Applied Economics Letters ›
Volume 15, 2008 - Issue 15

Original Articles

An augmented Fama and French three-factor model: new evidence from an emerging stock market

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Pages 1213-1218 | Published online: 28 Nov 2008
Cite this article https://doi.org/10.1080/13504850601018049

Abstract

There were forty equity stocks listed on the stock exchange of Mauritius as at end of December 2004. Fama and French (1993) posit that a possible explanation for the size and book-to-market equity effects could be due to other risk factors not captured in a standard capital asset pricing model. This paper therefore investigates whether on the stock exchange of Mauritius, when taking into account the time variation in risk (as measured by time-varying betas), the two additional factors are still priced. The paper presents an augmented model, which takes into account the time variation in beta, in addition to the size and book-to-market equity factors. It is found that the coefficients for the size effect and the book-to-market equity effect are all significant at the one percent level and with the expected signs. These effects do not disappear. This shows

that the Fama and French three factor model is robust to taking into account time-varying betas.

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