Testing the Weak Form Efficiency of Emerging Colombo Stock Exchange (CSE)

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Efficient Market Hypothesis is a dynamic concept because a market which was not efficient in the past could be efficient today with the changes occurring in the capital market environment. Efficient Market Hypothesis can be studied under three forms as weak form efficiency, semi-strong form efficiency and strong form efficiency. This study attempts to test the weak form efficiency of the Colombo Stock Exchange (CSE) and to determine what strategies to follow to make profits in CSE. In this study, daily market closing index of ASPI of CSE for five years, from June 2010 to June 2015, without adjustments, is selected as the sample. Both parametric tests and non-parametric tests were used to analyze the data. This study uses, Augmented Dickey-Fuller Unit Root Test, Autocorrelation Test and Runs Test for analyzing data. Augmented Dickey-Fuller Unit Root Test revealed that the ASPI index series in First Difference is stationary. In this study the log returns of the ASPI is considered for the statistical tests. Autocorrelation Test revealed that the return predictability exists in the CSE and confirmed that CSE is not weak form efficient within the sample period. The results of the Runs Test, which is a non-parametric test, are also consistent with the Autocorrelation Test and confirmed that the CSE is not weak form efficient within the sample period. Therefore, Technical Analysis techniques are valid in the CSE and can be utilized to generate excess returns. However, inclusion of transaction cost to the model will provided more opportunity for further studies.

Keywords: Colombo Stock Exchange, ASPI, Weak Form Efficiency, Technical Analysis, Predictability