Predictability of Stock Return Using Financial Ratios; Evidence from CSE FMCG Sector

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ABSTRACT

Introduction – Fundamental analysis uses annual reports with macroeconomic data to predict stock returns and buy and sell under-priced and overpriced securities, respectively. The present study aims to predict the stock returns using financial ratios for the FMCG sector in Colombo Stock Exchange.

Design/Methodology/Approach – The sample data was collected for the six years from 2014 to 2019 for 30 listed FMCG companies listed in Colombo Stock Exchange. The study uses four financial ratios from multiple areas i.e., profitability, liquidity, solvency and market valuation. The analysis was conducted using a multiple regression model via statistical software to understand the predictability of the stock return.

Findings – The results indicate that profitability, liquidity and market valuation ratios can predict the stock return in the short term and the long term. The return on assets, current ratio and price-earnings ratio had significant predictability on stock returns, while debt to equity ratio did not show any significant results due to the reasons the companies are in the mature stage of their own product lifecycle.

Conclusion – The final results concluded that the model is statistically significant in predicting future stock returns**.** The selection of the ratios under profitability, liquidity and market valuation will enhance the predicting ability of the financial ratios on stock returns.

Keywords: *Fundamental analysis***,** *multiple regression model, FMCG, predictability, Statistically, significant*