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ANOMALOUS RETURNS, RISK PREMIUMS AND DIVERSIFICATION: EVIDENCE FROM EMERGING MARKET

Abstract:

A simple size and volatility based zero-investment strategies yield 30% to 50% annual returns in Pakistan stock exchange (PSX), Pakistan. These returns are quite higher in comparison to comparable evidence for the most efficient market of the US. This study indicates that higher returns are not a vindication of market inefficiency rather, a compensation to investors for being exposed to market and illiquidity related local risks. Further, we find that PSX provides significant portfolio diversification opportunities to the international investors. These results are also manifested for other two relatively bigger emerging markets of India and Brazil with lesser diversification benefits.

Keywords:

Zero-Investment Strategy, Annual Returns, Market Risk, Illiquidity Risk, Diversification.

JEL Classification: G10, G12, G15