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European exchanges, investor behaviour and asset allocation criteria: Country vs Industry approach

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European exchanges, investor behaviour and asset allocation criteria: Country vs Industry approach

(Alessandro Carretta[1] and Gianni Nicolini[2])

Abstract

The integration of the European exchange industry, which began in the second half of the 1990s and was boosted by (1) the demutualization of securities exchanges, (2) the launching of phase 3 of the UME, and (3) the ICT developments in market management (trading-engine), has now emerged from its embryonic phase and has asserted itself on the international stage. Euronext and Omx are only the most widely known forms of a process that has concerned the European exchange industry for a number of years now.

The European securities market has abandoned a purely national outlook and has opened up to the continent as a whole, wherefore it is interesting to focus on the reaction of European investors. The removal of a series of regulatory (and psychological) barriers has unquestionably fostered the development of cross-border trade, broadening the scope for investment of the single investors and potentially questioning the asset allocation criteria used in the past.

The aim of this paper is to investigate the manner in which the integration of the European securities market has affected the asset allocation criteria of European investors. Based on an analysis of the dividend yields of the principal European markets we intend to verify the predominance, in relation to asset allocation, of geographical versus industry diversification criteria.

It can be plausibly assumed, in fact, that an integrated market, where transactions on foreign markets are one and the same with those on the domestic market, changes its diversification outlook, from Country (e.s. Italy, Germany, UK, etc.) to Industry (Industrials, Basic Materials, Financial, etc.). On the contrary, markets where cross-border trade is considered a scarcely viable alternative will remain attached to an essentially geographical approach.

The assessment as to which approach, Country vs. Industry, prevails on the European exchange market will be made analysing the index trends representative of the principal European markets. Using appropriate statistical methods – cluster analysis and principal component analysis – we will examine how the European market has evolved in the period between 1995 and 2006, also verifying the current situation, besides the development of this phenomenon over the years.

Lastly, the use of time windows taking account of the milestones in the integration of the European exchanges (agreements, alliances, mergers, etc.) shall allow us to verify the extent to which agreements between stock exchanges may affect market performance.

Key words: *integration (market integration), asset allocation, stock exchanges*

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