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The Pricing Of Finnish Stocks; A Survey of Some Empirical Research

This paper surveys Finnish equity market re-search carried out at Hanken during the last 10 years. The Finnish equity market is small in terms of trading volume and number of listed companies. Significant positive first order serial correlation is observed in daily, weekly and monthly return intervals. Finnish stock return distributions are typically negatively skewed and highly leptokurtic. Measured Finnish equity market risk premiums have been highly volatile and, in many instances, insignificantly different from zero, or even negative on average. Size and January effects are observed in Finnish stock returns like in most other countries around the world.

The main results from this body of Hanken-based equity research show that autocorrelation is persistent and related to both friction in the trading process (thin trading effects) and return predictability. Aggregation of thinly traded individual shares to portfolios creates autocorrelation in indices. On the other hand, it has been clearly estblished that a number of instrumental variables can statistically predict daily, weekly and monthly stock returns. Much of this predictability can be rationalized by conditional asset pricing models governing the pricing process of Finnish equities. The important sources of risk in these models tend to be both local and international in nature reflecting the continuing gradual market integration process. Several papers study the impact of international information on the first two moments of the Finnish stock return distribution. Finnish equity market volatility is shown to be related to fundamental macroeconomic uncertainty. Volatility also tends to spill over from (and to) other markets, in particular from the Stockholm Stock Exchange.

The Finnish equity risk premium has in subsequent refined studies based on time-variation in betas shown more plausible behaviour. For example, modelling time-variation in betas with a Kalman filter procedure yields positive average risk premium estimates. Conditional asset pricing model tests imply that important priced factors on the Finnish equity market include an interest rate factor apart from a market factor. Instrumental variables are able to capture time-variation in betas.

Finally, it has been established that increased co-movement between international equity markets and increasing stock market volatility have not reduced benefits from international diversification for Finnish investors. A comprehensive study of Finnish mutual fund performance shows that Finnish fund managers do not display significant selectivity or timing skills.