

2. Abstract

Our study's aim is to investigate the applicability of liquidity adjusted Multifactor CAPM to individual stock returns and industry portfolio returns in Borsa Istanbul throughout a time horizon of 2004-2015, and we aim to modify Fama-French 3 and Fama-French 5 factor models by incorporating additional risk factor candidates so-called "Profitability Factor" calculated out of the differences between net profit margins, as a fundamental analysis indicator and "Liquidity Factor" as a proxy to assess additional risk premium that may arise due to liquidity conditions of the firm expected as closely associated with the liquidity conditions of the market. As a result of creating a 5 factor Capital Asset Pricing Model, we try to establish a mechanism which links the uncovered risk portion to a firm specific liquidity factor & earnings yield (company fundamental).

We look to determine a multi factor model with additional explanatory variables which absorb the potential anomalies of asset markets by capturing the excess individual stock & portfolio returns other than general market risk premium of Borsa Istanbul. Hence, our main research objective can be summarized as finding a reasonable evidence of profitability & liquidity effects in addition to size and value factors introduced in Fama French 3 Factor Model and market risk premium in the original Capital Asset Pricing Model, and use them as proxies for additional separate risk factors in returns such as company based factors that are determinants of a company's financial performance to the extent which explains demands for assets & hence investments. Liquidity adjusted multi factor model we construct seems to perform well with no pricing error, hence explaining the variation of excess returns in individual stocks. Liquidity related factor is found to marginally contribute to the four and three factor models, and Market Beta is still verified as a dominant risk factor in comparison to firm level asset pricing proxies.