ASSET PRICING WITH LIQUIDITY RISK: A SOUTH ASIAN PERSPECTIVE

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Securities liquidity varies over time, which leads to equity return volatility. It implies that the liquidity in the capital markets is a significant source of risk. Therefore, liquidity risk in securities is difficult to diversify and contributes to the systemic market risk. This study aims to analyze the relationship between securities returns and liquidity risk while taking into account the time-varying characteristics of illiquidity on the Colombo Stock Exchange, Bombay Stock Exchange, Pakistan Stock Exchange, and Dhaka Stock Exchange from 2015-2019 and taking into account the effect of liquidity level, using the Generalized Method of Movements (GMM) framework model to assess the persistence of illiquidity securities contributions of the updated version of the Amihud illiquidity proxy to represent across time market illiquidity and to research the time-series relationship between liquidity and returns. Using a broad dataset of 4 countries, this study shows the persistence of stock liquidity globally. It shows that commonality in liquidity exists on an international level and that the relationship is priced in an adjusted LCAPM framework. The outcomes suggest that the diversification of liquidity risk is possible by investing internationally. This study contradicts findings that the illiquidity level of securities is a priced risk character. And estimate a negative liquidity risk premium which suggests a flight to liquidity effect.

Keywords: *Conditional beta; Liquidity risk; Liquidity-adjusted CAPM; GMM Framework; South Asia*