The Capital Asset Pricing Model: Evidence from the Jamaican Perspective.

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Abstract

The results of empirical tests of The Capital Asset Pricing Model (CAPM) in the Jamaican capital market are presented in this paper. The outcomes are based on monthly data of the two select indices on the Jamaican Stock Exchange. The developing Jamaican financial market has required careful examinations in methodology compared to that of developed markets such as the US. The CAPM acceptably describes the Jamaican landscape; however, comparing the same results with developed capital markets shows a much different representation of the reality.

JEL Classifications: GO, G12, .
Key Words**:** Capital Asset Pricing Model, Financial Markets, Portfolio Performance.

Introduction

Since the inception of capital markets, stakeholders have always tried to develop methods that effectively 'read' the market. The Capital Asset Pricing Model (CAPM) was borne of this innate need and was originally developed to analyze and estimate rates of return on capital market equity securities. The CAPM independently developed by Treynor (1961) and William Sharpe in 1964, "presents a powerful and intuitively pleasing forecast about how to measure risk and the relation between expected return and risk" (Fama & French, 2004, p. 1). In its various forms, it provides predictions for the equilibrium expected return on risky assets. Originally developed for use with marketable securities its use has now spread to include assets not traded publicly, such as intellectual property.

Previous research has been done, examining the plausibility of the CAPM in various markets but this research has been found to be lacking in the Jamaican context. Therefore, in order to fill the gap in the literature, the focus of this research paper will be empirical testing of the CAPM on Indices comprised of Jamaican publicly traded stocks.