RELATION BETWEEN EXPECTED RETURN AND VOLATILITY AT BUCHAREST STOCK EXCHANGE, ON BUSINESS CYCLE STAGES

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Abstract:

The study of the relation between risk and return is an important topic for investors in financial assets, which is the reason why many researchers have tackled it. It is only natural for an investor with aversion for risk, who undertakes a higher risk investment, mare to expect be rewarded accordingly, that is to achieve higher return rates. The research conducted on various stock markets had contradictory results, which means that the existence of such a connection is not certain on all stock markets. According to a new hypothesis, tackled by the latest studies, the aversion for risk of rational investors may be related to the stages of the business cycles. This paper deals with the connection between expected return and volatility at Bucharest Stock Exchange, by analyzing the return and volatility of the BET index portfolio. In order to assess this relation, we employed heteroskedastic autoregressive models. The study was conducted between January 2000 and April 2011, as well as during two sub-periods determined by different business cycle phases: economic growth and recession. The results revealed significant differences between the whole analyzed period and the economic growth and recession sub-periods. By studying BSE return throughout the analyzed period, we conclude that there is no relationship between expected return and risk, whereas volatility is asymmetric. Actually, one may witness a relation between return and risk, as well as a non-asymmetric response of volatility to shocks during economic growth, and no risk-return relationship and asymmetric volatility during economic recession. Also, results have shown a positive relationship between return and volatility during economic growth, and a negative relationship between the same during economic recession.

Keywords: *business cycle, return, volatility, return-volatility relation*

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