

**INVESTIGATING THE EXCESS RETURN OF CONTRARIAN STRATEGY
IN THE ACTIVE INSURANCE FIRMS IN TEHRAN STOCK EXCHANGE**

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ABSTRACT

Obtaining the appropriate rate of return is the most important expectation of investors in the investment process and different strategies have been used by investors to gain a required rate of return. Contrarian strategy is one of the strategies used recently to predict the return of stock using the historical information. Contrarian strategy suggests that an excess return can be gained by selling winners stock and buying losers stock. This study examines the excess return of contrarian strategy in the active insurance firms in Tehran Stock Exchange. For this purpose, data of five insurance firms activated from 2007 to 2011 has been collected and analyzed. The variables in this study are return of contrarian strategy in daily, monthly and seasonal courses. Data analysis and hypotheses testing include Philips model and AVOVA and T-test statistic has been used to examine the significance of test and the confidence level. The results of study shows that the return of contrarian strategy is effective in daily, monthly and seasonal courses.

Keywords: Excess Return, Contrarian Strategy, Insurance Firms, Winner Stock, Loser Stock

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1. INTRODUCTION

Over the decades and years, financial professors in the management colleges around the world have examined the financial records and documents related to securities and accounting records accurately to find some patterns and signs of market behavior (Robert Hagen, Translation by Islami Bidgoli, 2007).

Economic human is a simple pattern of economical behavior in human based on some principles such as full self-interest, perfect rationality and economic decisions on complete information. The studies began in the late 70's and was introduced as knowledge of behavioral finance, show that rationality is not always the drive of behavior and decision-making is not always influenced by economic interest. Moreover, complete information on economic decisions is an idealistic assumption, because many economic decisions are taken in the absence of complete information. Contrarian Investment Strategy is one of the consequences of irrational decisions in the stock market. Contrarian Strategy states that excess returns can be gained by selling the stocks that have performed well in the past (winner stocks) and buying the stocks that have not performed well in the past (loser stock) and it was stated that past winner stock should be sold and past loser stock should be acquired to overcome on the market. To examine the contrarian strategy, some portfolios of stock based on the return or financial performance trend are formed in the course called portfolio formation period and then, in the next period called test course, is examined whether return is done in these portfolios or not?

Problem Statement

The researchers conducted different investments in the global stocks and founded that some approaches can be used for investment to obtain some returns over the Conventional returns of the market and lower risk was incurred in this regard.

Markowitz proposed a model in 1956 given the statistical discussions of portfolios optimization and presented his model to the capital market that has been interested. Several years later, he proposed CAPM model according the approaches in the Sharp stock market. Financial management has been concerned as a rigorous and enough theory. To validate positive looks about an efficient market and efficiency of financial markets, the researchers converted out financial theories to modern finance period. Jagadeesh and Titman studies in 1993-1995 showed that not only there are some concerns about

market instability; but also, some solutions should be proposed for market instability and some rules and theories should be selected. In the evolution course of financial theories and approaches and behavioral financial theory, various strategies of investment have been proposed including contrarian and Momentum strategy that have been analyzed in different studies. Due to heterogeneity and irregularities seen in the Tehran Stock Exchange, this study shows that the excess return can be gained by Momentum and excess strategies. The main issue in this study is to examine, whether contrarian strategy affect the excess return or not?

3-1- The Purposes of Study

1-3-1- Main Purpose

Study the excess return of contrarian strategy on stock of active insurance companies in Tehran Stock Exchange.

2-3-1-Subsidiary Purposes

Study the excess return of contrarian strategy in daily time interval in insurance industry.

Study the excess return of contrarian strategy in monthly time interval in insurance industry.

Study the excess return of contrarian strategy in seasonal time interval in insurance industry.

4-1 – Hypotheses

1-4-1 Main Hypothesis

Mean of return of contrarian strategy is more than mean of actual return of stock in insurance firms.

2-4-1 Subsidiary Hypothesis

Mean of return of contrarian strategy in daily time intervals is more than mean of actual return of stock in insurance firms.

Mean of return of contrarian strategy in monthly time intervals is more than mean of actual return of stock in insurance firms.

Mean of return of contrarian strategy in seasonal time intervals is more than mean of actual return of stock in insurance firms.

5-1 The Methodology

This study is descriptive and the methodology is based on analysis and regression and in term of purpose is applied. The data was extracted through stock return of active insurance firms in Tehran Stock Exchange (5 Firms) and the investment return has been calculated using the contrarian strategy based model for daily, monthly and seasonal time intervals. The statistical population included all insurance firms listed in Tehran Stock Exchange from 2006 to 2011. In this study, data collection was done using librarian and field method. Using librarian method, the data for literature review and history was gathered and in the field method, the data in Stock Exchange site have been used. Other databases will be used to gather the required information.

Data Analysis Method

To determine the excess return of contrarian strategies, multiple linear regression models, as well as econometric models have been used in this study. To examine the difference between return of contrarian strategy and actual return, T-Test and ANOVA have been used.

Definitions of Variables

Contrarian strategy: this strategy expresses that excess return can be gained by selling the stock have performed well in the past or buying the stock have not performed well in the past.

Excess return: is called a return is gained more than market return.

Winner stock: is called a stock have performed well in the past.

Loser stock: is called a stock have not performed well in the past.

Literature Review

Any investment in the arrival to the capital market tries to find some solutions and apply strategies to overcome the changes in the market and gain the excess return. Financial model theory and its main principle such as efficient market assumption believe that the market can not be won on the market and gain the return more than market average. It is claimed that there is no trend in market return and price and the profit can not be gained through market trends.

At the moment, two exchange and portfolio management are used widely in the capital market and several studies confirmed their effectiveness in excess return. These strategies are Momentum and Contrarian Strategies. These strategies are known and technical analyzing and today is waiting to be validated by fundamentalist Investors and even the

academic community. High volume of studies have been done in this regard and extended literature has been formed. This strategy is based on psychology, Crowd behavior and market atmosphere

Momentum is a concept in physics science that express an object moving tends to stay in motion unless an external force to be entered (Newton's first law). In other word, this law is applicable on the market that a price trend tends to be stable unless an external force avoid it. This strategy includes investment in the market and claims that positive or negative return in the past is continued in a certain period in the future. Contrarian strategy believes that market majority and public is wrong and the recent trends of price will be returned; therefore, to achieve excess returns must be patient with the courage to act opposite direction to the market. Generally, these strategies try to find some trends using various criteria and applying them. Other interesting review of this strategy is in direct opposition to the accepted doctrine of market efficiency. Efficient market hypothesis claims that there is no particular pattern in the returns and price of securities and price behavior is non-random and unpredictable. According to the market efficiency hypothesis, portfolio performance independent of its past performance. Thus confirming the usefulness of this strategy can be a major challenge in the face of modern financial theory and market efficiency discussions (Han and Tankez, 2003).

Data Analysis

The data is for 5 years and five firms calculated the data daily and their mean have been calculated. Then, data were inserted in Eviews 7 as panel data and then the hypotheses are examined. Number of observations were 763. These observations were stock portfolios formed by contrarian strategy. The data used generally in empirical analysis are discussed in three groups:

Time series data

Cross-sectional data

Time-series and Cross-sectional Panel data

Panel data is a combination of cross-sectional and time-series data; i.e, the data related to sectional data is observed over the time. Such data has two aspects; one aspect is related to different units in a certain time section and other aspect is related to time. In general, panel data has more advantages compared to cross-sectional or time-series data. The variables used in this study and should be used in other studies are explained in the

earlier parts and is specified using below signs in this section and are used in the software output.

RARS	CARS	RARM	CARM	RARD	CARD
The average of return in seasonal random strategy	The average of return in seasonal contrarian strategy	The average of return in monthly random strategy	The average of return in monthly contrarian strategy	The average of return in daily random strategy	The average of return in daily contrarian strategy

Descriptive statistics include mean, median, maximum, minimum, standard deviation, skewness, kurtosis and total.

Table 4-1: Discriptive Statistic

RARS	CARS	RARM	CARM	RARD	CARD	
0.136	0.089	0.065	0.5	0.019	0.031	Average
0.167	0.102	0.059	0.412	0.02	0.031	Mean
3.24	0.13	0.249	10.591	0.091	0.082	Maximum
- 12.527	-0.78	-0.1	-9.953	- 0.045	- 0.011	Minimum
0.633	0.07	0.065	0.948	0.02	0.014	Standard deviance
- 15.849	- 7.242	0.281	-0.897	0.122	0.062	Skewness
296.56 9	66.79 2	2.813	65.288	3.119	3.043	Kurtosis
100.24 3	65.85 1	48.41 2	370.31 2	14.86 3	23.99	Total

As shown in Table above, daily and monthly mean of contrarian strategy has higher mean and total and this indicates that contrarian strategy has higher return in the time intervals.

This event is occurred when the mean of the portfolio in seasonal time interval unlike two previous time interval had contrarian strategy return as 0.089 lower random strategy as 0.136 as a point against two previous interval. So, the time interval affect the Momentum and Contrarian Strategy.

Durability

A random process $\{X_t : t \in Z\}$ is called weak durability, if:

There is a mean not related to t.

$$i) E(X_t) = \mu$$

There is Co-variance as a function of t-s.

$$ii) \text{var}(X_t - \mu)(X_s - \mu) = \text{Cov}(X_t, X_s)$$

As result, X_t variance is fixed not related to t.

$$iii) \text{var}(X_t) = E[X_t - \mu][X_t - \mu] = \sigma^2$$

Noting: through above three conditions, it can not be concluded that third and fourth momentus are fixed. So, if X_t has μ mean and X_t are not related together and X_t variance be fixed, then X_t has weak durability, if X_t , i.i.d is limited to variance, X_t has weak durability.

A random process of $\{x_t : t \in Z\}$ is called strong durability; If Common density function $X_{t_1}, X_{t_2}, X_{t_k}(\text{cdf})$ for t_1, t_2, \dots, t_k is like common density function of $x_{t_1+h}, x_{t_2+h}, x_{t_k+h}$ for different values of h (AbbasiNejad, 2005)

H_0 = data has unit root

H_1 : Data has not unit root (Durability)

Before hypotheses testing, the durability of data should be confirmed. So, each variable has been examined in durability test in Tables 2-4 to 7-4. Phillips test was used to examine the durability and the durability of data can be explained by significance level.

Table 4-2: Phillips Test of Average of Return in Random Strategy

		Adj. t- Stat	Prob.*
		-	
		25.6612	0.000
Phillips-Perron test statistic		2	0
		-	
Test critical	1%	3.43870	
values:	level	5	
		-	
	5%	2.86511	
	level	8	
		-	
	10%	2.56873	
	level	0	

Table 4-2 shows the results of Phillips test on the data durability related to average of return of daily random strategy, the prob value is less than 5% and this indicates data is durable.

Table 4-3: Phillips Test of Average Return of Monthly Random Strategy

		Adj. t- Stat	Prob.*
		-	
		24.3228	0.000
Phillips-Perron test statistic		7	0
		-	
Test critical	1%	3.43896	
values:	level	0	

	-
5%	2.86523
level	0
	-
10%	2.56879
level	1

Table 4-3 shows the results of Phillips test on the data durability related to average of return of monthly random strategy, the prob value is less than 5% and this indicates data is durable.

Table 4-4: Phillips Test of Average Return of Seasonal Random Strategy

		Adj. t-	
		Stat	Prob.*
		-	
		20.6999	0.000
Phillips-Perron test statistic		6	0
		-	
Test critical	1%	3.43898	
values:	level	4	
		-	
	5%	2.86524	
	level	0	
		-	
	10%	2.56879	
	level	6	

Table 4-4 shows the results of Phillips test on the data durability related to average of return of seasonal random strategy, the prob value is less than 5% and this indicates data is durable.

Table 4-5: Phillips Test of Average Return of Daily Contrarian Strategy

		Adj. t-	
		Stat	Prob.*
		-	
		13.7534	0.000
Phillips-Perron test statistic		8	0
		-	
Test critical	1%	3.43870	
values:	level	5	
		-	
	5%	2.86511	
	level	8	
		-	
	10%	2.56873	
	level	0	

Table 4-5 shows the results of Phillips test on the data durability related to average of return of daily contrarian strategy, the prob value is less than 5% and this indicates data is durable.

Table 4-6: Phillips Test of Average Return of Monthly Contrarian Strategy

		Adj. t-	
		Stat	Prob.*
		-	
		25.8669	0.000
Phillips-Perron test statistic		7	0
		-	
Test critical	1%	3.43896	
values:	level	0	
		-	
	5%	2.86523	
	level	0	
		-	
	10%	2.56879	
	level	1	

Table 4-6 shows the results of Phillips test on the data durability related to average of return of monthly contrarian strategy, the prob value is less than 5% and this indicates data is durable.

Table 4-7: Phillips Test of Average Return of Seasonal Contrarian Strategy

		Adj. t-	
		Stat	Prob.*
		-	
		14.0548	0.000
Phillips-Perron test statistic		8	0
		-	
Test critical	1%	3.43898	
values:	level	4	
		-	
	5%	2.86524	
	level	0	
		-	
	10%	2.56879	
	level	6	

Table 4-7 shows the results of Phillips test on the data durability related to average of return of seasonal contrarian strategy, the prob value is less than 5% and this indicates data is durable.

4-3 Jarque and Bera Test

This test is used to verify the claim about the data distribution of quantitative variable.

H0: The distribution is normal

H1: The distribution is not normal.

The result is an output that provides number of data, the parameters to examine the distribution, absolute value of highest deviation, highest positive deviation, highest negative deviation, statistic Z and sig value. The sign is less than 5%; Therefore, H0 is rejected and the normality claims is not accepted and is normal, if it is higher 5%. It is revealed that the distribution of all variables is normal.

Table 4-8: Jarque and Bera Test

	CARD	RARD	CARM	RARM	CARS	RARS
Jarque-Bera	0.549198	2.330944	119888.9	10.83316	131762.5	2684640
Probability	0.759877	0.311775	0	0.004442	0	0
H ₀	Accepted	Accepted	Rejected	Rejected	Rejected	Rejected
Distribution	Normal	Normal	Non-normal	Non-normal	Non-normal	Non-normal

Natural logarithm can be used to normalize the data. Table below shows data and Jarque and Bera test for non-normal data.

Table 4-9: Normal Distribution of Jarque and Bera Test

lnRARS	lnCARS	lnRARM	lnCARM	
1.3410851	1.5885498	0.9946345	1.440071	Jarque-Bera
0.5607206	0.4984842	0.6478515	0.535826	Probability
Accepted	Accepted	Accepted	Accepted	H ₀
Normal	Normal	Normal	Normal	Distribution

Data has normal distribution after using natural logarithm and re-calculations.

4-4- Hypotheses Testing

Independent samples tests based on T-distribution is a parametric test in which the differenced between average of both societies are examined. When, there are two societies, this test is used to test the hypotheses.

Return Average Difference Assumption Test of Contrarian Strategy

(H₀): The return average of contrarian strategy in dairly period is equal to return average of actual stock in insurance firms.

(H₁): The return average of contrarian strategy in dairly period is more than the return average of actual stock in insurance firms.

This test is used t examine the assumption that the average of both variables (error level of 5%) is not equal.

$$H_1: \begin{cases} H_0: \mu_m = \mu_f \\ \mu_m \neq \mu_f \end{cases}$$

The equality variances test is superior on average equality. To use average test, two societies as a quantitative variable and a categorical variable are needed.

In this test, the equality or inequality of variance in both societies should be determined. Using this test, the software displas the results of variance equality test (Levin). In output of Levin test, if the significance level is less than error value, the variance unequality is concluded and in the next ouptput related to main test; i.e, the average of both societies regard the significance lvel of second row in the output table and otherwise, the significance level in the first row of table should be concerned.

Table 4-9

Method	df	Value	Probabil ity
		13.5145	
t-test	1524	8	0.0000
Satterthwaite-Welch	1396.82	13.5145	
t-test*	8	8	0.0000
	(1,	182.643	
Anova F-test	1524)	7	0.0000
	(1,		
	1396.83	182.643	
Welch F-test*)	7	0.0000

In the output of table, if the significance level is lower than the error value, it is concluded that there is singificnadifferene between the averages of both societies in the variable under the study. If the average differences is concluded, the value of average differences should be concerned to find which average in which society is higher. In the case of inequality between the averages in both societies, the portfolio should be

concerned and their difference should be analyzed. The difference between two groups indicate the hypotheses; however, indicates the performance difference of both strategies in the investment.

Analysis using equality variance assumption in both societies

Table 4-10: Analysis of Equality Variance in Both Societies Dairly

	Statistic	Significance level	Equality of averages
t-test	13/51458	0	Rejected
Anova F-test	182/6437	0	Rejected

Analysis using equality variance assumption in both societies

Table 4-11: Analysis of inequality Variance in Both Societies Dairly

	Statistic	Significance level	Equality of averages
Satterthwaite-Welch t-test*	13/51458	0	Rejected
Welch F-test*	182/6437	0	Rejected

In both societies, the equality assumption of averages is rejected. In other hand, it is concluded that returns (daily time interval) in both contrarian and random strategies are not equal and it is clear that contrarian strategy has proper performance. The reason is shown in descriptive statistic table. In descriptive statistic table, the average of portfolio return made by contrarian strategy is more than random strategy. The output of table shows that the null hypothesis in significance level of 99% is rejected and a difference is seen between the returns in both strategies.

Return Average difference assumption test of contrarian strategy.

Contradictory assumption (H0): the return average of contrarian strategy in monthly time interval is less than actual return average of insurance firms.

Assumption (H0): the return average of contrarian strategy in monthly time interval is more than actual return average of insurance firms.

Table 4-12: Monthly Average Test of Both Societies

Method	df	Value	Probability
		12.4413	
t-test	1480	0	0.0000
Satterthwaite-Welch	747.011	12.4413	
t-test*	2	0	0.0000
	(1,	154.785	
Anova F-test	1480)	9	0.0000
	(1,		
	747.011	154.785	
Welch F-test*)	9	0.0000

Analysis using equality variance assumption in both societies

Table 4-13: Analysis of equality Variance in Both Societies Monthly

	Statistic	Significance level	Equality of averages
t-test	12/4413	0	Rejected
Anova F-test	154/7859	0	Rejected

Analysis using equality variance assumption in both societies

Table 4-14: Analysis of inequality Variance in Both Societies Monthly

	Statistic	Significance level	Equality of averages
Satterthwaite-Welch t-test*	12/4413	0	Rejected
Welch F-test*	154/7859	0	Rejected

In both societies, the equality assumption of averages is rejected and it is clear that contrarian strategy has proper performance. In other hand, it is concluded that returns (Monthly time interval) in both contrarian and random strategies are not equal. The reason is shown in descriptive statistic table. In descriptive statistic table, the average of portfolio return made by contrarian strategy is more than random strategy. The output of table shows that the null hypothesis in significance level of 99% is rejected and a difference is seen between the returns in both strategies.

Return Average difference assumption test of contrarian strategy.

Contradictory assumption (H₀): the return average of contrarian strategy in seasonal time interval is less than actual return average of insurance firms.

Assumption (H₀): the return average of contrarian strategy in seasonal time interval is more than actual return average of insurance firms.

Table 4-15: Seasonal Analysis of Avearge in Both Societies

Method	df	Value	Probabil ity
		-	
t-test	1476	1.98608	0.0472
		-	
Satterthwaite-Welch	755.911	1.98608	
t-test*	6	7	0.0474
	(1,	3.94454	
Anova F-test	1476)	0	0.0472
	(1,		
	755.912	3.94454	
Welch F-test*)	0	0.0474

Analysis using equality variance assumption in both societies

Table 4-13: Analysis of equality Variance in Both Societies in Seasonal time interval

	Statistic	Significance level	Equality of averages
t-test	-1/986087	0/0472	Rejected
Anova F-test	3/944540	0/0472	Rejected

Analysis using inequality variance assumption in both societies

Table 4-13: Analysis of inequality Variance in Both Societies in Seasonal time interval

	Statistic	Significance level	Equality of averages
Satterthwaite-Welch t-test*	-1/986087	0/0472	Rejected
Welch F-test*	3/944540	0/0472	Rejected

In both societies, the equality assumption of averages is rejected and it is clear that contrarian strategy has proper performance. In other hand, it is concluded that returns (Seasonal time interval) in both contrarian and random strategies are not equal. The reason is shown in descriptive statistic table which average of return in random strategy is more than contrarian strategy. In descriptive statistic table, the average of portfolio return made by contrarian strategy is more than random strategy. The output of table shows that the null hypothesis in significance level of 99% is rejected and a difference is seen between the returns in both strategies.

4-5- Summary

In this section, first portfolios have been introduced and two contrarian and actual portfolios have been examined separately and then some features of portfolios have been specified using descriptive statistic and different returns have been examined in different time intervals. The assumptions have been analyzed using deductive statistic average difference test and hypotheses testing have been done in different time intervals.

CONCLUSION

According to the statistical analysis and the reasons in the previous section to implement the study and conclusion, in this section the answer of questions are provided.

At the moment, two exchange and portfolio management strategies are used widely in capital market around the world and recent studies have confirmed their effectiveness in excess returns, these strategies are Momentum and Contrarian. These strategies are known as technical analyzing that are waiting to be approved by fundamentalist

investors and also academic society. A large amount of studies have examined this context and extended literatures have been formed. These strategies are based on psychology, crowd behavior and market atmosphere.

FadaeiNejad and Sadeghi examined the effectiveness of Momentum and Contrarian strategies in Tehran Stock Exchange. They formed and compared the portfolios in a five-year period (2001-2005). Their findings showed the effectiveness of these strategies, so that excess returns can be gained in one month, three months and six months using Momentum strategy and in longer time intervals using Contrarian strategies. In a similar study by Kamali, it was concluded that Momentum strategy affects the capital market of Iran in short-term and this will result in extraordinary returns for investors.

Ghalibaf and Kamali examined the Momentum and Contrarian strategies in Tehran Stock Exchange. For this purpose, they used data of 50 firms in a five-year period (2002-2006) and the effect of Momentum strategy was observed in short-term, but the effect of contrarian strategy has not been observed.

Kanrad and Kavel (1998) conducted a long-term study in America and concluded the success of contrarian strategy in long-term and Momentum strategy in short-term. They stated that the success of these strategies depends on the time intervals. The Momentum strategy was effective in a middle-term of three to twelve months and contrarian strategy was useful in a short-term course of weekly to monthly or a long-term interval of three to five years.

5-2-1 Main Hypothesis

Mean of return of contrarian strategy is more than mean of actual return of stock in insurance firms.

5-2-2 Subsidiary Hypothesis

Mean of return of contrarian strategy in daily time intervals is more than mean of actual return of stock in insurance firms.

Mean of return of contrarian strategy in monthly time intervals is more than mean of actual return of stock in insurance firms.

Mean of return of contrarian strategy in seasonal time intervals is more than mean of actual return of stock in insurance firms

Results	Hypotheses
Accepted	Mean of retrun of contrarian strategy in darily time intervals is more than maen of actual retrun of stock in insurance firms.
Accepted	Mean of retrun of contrarian strategy in monthly time intervals is more than maen of actual retrun of stock in insurance firms.
Accepted	Mean of retrun of contrarian strategy in seasonal time intervals is more than maen of actual retrun of stock in insurance firms

5-3 Recommendations of Study

Contrarian Investment Strategy is one of the consequences of irrational decisions in the stock market. The basic of this strategy is Overreaction or, reaction of investors to information that has just been published. According to this strategy, excess returns can be gained by selling the stocks that have performed well in the past (winner stocks) and buying the stocks that have not performed well in the past (loser stock) and it was stated that past winner stock should be sold and past loser stock should be acquired to overcome on the market.

According to testing, three hypotheses are rejected in this study; therefore, investors and securities activists can gain required amount of return using contrarian strategy in daily, monthy and seasonal time intervals and using this strategy is recommended more in daily interval compared to monthly and seasonal time intervals.

Research Proposal Based on Future Research

The use of other strategies such as Momentum strategy, equity portfolio strategy, Markowitz selection strategy and random sampling compared with the results of contrarian strategy

The effect of other variables in the industry and its impact on Contrarian Strategy
Comparative study between Iran the stock exchange and other countries in the contrarian strategy

Using financial ratios to predict the return in the contrarian strategy

Constraints of Study

Using control variables such as macroeconomic indicators was not possible due to the Constraints of the research.

Cost and time constraints of researcher

Lack of access to financial markets core for further research of strategy

The validity of model should be examined by more data using better scientific outlook, while this was not possible in the study due to time interval and the comparative study to other countries was not possible.

Some of the data related to the company have been lost due to time synchronization.

There are volume based and limitations prices could exacerbate an effective strategy and this not allow the researcher to realize it.

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