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A Summary of Recent ADR Return Literature

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Abstract

This paper highlights the various ADR literature dealing with ADR performance versus US market index returns. It includes recent articles dealing with how national elections impacted ADR returns. Also reviewed are articles regarding market timing impacts on ADR investing, ADRs listing from emerging versus developed economies, IPOs and SEOs, country specific ADR results and small firm ADR investing. The majority of the articles are dated 2013 or later.

Keywords: ADR literature; IPOs and SEOs

Introduction

American Depository Receipts (henceforth ADRs) represent equities of foreign firms traded in US markets. Investing in ADRs allows local US investors to obtain international diversification without needing access to international currencies or exchanges because the foreign shares are translated into dollars before trading in the US market. Many ADR studies examine return behaviour utilizing standard IPO methodology which examines excess returns versus a market index [1-4]. These returns are sometimes cumulated over time or computed as holding period returns [5,6]. Practitioners often prefer excess return methods (as used in IPO studies) that make direct comparisons to a typical investor's attainable investment set whereas some academics prefer the use of abnormal return models for event studies based on beta computations and statistical assumptions [7, 8].

Literature Review

Recently, ADRs have been utilized in event studies regarding national elections. For example, the Brexit vote was associated with losses of 15 percent of UK ADR values immediately and an underperformance of 10 percent relative to the S&P 500 index after one year as of the Brexit vote date of June 23, 2016 [9,10]. However, there were no significant abnormal returns associated with 10 large British ADRs on the Brexit announcement date of February 22, 2016 [11]. In non-ADR research, no statistical evidence was found for significant changes in the values of cryptocurrencies after the Brexit vote; however, REITs significantly outperformed the S&P 500 index [12,13]. Other ADR research examined the impacts of the 2016 US Presidential election on ADRs from Mexico and Russia [14-16]. Mexican ADRs lost 7.7 percent of their value the day the election results were made known [14] and proceeded to underperform the S&P 500 index by 19 percent after one year and 41 percent after two years of the election. These results were mainly because the winner of the election was a “surprise event” (due to the media stating he had no chance to win) and the new US President desired to renegotiate trade agreements. In another study of the impacts of the election, cumulative abnormal returns associated with Russian ADRs were concluded by the authors to not have been significantly impacted. ADR research often examines ADRs like IPOs. Returns are computed starting from the day of issuance until a few days or years later, and are compared to a standard market index. A recent study of 354 NYSE-listed ADRs listed from 1990 through 2010 found that, based on 3-year holding period returns, ADRs listed in the 2000s decade performed better than those listed in the 1990s and ADRs sold as Seasoned Equity Offerings (SEOs) had higher excess return performance when compared to the S&P 500 index than those sold as Initial Public Offerings (IPOs). Regression results found the best predictors of ADR performance were regional index returns associated with the country of issue, the date of listing and whether the ADR was from a country with an emerging economy. Studies that examine long term NYSE-listed ADR performance differences based purely on date of the issue (stock market timing) find that ADRs listed in the first decade of the 2000s outperformed those listed in the 1990s when compared to the S&P 500 index over the initial 3-year holding period. This is true for Asia Pacific ADRs, European ADRs, Latin American ADRs, ADRs listed from countries in developed markets and those listed from countries in emerging markets [17-20]. Also ADRs listed and trading through US bear markets (when the US market is correcting) tend to outperform the respective US index, while those listed during US bull markets (while the US index is increasing in value) tend to underperform the US index returns. This timing effect was shown to exist for IPOs and SEOs, Asia Pacific and European ADRs and emerging and developed market ADRs [21-23]. These "market timing" results are often attributed to timing ADR issuance (like that of domestic IPOs) to take advantage of an overpriced market. These same studies find that European ADRs performed better in stable US markets while Asia Pacific ADRs did better in the volatile US markets [22]. Essentially, developed market ADRs tend to perform better in a stable US market whereas emerging market ADRs perform better during times of decline and volatility in the US markets. Another interesting segment of ADR performance studies examines country specific results. Usually China has the most ADRs listed in the US on both the NYSE and the NASDAQ [24]. To put this in perspective, China had over 80 ADRs listed in the US in 2009 while Korea had only a dozen [25]. Although the NYSE-listed Chinese ADRs have outperformed the S&P 500 index overall for a 3-year holding period ADRs from India were the best performers on average versus the US market index from the Asia Pacific region for issues listed from 1990 through 2010 [26-28]. For NASDAQ-traded ADR issues from the Asia Pacific region, Chinese ADRs had the best 3-year average excess performance (29.6%) versus the NASDAQ index for issues listed from 1990 through 2009. However, Japanese ADRs performed better (46%) versus the MSCI Asia Pacific regional index [27]. It is interesting to note that one study concluded that a portfolio of single-listed Chinese ADRs (listed only in the US as IPOs) outperformed a portfolio of dual-listed ADRs. However this may change in the future because many US-listed Chinese firms are delisting in the US and relisting in China due to advantageous policy and regulatory changes in China [29,30]. A final slice of ADR return literature focuses on small firms listed on the NASDAQ. These firms tend to have more informational asymmetry associated with them than the larger firms that list on exchanges (and must therefore meet the extensive information requirements of those exchanges) [31]. One study found that 202 NASDAQ-listed ADRs on average had a 3-year holding period return 13 percent higher than the NASDAQ average [32]. These results were highly skewed due to tremendous performers making up for tremendous underperformers (only 28% of the observations actually outperformed the NASDAQ while the other 72% underperformed). The best NASDAQ-listed ADRs for overall performance were from European developed markets. Another paper compared the NASDAQ ADRs to both the US index (NASDAQ index) and a regional index (MSCI indexes) and found the ADR portfolios containing European and Asia Pacific ADRs performed the same or better than both the NASDAQ index and a respective regional index regardless of the ADRs' listing date or where the ADRs listed from.

Conclusion

There exists an enormous amount of research into American Depository Receipts. This research looked only at articles dealing with ADR return behaviour. To limit the size and scope, only recent articles dealing with events such as the 2016 Brexit and US Presidential elections, market timing studies that differentiate return behaviour based on when the ADRs were issued and from where, popular country and regional studies, and recent small firm ADR articles were briefly highlighted. The overall indication is that ADR returns react to informative announcements just like domestic stocks and that timing plays a large role in how well ADRs do versus the market index. Finally, smaller firm ADRs, like domestic stocks, tend to have very volatile returns with a small number of "winners" more than making up for the large number of "losers".

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