

Preface

September 15, 2008 did not start as just another day in our lives. The world woke up to the news of the collapse of Lehmann Brothers, the fourth largest investment bank in the US and Merrill Lynch, another iconic investment bank, was acquired by Bank of America. “In a period of less than eighteen months Wall Street had gone from celebrating its most profitable age to finding itself on the bank of an epochal devastation. Trillions of dollars in wealth had vanished, and the financial landscape was entirely reconfigured” (Sorkin 2010).¹

Stock prices across the globe were on a downhill path throughout the year 2008. But something was terribly wrong this time. The ongoing recession soon turned into a doomsday situation as the whole world plunged into a full blown financial crisis. What followed were unanticipated and unprecedented memories of the Great Depression. Between October 2008 and March 2009, Dow Jones fell by 52.5%, a breath short of the record 54.5% between 1929 and 1931, at the height of the Great Depression. Dow Jones was not alone in this race to the bottom. In 2008, Britain’s FTSE recorded its worst fall, a 31.3%; Shanghai’s stock market recorded a 65.2% fall, Germany’s DAX fell by 40.4%, SENSEX went down by 51.9% and Hong Kong stock market saw a fall of 48.3%.² For all who believed that the good times will never end, were in for a very, very rude shock. As the stock market plunged worldwide, the worst nightmare of investors started coming true. As the markets fell, then stopped as if catching a breath to its long way down and then fell again, the age old beliefs and rationales about the market that the market knows best started crumbling down all over. Best put in the words of Alan Greenspan, “the whole intellectual edifice, however, collapsed...”.³ As investors and traders saw the markets come crashing worldwide, economists and researchers,

¹ Sorkin A (2010) *To big to fail*. Penguin, India.

² Record stock market falls in 2008 http://bbc.co.uk/news/world/asia_pacific/. Accessed 24 August 2011.

³ As quoted by Alan Greenspan before the committee of Government Oversight and Reform, October 23 2008. <http://clipsandcomments.com/wp-content/uploads/2008/10/greenspan-testimony-20081023.pdf>. Accessed 24 August 2011.

dumbfounded by the unexpected development, groped for a suitable explanation. And all answers led to one direction ... a prolonged misinterpretation of the market behavior, which stood firmly on the traditional belief of the market's rationality. The stock market collapse had a severe ramification on not only other financial markets but also on people's lives. As by-products of the crisis, millions were soon jobless, homeless and suddenly poor all over the world. Everybody started believing that the "invisible hand" was dead.

Under these circumstances, it becomes important both on part of a researcher and a policy maker to understand what actually causes the turbulence. This book addresses the dynamics of stock prices and investigates into its underlying characteristics with focus on the last two stock market cycles. This study aims to investigate the nature of global stock market dynamics and their association during the financial crises between 1998 and 2011. It identifies two stock market cycles, the first between 1998 and 2003 and the second between 2006 and 2011. The second cycle has been more global in nature. Also, several structural breaks are identified during each cycle, for each market. The breaks in 2007 and especially in 2008 have been largely global in nature, hinting toward a dynamic interlinkage among the markets. The study delves deeper and finds evidence of latent structures in the global stock market around the stock market cycles. Some degree of internal association among the markets is also found to be present. Finally, the study investigates any possible chaotic nature of the stock markets. Results reveal a majority of the markets to be chaotic and all of them being deterministic in nature. This is likely to establish, particularly during the years of the global financial crisis, the inefficacy of the traditional asset pricing models as well as traditional policy tools which largely assume linearity.

Finally, the authors would like to thank Springer Briefs for publishing the manuscript and the anonymous referees for their valuable comments. However, it is us who should be held responsible for any flaw in the study.

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<http://www.springer.com/978-81-322-0462-6>

Anatomy of Global Stock Market Crashes

An Empirical Analysis

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2012, X, 62 p. 7 illus., Softcover

ISBN: 978-81-322-0462-6