EFFECT OF SIZE AND BOOK-TO-MARKET ON STOCK RETURNS: EVIDENCE IN MALAYSIA

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ABSTRACT

EFFECT OF SIZE AND BOOK-TO-MARKET ON STOCK RETURNS

EVIDENCE IN MALAYSIA

By

Yee Tat Kong

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Supervisor : **Associate Professor Loo Sin Chun**

Faculty : **Centre For Graduate Studies**

This study examines the information content of two firm-specific characteristics', firm size and book-to-market effect on the Malaysian Stock market returns for the year 2004 and 2005. A sample of seventy companies stocks listed in Kuala Lumpur Stock Exchange Composite Index was used for this study.

The regression results show a negative relationship between book-to-market and stock returns. However, the results from the various sectors did not show any significant effect of book-to-market on stock returns. The finding is contrary to Fama and French (1992) in which positive relationship between book-to-market and stock returns was observed.

Empirical results prove that book-to-market ratio cannot explain cross sectional variation in stock returns and has weak support in Malaysia context, while the size effect is not significant. Thus the overall results show that both book-to-market ratio and firm size do not have impact on stock returns. The evidence appears to support the efficient market hypothesis.

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CHAPTER ONE

INTRODUCTION

This section provides a brief overview on numerous theories related to Size and Book-to-Market effect on stock returns, followed by the research problem of the study. The significance and contribution of this research are explained and emphasized. This is followed by the general and specific objectives of the research project. The organization of the paper is provided.

1.1 BACKGROUND

In this section, basic knowledge of the investment management is reviewed, then followed by a general discussion on various important investment theories. It is aimed to explore the essential concepts before looking into the application of the theory on a specific issue.

1.1.1 Portfolio Management

Markowitz employed two parameters, the expected rate of return of a portfolio and a measure of expected risk, which is the standard deviation of expected rate of returns to derive the portfolio model.

Markowitz shows that the expected rate of return of a portfolio is the weighted average of expected return of the individual assets in the portfolio. The standard deviation of a portfolio is a function of not only the standard deviations for the individual assets but also the co-variance between the rates of return for all