

IS TRADITIONAL CAPM A GOOD MEASURE FOR RISK AND RETURN  
IN KSE



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*Be informed that there is no way bringing success than thinking well of Allah, for He is according to what His believing servant thinks of Him: good for good and vice versa. Be informed that there are venues which lead to Allah and which number as many as the beings themselves. For each of Allah's creation there are as many paths leading to Him as many as there are beings. A wretch is one who sees the mercy of Allah as straitened though it encompasses everything.*

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## Dedication

*This thesis is dedicated to my parents for their endless support, encouragement and unconditional love, who taught me that the best kind of knowledge to have is that which is learned for its own sake, who taught me that even the largest task can be accomplished if it is done one step at a time and whose good examples have taught me to work hard for the things that I aspire to achieve.*

# Table of Contents

CHAPTER 1 .....	1
1. INTRODUCTION .....	1
1.1 Field of inquiry .....	1
1.2 Background of the study .....	2
1.3 Area of study.....	3
1.4 CAPM: the traditional framework .....	4
1.5 Problem statement.....	4
1.6 Objectives of the study.....	5
1.7 Research questions.....	6
1.8 Significance of study.....	6
1.9 Limitation of the study.....	7
1.10 Summary.....	7
2. LITERATURE REVIEW .....	8
2.1 Summary.....	27
3. THEORATICAL FRAMEWORK.....	28
3.1 Conceptualization of CAPM.....	28
3.2 Framework for traditional CAPM.....	28
3.3 Hypothesis .....	29
3.4 Summary.....	30
4. METHODOLOGY .....	31
4.1 Variables .....	31
4.2 Unit of analysis .....	31
4.3 Research approach .....	32
4.4 Population .....	33
4.5 Research sample.....	33
4.6 Data collection .....	34
4.7 Econometric specification of CAPM .....	34
4.8 Summary.....	35
5. DATA ANALYSIS AND FINDINGS .....	36
5.1 Descriptive statistics .....	36

5.1.1	<i>Average excess returns</i> .....	37
5.1.2	<i>Beta</i> .....	38
5.2	Covariance analysis .....	39
5.3	Pooled OLS regression method .....	40
5.4	Sector wise OLS regression model .....	42
5.4.1	<i>Oil and gas sector</i> .....	42
5.4.2	<i>Banking sector</i> .....	43
5.4.3	<i>Chemical sector</i> .....	45
5.4.4	<i>Food producers</i> .....	46
5.4.5	<i>Tobacco</i> .....	47
5.4.6	<i>Pharma and bio tech</i> .....	49
5.4.7	<i>Automobile and parts</i> .....	50
5.4.8	<i>Fixed line telecommunication</i> .....	51
5.4.9	<i>Insurance</i> .....	53
5.4.10	<i>Construction</i> .....	54
5.4.11	<i>General industries</i> .....	55
5.5	Summary .....	57
6.	CONCLUSION AND RECOMMENDATION .....	58
7.	REFERENCES .....	60
8.	APPENDIX.....	63

## LIST OF TABLES

Table 1: Distribution pattern.....	36
Table 2: Covariance analysis .....	39
Table 3: Pooled OLS regression .....	40
Table 4: OLS regression method (Oil and gas sector).....	42
Table 5: OLS regression method (Banking sector).....	43
Table 6: OLS regression method (Chemical sector).....	45
Table 7: OLS regression method (Food producers).....	46
Table 8: OLS regression method (Tobacco sector) .....	47
Table 9: OLS regression method (Pharma and bio tech).....	49
Table 10: OLS regression method (Automotive and parts).....	50
Table 11: OLS regression method (Fixed line telecommunication).....	51
Table 12: OLS regression method (Insurance) .....	53
Table 13: OLS regression method (Construction sector) .....	54
Table 14: OLS regression method (General industries) .....	55

## ABSTRACT

*Although there are overabundance of asset pricing models developed by many researchers in order to illuminate the cross sections among asset returns, though, all these models entails perfect market conditions that entirely exists in the developed markets of world. The aim of contemporary study is to examine the empirical validity and applicability of traditional capital asset pricing model (CAPM) in enlightening the cross sections of returns on stock in the contextual framework of developing equity market of Pakistan i.e. KSE. In order to empirically analyse the CAPM, a sample of 70 stocks were undertaken that comprises of 11 different sectors listed on KSE while KSE-100 index was taken as a proxy for market portfolio. In order to obtain better results, monthly data was obtained for the variables used in the current study for a sample period of 5 years commencing January 2009 to December 2013. While for risk free rate, rate on six month Treasury bill was obtained as proxy for risk free rate. For empirical analysis of traditional capital asset pricing model, techniques of time series regression and cross sectional regression are applied to examine the cross sections of stock returns listed in KSE.*

*The findings of the current study on empirical validity of traditional CAPM are inconclusive. Findings of the study suggests that traditional CAPM fails to explain the cross sections of stock returns in KSE on the whole. The empirical findings of the study exhibited statistically insignificant intercept term which indicates the absence of regular mispricing of stocks listed in KSE over a sample period. But the findings of the current study revealed statistically no significant results for the risk premium grossed for undertaking systematic risk over the sample period as illustrated in traditional CAPM.*

*Grounded on the key findings of the current study, it is revealed that traditional CAPM is not empirically validated in KSE. Therefore, findings implies that KSE may be considered as inefficient equity market which doesn't deliver rational trade-off among risk and return. So, findings implies that if investors uses the traditional CAPM for the formation of diversified portfolio than that may result in losses and poor investment performance. So, investors are advised to attain and analyze the evidence that is accurate, adequate and timely.*