

THE LOW VOLATILITY PUZZLE: EVIDENCE FROM KSE 100 OF PAKISTAN

By

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DEDICATION

This dissertation is dedicated to my parents who have never forgotten me in their prayers.

ABSTRACT

Modern portfolio theory suggests that investors hold a portfolio of stocks to diversify idiosyncratic risk. The capital asset pricing model (CAPM) builds on the portfolio theory and predicts that all investors hold the market portfolio in equilibrium. As a result, only systematic risk is priced in equilibrium and idiosyncratic risk is not. This study investigates the relation between idiosyncratic volatility and returns in Karachi Stock Exchange (KSE) 100 index of Pakistan for the period July 2009 to June 2015. The results show that there is a negative relationship between idiosyncratic risk and expected returns and the internationally documented strong performance of low volatility stocks relative to high volatility stocks is present in Pakistan.

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