Forecasting future stock returns using financial ratios:
a case of Dar es Salaam Stock Exchange

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This study empirically examines the predictability of future stock returns by using financial ratios in Tanzania for the period of 2009 to 2014. The study uses Dar es Salaam Stock Exchange as a case study, and a sample of 14 companies listed at DSE. The financial ratios used for this study include; Earning yield, Dividend yield, Book to Market ratio, Return on Equity, and Debt to equity ratio. In addition to these ratios, the study includes dummy variables for companies' individual features such as; management style, quality of labor force and market share, that may impact their stock returns. The study employs both fixed effect panel model and Least Square Dummy Variable Model to fulfill the objectives of the study. First, the study estimates the fixed effect model using financial ratios as the independent variables. The estimation finds all the ratios have a positive sign which is consistence with many studies on the subject matter, but only one variable is significant; that is Book to Market ratio at 5 per cent significant level. Second, the study estimates the Least Square Dummy Variable Model which includes dummies for each company to capture their individual effects. The study reveals that 44 percentage of stock return are explained by companies' unobserved individual features. Therefore, any strategy to analyze financial ratios other than book to market ratio will not give good results on future stock return. As of now, investors have to analyze more of company's individual features. This study is not completely ruling out financial ratios, but it calls for more studies with different methodologies that may reveal otherwise.