

# Application of Capital Assets Pricing Model (CAPM) and Arbitrage Pricing Theory (APT) in Nepali Stock Market

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## ABSTRACT

The study examined two assets pricing theories namely CAPM and APT in Nepali capital market and also analyzed the long run association and short run impact of macroeconomic variables to the stock market return in Nepal. The model of CAPM and APT were tested by using OLS regression and cointegration followed by VECM and Wald test have been used to dig out the dynamic relation among the macroeconomic variables. The result was unable to verify that the single factor market risk premium is not sufficient to explain the stock return as defined by CAPM in Nepali capital market. However, some of the macroeconomic variables in the APT model can be used to predict the stock return. The influencing macroeconomic variables are the inflation rate and short term interest rate, which make negative effect on stock return, and the remittance which has positive impact in the stock return. Similarly, the cointegration and VECM analysis showed that there is long run association between stock market return and macroeconomic variables like inflation rate, interest rate and remittance income where as it was revealed that in the short run the cointegration can be affected by shock and would be corrected in long run. In case of short term effect, up to six lag value of NEPSE index and remittance have effect on stock market return. The study will have practical implication for the policy makers as well as the investors.