

Momentum in Security Returns and Investor Behavior: Evidence from Sri Lanka

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ABSTRACT

This paper examines the validity of the behavioral explanations of the momentum effect. Although, the momentum effect seems to be captured by the risk based asset pricing models, there are behavioral explanations developed to explain the existence of the momentum. Barberis, Shleifer and Vishny (BSV) (1998) and Daniel, Hirshleifer and Subrahmanyam (DHS) (1998) provide two most logical behavioral explanations for the existence of the momentum effect. However, these behavioral explanations are not generally accepted due to lack of empirical validity. Hence without identifying the real market validity of these behavioral explanations it is difficult to reach any conclusion regarding the reason for the existence of the momentum effect. Therefore, based on BSV (1998) and DHS (1998), this study formulates testable hypotheses to evaluate their empirical validity. We develop event based method to test the behavioral explanations of the momentum effect empirically. Finally hypotheses are tested in the Colombo Stock Exchange over the period from 2005 to 2013 using the event based method. Investors' conservative behavior suggested by BSV (1998) seems to have contributed to the momentum effect in the Colombo Stock Exchange but the overreaction of DHS (1998) is not supported.

Keywords: *Biased self-attribution, Conservatism bias, Momentum effect, Overconfidence,*