

PANDEMIC OUTBREAK, INVESTOR SENTIMENT, AND STOCK MARKET REACTION: EVIDENCE FROM THE FRONTIER MARKET, SRI LANKA

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Abstract

This paper examines the impact of the COVID-19 pandemic, the resulting investor sentiment in determining stock returns of different sector portfolios; healthcare, telecommunication, banking, insurance, and hotel companies in the Colombo Stock Exchange (CSE), Sri Lanka, in the year 2020. Firstly, the event study methodology focuses on the impact on sector portfolio returns after the World Health Organisation declared COVID-19 as a global pandemic on 11th March 2020. Then, a second-stage regression-based methodology is adopted to evaluate the impact of pandemic-related news to identify the influence of investor sentiment on sector portfolio returns and its persisting effects. Statistically, significant positive Cumulative Average Abnormal Returns (CARs) are observed surrounding the event day. The most striking phenomenon is positive and persisting CARs perceived after an extended Island-wide lockdown curfew is lifted on 11th May 2020. CSE investors are likely to be more sensitive to local events than to global news, and persisting CARs indicate market inefficiency. Results of a second-stage regression-based analysis reveal an initial negative sentiment effect on portfolio stock returns, followed by a positive sentiment thereafter. The initial negative effect is relatively robust on banks and hotel sector stock returns. A positive sentiment might emanate from overreaction to the subsequent rebound with the removal of lockdown curfew and the Government's COVID-relief moratorium packages offered to businesses. CSE investors are likely to react based on psychological bias or sentiment.

Keywords: COVID-19 pandemic, Frontier market, Investor sentiment, Market efficiency