of this study are i) to explore whether foreign equity flows have an effect on market return volatility, ii) to identify which classes of equity flows have an effect on market return volatility and iii) to identify what types of equity trades have an effect on market return volatility. This study employs VAR Granger Causality test and VAR Variance Decomposition to explore the impact of foreign equity flows on market return volatility. The findings of this study reveal that foreign equity flows do influence market return volatility with the value of trades affect market return volatility more than the quantity of trades. Institutional net flows have a bigger impact on market return volatility as compared to the retail net flows. While both the institutional buy and sell trades have an impact on market return volatility, only the retail buy trades have positive relationships with market return volatility. The institutional sell trades appear to explain more the variations in market return volatility than the institutional buy trades. On the contrary, the retail buy trades have more impact on market return volatility than the retail sell trades. The roles of the retail buy trades tend to diminish whereas the retail sell trades become more prominent with the longer time horizon. Similarly, the roles of the institutional buy and sell trades also show significant positive impact on market return volatility overtime. The findings of this study also demonstrate that innovations to foreign equity flows account for a small percentage variation of fluctuation in market return volatility. Thus, there are other factors may also influence the market return volatility.

### **Keywords:**

Foreign equity flows, market return volatility, emerging equity market, institutional and retail investors, buy and sell trades, granger causality, variance decomposition

**JEL Classification:** G11