Reply to Reviewer 1

I appreciate your comments, which have been extremely constructive in improving the paper. In the following reply, I will outline copy comments and my replies. In revising this paper, I also incorporated the editor’s and other reviewers’ suggestions in the paper. Your comments and suggestions greatly strengthen this paper.

(1) Lopes de Carvalho (2017) finds that EPU has great influence on stock returns and conditional volatility, for most of the countries in her sample. Moreover, she also finds that previous stock returns are significant in explaining the current stock returns estimation for many countries.

Reply: Since this question is related to question (6), a comprehensive reply provided below.

(2) Section 2 on the Theory of Market Efficiency should be an appendix, in my view.

Reply: The other two reviewers suggest adding hypothesis testing following the theory. For this reason, I kept the theory of market efficiency in the text.

(3) Page 7 describes Figures 3 and 4, however, there are no Figures 3 and 4 in the paper.

Reply: Figures 3 and 4 now were added.

(4) The title for Table 6 should contain APLA instead of G7.

Reply: The correction of APLA was made.

(5) The content on the last column on Tables 2 and 3 remains a mystery, as it is not described in the text or captions of the paper.

Reply: The content in the last column on Tables 2 and 3 is in the table’s footnote. More specifically, $Q_{12}$ is the Ljund-Box statistics for testing joint significance of 12 order lags. The discussion is in the text toward the end of section 4.

(6) The model presented does not include a significant contribution with respect to Lopes de Carvalho (2017). References


Reply:
Thank you for referring the article by de Carvalho (2017), which has been cited in the current paper. This study differs from that of de Carvalho’s (2017) model in the following ways.

- First, the inclusion of longer lags of EPU in this study allows us to examine the market efficiency of stock returns by testing the presence of lagged news.

- Second, the global news, which is also included in the test equation, helps to specify the EPU effects due to global spillovers.

- Third, the lagged EPU innovation is evidently helpful in explaining the conditional variance. However, the de Carvalho’s specification (2017) only uses the current level of EPU in her test equation, which is inconsistent with the conventional GARCH-X specification.

- Fourth, in addition to G7 markets, the other eight markets, most of which are emerging markets, are also included in the current study. The evidence indicates that stock returns are negatively correlated with the current EPU, but positively correlated with the lagged EPU in the mean equation, which leads us to reject the efficient market hypothesis. Nevertheless, the EPU innovations on conditional variance are less significant for emerging markets when compare with those of the G7 markets.