Fundamentals Efficiency of the Italian Stock Market: Some Long Run Evidence

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Abstract

A predictive regression approach is adopted to test fundamental efficiency of the Italian equities market on a new long run (1913 to 1999) time series of returns and fundamentals, namely dividend price, earnings price, and price to book. Univariate and vector autoregression significance is tested with Monte Carlo and bootstrapping simulation methods. Some evidence of predictability of stock returns is found especially with respect to the price to book ratio.

Key words: dividend yield; price earning; price to book ratio; VAR; long horizon predictive regressions

JEL classification: G10

1. Introduction

We report some exploratory evidence about fundamental efficiency in the Italian Stock Exchange based on a new and unique database. Working on new data is considered one way to avoid data snooping, especially in the ever flourishing literature about stock return predictability; see Ang and Bekaert (2001) and Rey (2004). Although recently there has been a spate of papers proposing new econometric methods for testing stock return predictability, all these new models have been applied to US data; see for instance Goyal and Welch (2006), Campbell and Yogo (2005a, 2005b), Boudoukh et al. (2005), Moon et al. (2006), and Cochrane (2006).

Studying predictability of US equity returns with respect to the fundamentals information set has become the main research objective of several generations of financial economists in US finance academia. Foreign equities markets have been generally neglected by mainstream economists—Campbell and Shiller (1998) being an exception though they consider a short time series—because they are relatively...