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THEORETICAL BASIS OF STOCK MARKET CLASSIFICATION

The most common definition of emerging stock markets is stock markets of emerging economies. Most modern stock indices use complex matrices and classification systems to categorise stock markets by degree of sophistication.

Traditionally, three types of stock markets are distinguished by the level of development: frontier; emerging markets; developed markets [1].

A clear understanding by an investor of the key characteristics of emerging stock markets that distinguish this type of market from the other two, serves as a kind of benchmark, a qualitative basis for quantitative analysis and clustering of stock markets in the field of portfolio investment.

The main stock indices are: FTSE Russel, S&P Dow Jones Indices, MSCI.

In early classifications of the FTSE Russel Index, the distinction between developed and emerging markets was blurred and tended to focus on the relative wealth of countries as a distinguishing feature. Analyses for market quality were subjective and lacked depth. The vague criteria and lack of transparency made it difficult for investors to assess the likelihood of countries moving between categories with sufficient reliability [2].

The main factors of stock market classification according to the FTSE Russel methodology:

– volume of gross domestic product (GDP) per capita – assessment of the relative wealth of the country's economy;

– quality of the stock market – the efficiency of government regulation of the organisational structure, mutual settlements, availability of the derivatives market;

– size of the domestic stock market – the latter should have a sufficient level of capitalisation;

– predictability and stability of the market – assessment of its volatility;

– cost limitation – marginal cost (commission) for operations on the financial market;

– accessibility of the stock market – international investors should be able to invest and withdraw funds in a timely, safe manner and at a reasonable price [3].

According to the concept of the MSCI Emerging markets (EM) index, there are three main criteria for the distribution of countries according to the level of stock market development:

– level of economic development;

– size (capitalisation) of companies and liquidity of securities in the financial market;

– market openness to foreign investors [4].

S&P Dow Jones indices use quantitative data to assess and classify financial markets by type: frontier, emerging and developed [5].

Although the methods of market classification by FTSE Russel, MSCI, S&P Dow Jones Indices differ from each other, the global approach to analysing country markets is identical.

Thus, the actual classification of markets by degree of development increases transparency and simplifies the analysis of investors in a particular financial market, allows to assess risks and potential profits faster and with greater reliability, as well as to identify new trends and build their own forecasts.

Stock market analysis includes various methods and techniques of researching its indicators, factors, indicators, etc. To carry out an effective analysis of the stock market, such indicators as stock (stock exchange) indices are used, which are indicators calculated for a representative set of securities (shares, bonds) circulating on the market in order to assess the level and general direction of movement of their value. In general, they are indicators of price changes of a certain group of securities [5].

When compiling lists of major stock indices, preference is given to those whose price behaviour more clearly reflects the state of a particular sector of the economy. There are several methodologies for calculating stock indices. Depending on these methodologies, indices reflect different indicators of securities.

When carrying out activities on the stock exchange, the stock market is analysed every time the subject opens a position. This condition is very important, because when closing a transaction, the subject looks exclusively at the movement of the price of the stock he trades. And since opening a position is the moment when one's own money is at risk, adequate and thorough stock market analysis is the most important component of success in trading.

There are two important reasons that make analysts create and maintain stock indices. Firstly, a stock index competently calculated on the basis of a liquid secondary stock market can serve as a good and convenient macroeconomic indicator for analysis and comparisons. Secondly, the emergence of an objective assessment of the dynamics of the price situation on the stock market (it is believed that a stock index, especially based on a wide sample of shares, gives an objective picture of changes in the price situation on the capital market) creates a necessary benchmark for the analysis of investors' and portfolio managers' behaviour. Thus, when assessing the results of the dynamics of the market value of their stock portfolio for any reporting period, both an ordinary investor and a sophisticated financial manager are equally entitled to compare the extent to which the chosen investment strategy allowed the investor to “outperform” the market (i.e. to achieve a more significant growth rate of the market value of assets than the growth rate of the stock index) or, on the contrary, to “lose” to the market [2-4].

A stock exchange index is a number that characterises the level or dynamics of listed share prices at a certain point in time. All stock exchange indices used in the world practice can be classified according to the following features:

– by the place of calculation and area of distribution;

– by the number of companies represented in the index and the share of stock market coverage;

– by the method of calculation and the nature of use [2-4].

Based on the degree of generalisation of the information under study, some researchers propose to distinguish indices:

– integral (averaged), characterising in general the state of the market under study by one synthetic (generalised) indicator (e.g. Dow Jones index for shares of industrial companies);

– private (local), supplementing the integral index by characterising individual elements or parameters of this market (for example, changes in the share price of individual industrial companies or dividend yield of shares of these companies, etc.) [2-4].

Stock indices are also used to calculate market returns. They can be used to measure price fluctuations for a certain group of securities. Stock indices can be considered analogues of commodity market price indices – both measure the weighted average price level for a certain group of objects. The growth of a stock index over a certain period is the weighted average capital gain of the securities whose prices are used to calculate the index.

In generalised form, the role of stock indices can be summarised into three functions: diagnostic, indicative and speculative. The diagnostic function means the ability of the index system to characterise the state and dynamics of development of both the national economy as a whole and its individual components. For example, a comparative analysis of the movement of national and sectoral indices can show (and partly predict) which sector of the economy tends to rapid, dynamic growth, and which is on the verge of stagnation or crisis. The mechanism of index changes is simple – growth or decline in the profitability of production in an industry or in a significant part of it immediately affects the quotation price of the relevant shares, which in turn is reflected in the level of the stock exchange index of the industry.

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