Predictability of Stock Returns Using Financial Ratios: Empirical Evidence from Colombo Stock Exchange

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ABSTRACT

Introduction – The purpose of this study is to examine the predictability of stock return using financial ratios in Sri Lankan context including the macroeconomic variables using data collected from the listed Companies in Colombo Stock Exchange.

Design/methodology/approach – The investigation is performed using panel data procedures for a sample of 37 manufacturing firms listed on the Colombo Stock Exchange during 2014-2018. Descriptive statistics, correlation matrix and panel regression analysis are used to analyse the collected secondary data.

Findings –The results suggested that the study used the Earning per Share, Dividend Per Share, Earning Yield, Dividend Yield, Book Value to Market Value as Independent variables and Market Capitalization, Inflation, and Gross Domestic Production as the Control variables. Some of the Variables are statistically significant and better predictor of the stock return those are, EPS, DPS, DY and BV to MV. All of the control variables are statistically insignificant to predict the stock return using Financial Ratios.

Conclusion – The final results emphasize that the overall model is significant and the researcher conclude that the Financial ratios can be used to predict the stock returns. But all the control variables are statistically insignificant and cannot predict the stock return. This study has laid some groundwork to explore the predictability of stock returns using financial ratios of Sri Lankan listed companies upon which a more detailed evaluation could be based.

Keywords: *Financial Ratios, Stock Return Predictability, Market Capitalization, Listed Manufacturing Companies*