

Relationship between systematic risk and expected stock return on Colombo Stock Exchange (CSE): post war modalities in Sri Lanka

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Prices of common stock are influenced by systematic risk factors. As a proxy for these factors, researchers use market portfolio in empirical investigations. There is voluminous evidence documented on the relationship between systematic risk and expected returns. However, post war cursory look into this model is a vacuum in Sri Lankan context. Thus, this paper attempts to investigate the post war modalities of risk and return in CSE. The sample of this study is all listed companies on the CSE for a period of six years from July, 2009 to June 2015. The FM cross-sectional regression approach is employed in this study. The sample period is first separated into three-year sub periods, which are further divided into a portfolio formation period, a portfolio beta estimation period and a testing period of one year each. The relation between beta and return is tested in the test periods for the total sample (test of unconditional relation) and by separating the total sample into up and down market sample periods (test of conditional relation). The results revealed that a significant unconditional relation between beta and stock return exists only in the total sample period. However, there is no enough evidence to support a significant conditional relation between beta and return in up and down market sample periods. Further, the results of both conditional and unconditional tests in the total sample period are not consistent with those of the sub-sample period (Table).

Results of the Unconditional and Conditional Tests of Beta-Return Relation						
Part A – Unconditional Test	Mean	t-stat	p-value			
Overall sample (2011-2015)	-1.510	-2.704	0.008			
Part B – Conditional Test	Up-market			Down-market		
	Mean	t-stat	p-value	Mean	t-stat	p-value
Overall sample (2011-2015)	-1.462	-1.603	0.113	-1.550	-2.232	0.028
Sub-sample Test periods:						
2011-2012	0.746	1.852	0.085	-0.479	-1.227	0.228
2012-2013	0.197	0.274	0.787	-0.958	-1.811	0.083
2013-2014	-4.265	-2.051	0.050	-3.796	-1.634	0.116
2014-2015	-0.343	-1.659	0.098	-0.214	-0.643	0.522

Keywords: Capital asset pricing model, Civil post war, Conditional relation