A test of the present value model of stock prices under rational and adaptive expectations using bursa Malaysia data from 1983 to 2003

Abstract

The rational expectations model has been the central expectations hypothesis used by economists while the adaptive expectations hypothesis has been considered by many as inefficient because expectations cannot fully exploit all available information. The aim of this study is to determine which of these two expectations formation hypotheses best explains the behaviour of investors in the Malaysian stock market. We employ the Chow (1988) methodology in which the two expectations hypotheses are applied to the present value model of stock prices for Malaysian stock market data consisting of stock prices and dividends for 13 companies over 21 years. Our results provide strong statistical support for the adaptive expectations hypothesis. This finding is in line with the empirical findings of Chow and his collaborators.