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Market sentiments and firm-level equity returns: panel evidence of Malaysia

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\begin{abstract}
This study focuses on the impact of market sentiment on firm-level equity returns in Malaysia by hypothesising that market sentiment is a relevant risk factor. Understanding how the market sentiment reflects the equity return is crucial to market participants managing their portfolio investment risks. In modelling for firm-level equity return determinants using augmented Fama and French (1992, 1996) three-factor model, this study used data from a sample of 608 publicly listed firms for 2010–2019 and the dynamic panel GMM estimation technique. The findings revealed that market sentiment indices, namely Business Conditions Index (BCI) and Consumer Sentiments Index (CSI), strongly and positively influenced firms equity returns. Excellent market sentiment encouraged a bullish strategy, increasing share prices and, consequently, stock returns. In addition to market sentiment, other related variables, namely domestic market returns, international market returns, small minus big (SMB), high minus low (HML), and firms’ liquidity ratio, are also found to be statistically significant in influencing firms equity returns. The policy implication provides a vital strategy to market participants, particularly fund managers and investors, to accordingly manage their risks and returns on their portfolio investment.
\end{abstract}

1. Introduction

One of the crucial topics in behavioural finance is the impact of investor sentiment on stock returns. Behavioural finance believes that investors do not always act rationally as they are influenced by various behavioural biases (Rupande et al., 2019). Investors are subject to sentiment, and that there are noise traders or irrational traders who may not apply a company’s fundamentals when making investment decisions (Sayim & Rahman, 2015). Although sentiment does impact the activities in the stock market, understanding how it influences stock returns is crucial for market participants managing their portfolio investment risks.