Sri Lankan Journal of Management
Vol. 2, No. 3, July - September, 1997

THE CROSS-SECTION OF EXPECTED STOCK RETURNS IN SRI LANKA

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ABSTRACT

This study investigates the ability of market beta, book-to-market equity, leverage, and earnings-price ratio to explain the cross-sectional variation in expected returns in the small stock market of Sri Lanka. The results show that, contrary to the central prediction of the Capital Asset Pricing Model, the relation between average returns and beta is strongly negative. Earnings-price ratio shows a reliable positive relation with average returns. Market beta and earnings-price are strongly related to returns jointly as well. Firm size, ratio of a firm's book value of common equity (BE), to its market value (ME), and leverage are not related to average returns in any significant manner.