Significance of Past Beta Estimation to Predict Future Beta

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Abstract

The objective of this paper is to examine the forecasting ability of the future beta values by using past beta of both individual securities and portfolios. Sample consisted with monthly data of twenty three securities in the Bank, Finance and Insurance sector in Colombo Stock Exchange for the period from 1999 to 2015. Blume's Method, Bayesian Technique and Merrill Lynch, Pierce, Fenner & Smith's Method were used as beta adjusting techniques to determine whether forecasting ability can be improved. According to the findings, individual beta estimates of one period are not good predictors for the future betas. But it can be improved by using the beta adjusting techniques. Predictability can be increased by grouping securities into portfolios and further it can be improved by increasing the portfolio size. In order to improve the prediction of future beta value, it is recommended to use sector index for individual securities as well as the portfolios.

Key words: Systematic Risk, Beta Estimate, Adjusted Beta, Forecasting Ability

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