

Stock Selection Based On Discriminant Analysis: Case of Capital Market of Bosnia and Herzegovina

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The main goal of this paper is to scientifically examine and propose new approach of stock selection and analysis based on multivariate technique, i.e. discriminant analysis, in order to help investors, individual and institutional, in their decision making process, especially in case of underdeveloped capital markets. These markets are generally characterized by low market capitalization, poor liquidity and turnover, weak legal protection for minority shareholders, low correlation with developed and emerging capital markets, etc. All of this directly determines investment decision making process on one hand and on the other may have crucial impact on portfolio performance as well. Therefore, in this paper we investigate the cross-sectional relation between the independent variables of the model, comprised of beta coefficient and some fundamental (market values, price to earnings ratio, etc.) variables and the average stock returns, as dependent variable, on the underdeveloped capital market of Bosnia and Herzegovina. Basically, capital market of Bosnia and Herzegovina is characterized by territorial division, the incompatibility of entity institutions and of legal regulations; which negatively affect the investment climate and the liquidity of securities. Therefore, in this paper, we created the sample which consists of stocks traded on capital market of Bosnia and Herzegovina, both on the Sarajevo Stock Exchange and the Banja Luka Stock Exchange, during the period of January 2004 to December 2012. Based on the realized historical returns, we split issuers into two groups. The first group consists of those stocks whose returns were in the top quintile (highest returns), and the second one consists of those stocks whose returns were in the lowest quintile (lowest returns). The main limitations of this study are to be found in the shorter available financial time series in newly formed capitalistic economy, missing data due to the lack of collective records on levels of securities offerings issues.

Keywords: Discriminant Analysis, Stock Selection, Stock Return, Beta Coefficient, Capital Market of Bosnia And Herzegovina.