

VALIDITY OF CAPM FOR PREDICTING PRICES OF STOCKS AT PAKISTAN STOCK EXCHANGE (PSX)

By

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Abstract

Purpose: The aim of the study is to test the validity of Capital Asset Pricing Model for calculating the required rate of returns of Pakistani companies registered with Pakistan Stock Exchange (PSX). The study talks about how the share price and returns shift over time. Further, how accurately the required rate of return can be calculated using CAPM.

Methodology: This study includes data obtained for fifteen companies from the year 2006 to 2015. While conducting this study, the impact of dividends issued by the selected companies, during period under consideration, has been omitted. The required rate of return is the dependent variable while independent variables are Risk-free return, Beta which is companies' systematic risk, and the actual market return on the stocks.

Analysis and Findings: Regression analysis is done to get the beta of the stocks using MS Excel and Paired Sample t-test is done to compare the actual returns with the required rate of returns using SPSS 23 which shows that there's significant difference between the returns. To summarize, the study shows significant deviations between the results, and that even though there is a positive correlation between the actual market returns and CAPM calculated returns, it is rather weak.

Practical Implications: The outcomes of the research might help the investors and decision makes in deriving accurate results while evaluating stocks for the measurement of their performance.

Keywords: Stock returns, CAPM, Investment, Pakistan Stock Exchange, Risk, Beta.