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ABSTRACT

Zimbabwe experienced forgettable money printing instigated hyperinflation conditions that decimated the viability of all economic sectors during the period covering years 2007 to early 2009. The hyperinflation conditions caused some unusual behaviour of the stock market, whose growth ballooned in nominal terms contrary to economic fundamentals that grappled under the heavily taxing macroeconomic conditions. Fascinated by the phenomenal growth of the ZSE (Zimbabwe Stock Exchange), investors committed huge proportions of their wealth on the bourse, oblivious of whether real value was being generated by the market, and also unmindful of the risks that would manifest when the hyperinflation conditions were contained.

Utilising the underlying assumptions of the Efficient Market Hypothesis and the Rational Expectation Theory, this study investigates the relationship between actual ("ex-post") inflation and stock market returns on the ZSE during the hyperinflation period 30 November 2006 to 30 November 2008, using monthly inflation rates and ZSE returns for the period. The study further exploits the generalised Fisher (1930) hypothesis that nominal stock returns are positively related to nominal inflation rate to ascertain if the ZSE was an effective hedge against inflation during the hyperinflation period. The macroeconomic conditions that inspired the derived results are examined.

In light of the high inflation expectations on the global economy stimulated by increased reliance by governments on quantitative easing measures to address macroeconomic dislocations, the study further searches for the "hyperinflation equity market *aggressive* sector", for investors to overweight in their portfolios because of its inherent ability to award superior returns during and post hyperinflation. The "hyperinflation equity market *inferior* sector" is also identified for investors to underweight during the same period as it awards the least shareholder value relative to other sectors on the exchange. The fundamental causes for the identified sectors' performance are investigated.

The study results indicate that the ZSE was an effective hedge against inflation and that there existed a strong positive relationship between inflation and stock market returns on the ZSE from 30 November 2006 to 30 September 2008, a period that excludes outlier variables for October and November 2008 that recorded atrocious monthly inflation rates. The result is consistent with Fisher (1930) hypothesis, Zvi Bodie (1976), Taufiq Choudhry (2001), Alexander Green, (2003), and Loannidis et al., (2004), who all found a positive relationship between inflation and stock returns in their studies and concluded that stocks were effective inflation hedgers. This conclusion however refutes findings by Geske and Roll (1983), Caporale and Jung (1997) who found an inverse relationship between the said variables and dismissed stocks as inflation hedging assets.

Results for 30 November 2006 to 30 November 2008 that include October and November 2008 outliers show an inverse relationship between inflation and stock market returns, and the stock market as a poor inflation hedge, a result attributed to the astronomical inflation rates recorded towards the end of the hyperinflation phase. The result is agreeable to Frank Bulthaupt (2004) observation that violent economic fluctuations are accompanied by an inverse relationship between inflation rates and stock market performance resulting in stocks being ineffective assets to hedge against rising inflation.

The financial sector and the insurance sector are respectively identified as the aggressive and inferior stock market sectors during hyperinflation. Assertions that the gold sector, World Gold Council,(1992), and NIA USA, (2009), and the properties sector, Chen and Thibodeau, (1984), Miles, (1996) are the superior sectors to invest in during hyperinflation are nullified as the two sectors are depicted as defensive sectors. Further study is proposed on (a) the causal relationship between stock market returns and macroeconomic variables on hyperinflation affected financial markets; (b) deriving the stock market sectoral asset allocation model for hyperinflation besieged markets; and (c) an investigation of the relationship between inflation and *real* stock market returns during hyperinflation episodes.

Key Words; Hyperinflation, Stock Returns, Fisher hypothesis, Inflation Hedge