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Momentum Effect, Value Effect, Risk Premium and Predictability of Stock Returns – A Study on Indian Market

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Abstract

The efficient market hypothesis (EMH), one of the central pillars of modern financial theories, often fails to explain the 'financial anomalies'. One fatal challenge of EMH probably comes from the theoretical assumption of 'rational man'. According to EMH, the fully rational investor may change his demand for financial assets on the basis of available information. According to EMH, at any given point of time, the stock price should reflect all the available information, and predictability of stock returns should be impossible. However, the literature shows ample evidence of abnormal returns related to firm and market-specific attributes. In financial literature, these variations are often termed as 'financial anomalies'. Within the framework of behavioral finance, there are research results that contain evidence on the predictability of future stock market returns based on financial anomalies (Stanivuk et al., 2012). Value effect and momentum effect are the two prominent financial anomalies (Ho, 2012). This paper explores the predictability of Indian stock market returns using multiple discriminant analysis. Our result shows that the risk premium, momentum and value effect may have significant power for predicting the Indian stock market returns. The validity test of the model also corroborates the impact of financial anomalies over the predictability of stock returns.

Keywords: Value effect, Momentum effect, Risk premium, Behavioral finance, Stock returns, Multiple discriminant analysis, Predictability**JEL Classification:** G12, C39[Suggested Citation](#) >[Show Contact Information](#) >[Download This Paper \(Delivery.cfm/SSRN_ID3521768_code864115.pdf?abstractid=3521768&mirid=1\)](#)[Open PDF in Browser \(Delivery.cfm/SSRN_ID3521768_code864115.pdf?abstractid=3521768&mirid=1&type=2\)](#)

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