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CROSS-SECTIONAL VARIATION IN STOCK RETURNS: EVIDENCE FROM AN EMERGING MARKET

Abstract:

Fama and French (1992) reported that the two fundamental factors, size and book-to-market (BM) explains the cross-sectional variation in stock returns and the relationship between beta and average returns is flat. This study reports the market risk as the most significantly priced factor for Pakistan's stocks. Investors in Pakistan's equity market are compensated for the size, BM and momentum factors, but the relationship between risk and return as given by Capital Asset Pricing Model (CAPM) is strong and remains powerful even with the addition of size, BM and momentum factors. The significant role of beta reported for Pakistan's stocks justifies the use of CAPM in stock valuation.

Keywords:

Market Beta, Size, BM Ratio, Momentum, Pakistan Stock Exchange.

JEL Classification: G11, G12, G14