

## Contrarian and Momentum Strategies in the Indian Capital Market

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The study attempts to evaluate if there are any systematic patterns in stock returns for the Indian market. The empirical findings reveal that there is a reversal in long-term returns, once the short-term momentum effect has been controlled by maintaining a one year gap between portfolio formation period and the portfolio holding period. A contrarian strategy based on long-term past returns provides moderately positive returns. Further, there is a continuation in short-term returns and a momentum strategy based on it provides significantly positive payoffs. The results in general are in conformity with those for developed capital markets such as the US.

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### Introduction

The mean-variance Capital Asset Pricing Model (or CAPM) developed by Sharpe (1964) and Lintner (1965) has been the most acceptable paradigm over time for determining expected return on any risky asset. The investment researchers and practitioners are, however, persistently involved in designing trading strategies that outperform the CAPM benchmark and hence provide extra-normal returns. Such extra-normal return strategies attempt to gain from probable stock market inefficiencies. One prominent CAPM anomaly has been addressed by De Bondt and Thaler (1985) relating to a pattern in long-term past returns. They document that stock portfolios with low long-term past returns (for the period three to five years) tend to outperform, in future, the portfolios with high long-term past returns for the US market. The investment strategies based on such a reversal in long-term past returns are commonly referred to as contrarian strategies. De Bondt and Thaler suggest that the contrarian strategy works owing to investor over-reaction to past information. Some researchers, however, suggest that the De Bondt and Thaler results can be explained by the systematic risk of the contrarian portfolios and the size effect (Chan, 1988; Ball and Kothari, 1989; and Zarowin, 1990).

Jagdeesh (1990) provides evidence of return reversals over very short-term periods (say a week or a month). He, however, insists that since such strategies are transaction-intensive and based on very short-term price movements, their apparent success may reflect presence of a short-term price pressure or lack of liquidity in the market rather than over-reaction. Lo and McKinley (1990) argue that a large portion of extra-normal returns shown by Jagdeesh is attributable to delayed stock price reaction to common factors.

Although contrarian investment strategies have received a lot of attention in recent years, a parallel body of literature on market efficiency focuses on relative strength or momentum strategies. Momentum strategies are based on continuation pattern in stock returns and imply buying past winners and selling past losers. For instance, Grimblatt and Titman (1989,