

Why do some Investors prefer Fundamentally Weak Stocks?

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This study investigates 'why do some investors prefer fundamentally weak stocks? The study about this matter is imperative and exciting because there are plenty of models to justify the investment in fundamentally strong stocks and at the same time those models debar the choice of fundamentally weak stocks. But among the stocks quoted in the Colombo Stock Exchange (CSE) fundamentally weak stocks outperformed the market both in terms of liquidity as well as price boost.

In order to discover the reasons, data have been gathered from a sample of active investors representing all categories of investors and analysed those using descriptive statistical tools. The pertinent secondary data compassionate to the hints and trends arising from the primary data gathered from the investors have used concurrently. A sample of stocks representing majority of the sectors in the CSE, whose trading volumes and number of transactions executed are among the highest in the market, were selected to study.

The study finds that bulk of the investors consider fundamental variables of Net Asset Value, Price/Earnings Ratio and Dividend Yield. They also muscularly use the pattern of price movement for setting buying strategies. Majority of the investors are keen about their required rate of return, but pays very poor attention for the stock's beta factor. Factors contain high degree of speculation such as trading on new information, react for improved quarterly results and high dividend expectation elevates the madness of investors to go after stocks. There is a strong correlation between the price of fundamentally weak stocks and number of trades.

Investors desire fundamentally weak stocks because they are fundamentally weak. That is, the value of the stock is coming from other factors such as higher number of trades, availability of new information, improved quarterly results, high dividend expectations and the degree of foreign buying. That is why the stock price movement cannot be justified using fundamental approach. Moreover the low level of market values and the abnormal capital gains too responsible for the fondness of these stocks in excess of the fundamentally strong stocks.

Key Words: Fundamentally weak stocks; Fundamentally strong stocks; Net asset value, price/earnings ratio; Dividend yield

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