TESTING THE WEAK FORM EFFICIENCY AND ANOMALIES IN STOCK RETURNS OF THE COLOMBO STOCK EXCHANGE

Student Name : K.A.G.H. Samarasinghe

Student No : FGS/02/25/01/2008/008

Subject Code : MBA 620812

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MBA Degree Programme- Faculty of Commerce and Management Studies, University of Kelaniya.

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ABSTRACT

The main objective of this research is to examine that the prices reflected on Colombo Stock Exchange (CSE) follow The weak form of the efficient markets hypothesis and anomalies in the returns. Thereby the study is attempted to examine whether past prices can be used to earn Normal or Abnormal profit.

There are three form of random walk hypothesis (efficient market hypothesis). That is Weak Form Efficiency, Semi-strong Form Efficiency and Strong Form Efficiency.

The CSE is responsible for the operation of the stock market in Sri Lanka. Currently it has 232 listed companies and 20 different sectors. All share price index (ASPI) and daily share prices of 50 listed companies of CSE are to be selected purposely, based on the trading intensity and market capitalization for the study and the observation period ranges from 1st January, 1998 to 31st December, 2009 for this study.

The random walk hypothesis is examined using four statistical methods, namely Autocorrelation (Serial Correlation Test), Runs Test, Unit Root Test and the Day-of-the-Week Effect which examine the anomalies in the returns.

Even though the results of ASPI do not support efficient market hypothesis (EMH), the results 50 stocks indicate mixed results. While the Auto correlation, Runs Test, and the Day-of-the-Week Effect indicate some stocks which support the EMH, Unit Root Test reject the EMH completely. At the same time the Day-of-the-Week Effect indicate the Thursday effect on CSE. The sector wise analysis indicates that the manufacturing sector is heading towards the efficiency.

Further research can be conducted to examine the increase or decrease in market efficiency over the period, investors buying and holding preference over such period and reasons for market anomalies such as the Thursday effect on CSE.