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Paper: Transformability

Testing the weak form efficiency and anomalies in stock returns of the Colombo Stock Exchange

The main objective of this research is to examine the prices reflected in Colombo Stock Exchange (CSE), which follow the weak form of the efficient market hypothesis and anomalies in the returns. Thereby the study is an attempt to examine whether past prices can be used to earn Normal or Abnormal profit.

There are three forms of random walk hypothesis (efficient market hypothesis). That is Weak Form Efficiency, Semi-strong Form Efficiency and Strong Form Efficiency.

The CSE is responsible for the operation of the stock market in Sri Lanka. Currently it has 232 listed companies and 20 different sectors. All share price index (ASPI) and daily share prices of 50 listed companies of CSE are to be selected purposely, based on the trading intensity and market capitalization for the study, and the observation period ranges from 1st January, 1998 to 31st December, 2009 for this study.

The random walk hypothesis is examined using four statistical methods, namely: Auto Correlation (Serial Correlation Test), Runs Test, Unit Root Test and the Day-of-the-Week Effect which examine the anomalies in the returns.

Even though the results of ASPI do not support efficient market hypothesis (EMH), the results 50 stocks indicate mixed results. While the Auto Correlation, Runs Test, and the Day-of-the-Week Effect indicate some stocks which support the EMH, Unit Root Test rejects the EMH completely. At the same time, the Day-of-the-Week Effect indicates the Thursday effect on CSE. The sector wise analysis indicates that the manufacturing sector is heading towards efficiency. Therefore the CSE indicates the characteristics of developed and emerging stock markets.