



Who Moves the Market? Long-term Dynamics between Investor Behaviour and Stock Performance in Sri Lanka

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Abstract

This study examines the long-term interaction between investor behaviour and market performance in Sri Lanka, a representative frontier market marked by moderate liquidity and macroeconomic fluctuations. Using monthly data from 1994 to 2024, investor transactions are categorised by type and origin, including purchases and sales by foreign companies, foreign individuals, local companies, and local individuals. Johansen cointegration and Vector Error Correction Models (VECM) are applied to assess whether these investor groups influence or respond to long-run market dynamics. The results indicate that while overall market movements, proxied by the All Share Price Index (ASPI), significantly affect all investor categories in the short term, only sales by local individuals play a leading role in long-run equilibrium adjustments. In contrast, foreign investors exhibit reactive behaviour, responding rather than anticipating market shifts. These findings question the assumed informational advantage of foreign investors in frontier settings and underscore the critical role of local retail sentiment in price formation. Policy implications include enhancing investor education and managing retail-driven volatility.

Keywords: cointegration, frontier, investor behaviour, price discovery, retail sentiment, stock markets, vector error correction model