

ABSTRACT

The single most important concern confounding the investment community is the element of risk. Hence, the concept of risk has so permeated the world of investment that its inclusion in investment analysis is a widely accepted practice. However, still of controversy is the question of what constitute risk and how it should be measured. This study examines the statistical properties of one measure of risk, namely the beta coefficient, as given in the Capital Asset Pricing Model which links the relevant risk and return. Beta coefficient has been widely accepted by academic circles, and over the years it has been increasingly recognised by the investment community.

This study investigates the predictability of three different methods in forecasting future beta coefficients of 31 stocks listed on the Second Board of the Kuala Lumpur Stock Exchange. These methods are : 1) the Ordinary Least Squares (OLS) method, 2) Blume's method, and 3) Vasicek's method. The empirical analysis involves both simple as well as multiple regressions using weekly returns on the securities and the market index. The Mean Square Error is used as a measure of forecast accuracy for each method.

The results showed that Vasicek's method is the most superior method of predicting future beta coefficients of the Second Board stocks. This is followed by the Blume's method while the OLS method proved to be the most inferior method.