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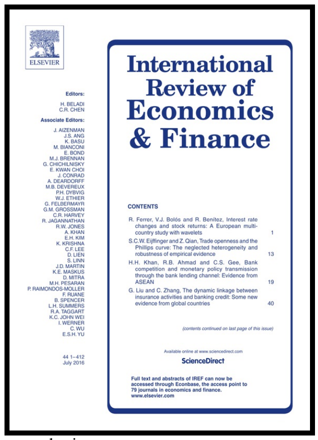

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Md Lutfur Rahman, Doowon Lee, Abul Shamsuddin

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Time-varying Return Predictability in South Asian Equity Markets

Md Lutfur Rahman, Doowon Lee*, Abul Shamsuddin

Newcastle Business School The University of Newcastle University Drive, Callaghan, NSW 2308, Australia

*Corresponding author. Doowon.Lee@newcastle.edu.au

Abstract

Time-varying return predictability in four South Asian stock markets is examined using the wild-bootstrapped automatic variance ratio test and price delay measures. Strong evidence of predictability is found in aggregate market and size-sorted portfolio returns. The cross-sectional variation in return predictability is inversely related to firm size and trading frequency, while the time variation in return predictability is related to market conditions—the level of equity market development, liquidity, volatility, automation of trading mechanism and financial crises. These results strongly corroborate Lo's (2004) adaptive market hypothesis, and are robust to controlling for thin trading, changes in data frequency, and use of alternative return predictability measures.

JEL Classification: F30, G14, G15

Keywords: Return predictability, Adaptive market hypothesis, South Asian stock markets, Variance ratio, Price delay

1. Introduction

The efficient market hypothesis (EMH) states that a market is infomationally efficient when asset prices fully and instantly reflect available information (Fama, 1970). Proponents of the EMH argue that market participants update their expectations about an asset's intrinsic