IMPACT OF FINANCIAL DISTRESS ON STOCK RETURNS: EVIDENCE FROM EMERGING MARKET OF PAKISTAN

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Supervisor

Mrs. Hina Samdhani

DEDICATION

I dedicate this thesis to my parents, my sister and my supervisor whose support has enabled me to complete this research study successfully

ABSTRACT

This study explore the relationship between financial distress and stock returns in equity market of Pakistan for the time period of June 2005 to June 2012 by Fama and French (1992, 1993) three factor model and Macbeth and Fama (1973) technique. This relationship is being explored empirically by adding distress factor HMU in three factor model of Fama and French by employing a sample of 100 firms listed on KSE. Analysis of the results reveals that distress factor is priced in equity market of Pakistan. Size factor, value factor and distress factor are found significantly related to returns of portfolio returns at confidence interval of 95%.Traditional model of asset pricing CAPM is found valid for Pakistani market as factor of market is significantly explain returns of all portfolios. However, four factor model is unable to explain the future returns for stock market of Pakistan as results of second pass regression are substantially insignificant, though it is valid for explaining the current returns of stocks. As distress premium exist in equity market therefore decision makers have to consider these four factor factors, three factors of Fama and French and distress factor in making decisions about investment, financing and evaluation of financial instruments. These results are important, in the sense, that these can facilitate investors in efficient resource allocation.

DECLARATION

I hereby declare that this thesis, neither as a whole nor as a part thereof, has been copied out from any source. It is further declared that I have prepared this thesis entirely on the basis of my personal effort made under the sincere guidance of my supervisor and colleagues. No portion of work, presented in this thesis has been submitted in support of any application for any degree or qualification of this or any other university or institute of learning.

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APPRECIATION AND GRATITUDE

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Muhammad Ahmad Jawad

FORWARDING SHEET

The thesis entitled "IMPACT OF FINANCIAL DISTRESS ON STOCK RETURNS: EVIDENCE FROM EMERGING MARKET OF PAKISTAN" submitted by Muhammad Ahmad Jawad as partial fulfilment of Masters Degree in business administration with specialization in Finance, has completed under my guidance and supervision. The changes advised by the external and the internal examiners have been incorporated. I am satisfied with the quality of student's research work and allow him to submit this thesis for further process as per BUIC rules & regulations.

Date: ________________ Signature: ______________

Name: _________________

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LIST of ABBREVIATION

CAPM	Capital Asset pricing model
E/P	Earning to Price Ratio
BE/ME	Book to Market Equity Ratio
C/P	Cash Flow to Price ratio
SMB	Small minus Big
HML	High minus Low
HMU	Healthy tninus Unhealthy
FF	Fama and French
SML	Security Market Line
APT	Arbitrage Pricing Theory
ICAPM	Intertemporal Capital Asset Pricing Model
NYSE	New York Stock Exchange
NASD	National Association of Security
AMEX	American Stock Exchange
CSE	Colombo Stock Exchange
EDF	Expected Default Frequency
BSA	Balance Sheet Analysis
S/H	Small High

S/L	Small Low
B/H	Big High
B/L	Big Low
S/H/D	Small High Distress
S/H/UD	Small High Undistress
S/L/D	Small Low Distress
S/L/UD	Small Low Undistress
B/H/D	Big High Distress
B/H/UD	Big High Undistress
B/L/D	Big Low Distress
B/L/UD	Big Low Undistress