Seasonality Effect of Emerging Stock Markets: Evidence from Sri Lanka

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The origin of share trading in Sri Lanka was date back to the 19th century. The Colombo Stock Exchange (CSE) has been one of the best performing stock markets in the Asian region, recording the best ever turnover statistics and a record-breaking growth rate of 35% per annum from 2001 to 2005. Thus returns generated by stock market supersede investment returns of all other competing investment avenues. In addition, the CSE possesses a state of the art infrastructure and a fully automated screen based online share trading system. These attributes have established the CSE as a world class market return of efficiency and fairness. Out of well-admired calendar anomalies this research investigates the existence of seasonality effect of Colombo Stock Exchange (CSE) over 17 years period: 1st January 1994 through 31st March 2007. Seasonal anomalies of stock prices are one of the most actively researched areas in Financial Economics. Seasonality Effect suggests that the share prices tend to behave differently depending on the day of the week, month of the year and following holidays. The majority of the research was confined to the developed capital markets with some research conducted on Asian stock markets. However, none of these studies included the CSE, despite the recent development in the market. Therefore, the main objective of this research is to fill a long-standing research gap in this area. This study employs the logarithmic form of non-dividend adjusted daily return data of the All Share Price Index (ASPI) and use the multivariate regression models with adjustments to control the influence of other events to stock returns and to avoid some of the restrictive assumptions that are inherent to the model. The importance of such adjustments needs to be stressed in order to avoid spurious conclusions. The results indicate the presence of day of the week effect during the period under study with highest (positive) and lowest (negative) returns are observed on Fridays and Mondays respectively. Therefore, it could be concluded that the stock returns in CSE are not in agreement with the Random Walk Hypothesis. This finding will lead to a trading strategy that investors buying shares should avoid Fridays and those wishing to sell should avoid Mondays.

Key Words: *anomalies, emerging stock markets, seasonality effect, stock returns, random walk hypothesis.*