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Accuracy of Capital Asset Pricing Model and Arbitrage Pricing Theory in Predicting Stock Return

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Abstract

The process of predicting the stock return is considered the main challenge confronting the financial analyst and the investment decision-maker in particular. The objective of the study aims at testing the ability of both CAPM model and APT theory in predicting the stock return. The study investigated a sample of 10 banks listed in the Iraq Stock Exchange for the period (2012-2021). A variety of appropriate statistical and financial means and tools were employed. The study results in many conclusions including the rejection of the study hypotheses and the acceptance of alternative hypotheses based on the analytical results, and then there is a difference in the required rate of return calculated according to each of CAPM model and APT theory as well as the actual return.

Keywords: actual return, required return, CAPM model, APT theory.

1. Introduction

The investor makes his investment decisions based on a careful analysis of scientific foundations, including the foundations of the predicting process related to determining the present value of the cash flows that the shareholders are expected to receive. This is what motivated interested investors, investment managers and financial analysts to seek and search for financial models that predict the required return on investment, establishing a more objective framework for evaluation of financial decisions. According to what has been proposed in the field of specialization, there are quite a few models that were used for predicting, but the experimental reality highlights a specific number of these models, including the capital asset pricing model and the arbitrage