Abstract

This thesis provides evidence of size and value premiums in returns in the Central and Eastern European (CEE) region, through its analysis of financial markets in 12 countries. Following the portfolio construction methodology of Fama and French (1996) we use a sample of 1245 stocks and record that small stocks outperform big stocks (size premium) and value stocks outperform growth stocks (value premium). In addition, we create nine portfolios to test the Fama and French three-factor model and show that the factor-mimicking portfolios that have been documented in the developed markets, SMB (small minus big) and HML (high minus low), also capture most of the cross-section variation in average stock returns in the CEE region. We demonstrate a similar pattern in terms of size return as documented in the U.S. market, but with small differences in the value returns found. Although the Gibbons-Ross-Shanken (GRS) test does not reject the null with 95%, we do not agree that the model completely explains the variation in average returns across the portfolios. The GRS rejects the null at 90% and implies that other factors are omitted from the model. Nevertheless, this thesis contributes to the literature applying asset pricing models to the CEE region, and should provide insights to investors active in the CEE region.