

THE CONDITIONAL RELATIONSHIP BETWEEN BETA AND RETURNS: A SOUTH ASIAN PERSPECTIVE

Fernando, PMS^a, Samarakoon, SMRK^a, Rajapakse, RPCR^b

^aWayamba University of Sri Lanka, Sri Lanka

^bUniversity of Sri Jayewardenepura, Sri Lanka

The capital Asset Pricing Model (CAPM) is one of the most important models in the finance literature, which assumes the existence of a positive linear relationship between the required rate of return and systematic risk on stocks. This paper investigates both the conditional and unconditional versions of CAPM in both individual stock returns and portfolio stock returns between January 2008 and December 2019 on the stocks listed in the Colombo Stock Exchange (CSE), Bombay Stock Exchange (BSE), Karachchi Stock Exchange (KSE). The population of this research includes all the companies listed on CSE, BSE, and KSE and the top 50 stocks with a large market capitalization in each country has been selected as the sample. The unconditional test procedure developed by has been applied to test both beta-return relationships and found that there is a statistically significant individual stock beta - return relationship in KSE in the 2014-2016 observation period but there is no statistically significant unconditional risk-return relationship is found in any of test periods in both individual stock returns and portfolio stock returns in CSE and BSE. The results of the conditional tests show that there is a significantly positive (negative) risk-return relationship in both individual stock returns and portfolio stock returns in PSX and BSE during up (down) market months. In contrast, the conditional test results on portfolio beta-return show that there is no positive (negative) risk-return relationship during up (down) market in CSE but findings indicate a significant positive risk-return relationship in individual stock returns in upmarket periods; whereas, a significant inverse risk-return relationship is not provided in down market periods where market excess returns are negative.

Keywords: *Conditional Relation; Beta and Return; South Asia; CSE; BSE; PSX*
