# Chapter I

# INTRODUCTION

## *1.1 Background of the Research*

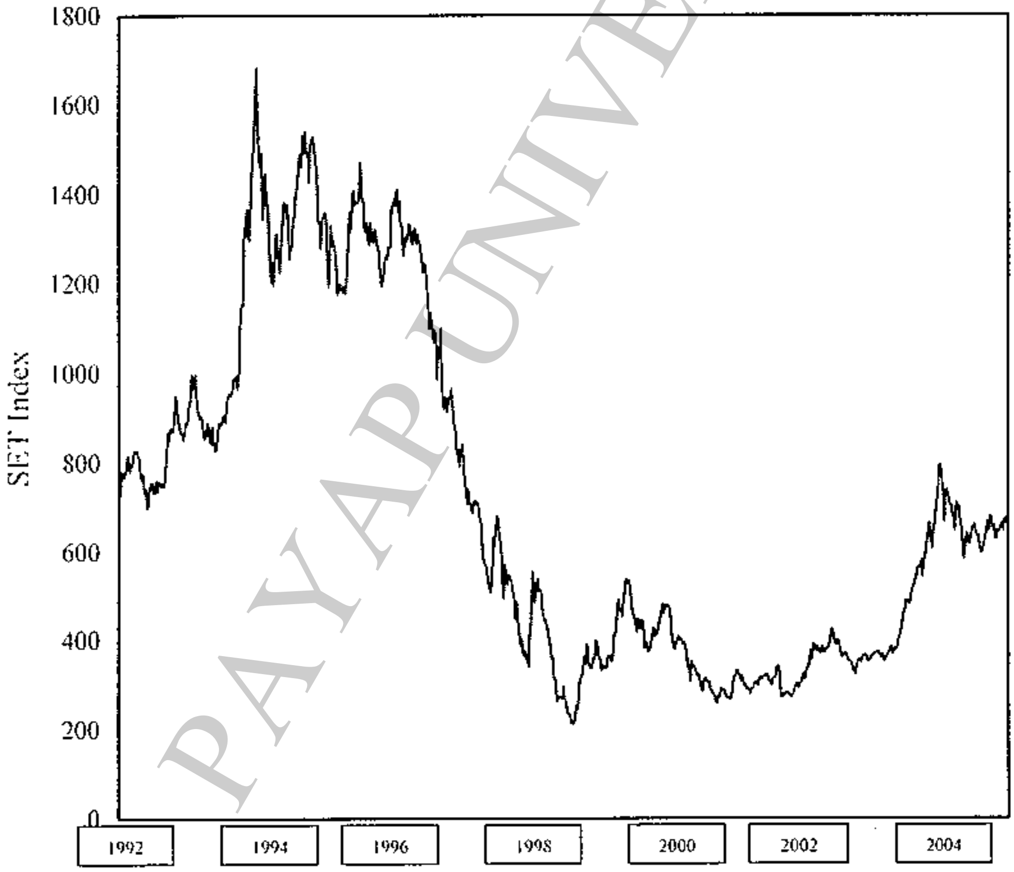
Selectivity and Market Timing of fund performance refers to mutual fund managers' ability to select undervalued stocks and time their buys and sells to upswings and downswings in the market (Dellva, Demaskey and Smith 2001). Examination of selectivity and market timing of fund performance has been extensively covered in the finance literatures, with main focus on developed economies experiences (see, for example, Treynor and Mazuy 1966; Kon and Jen 1978; Henriksson and Merton 1981; Veit and Cheney 1982; Kon 1983; Henriksson 1984; Chang and Lewellen 1984; Admati, Bhattacharya, Pfiederer, and Ross 1986; Lehmann and Modest 1987; Grinblatt and Titman 1989a; Lee and Rahman 1990; Beckers 1997; Danial, Grinblat, Titman, and Wermers 1997; Kao, Cheng, and Chan 1998; Umamaheswar Rao 2000; Dellva, Demaskey and Smith 2001). On the other hand almost negligible efforts have been made on the frontier of developing economies experiences. Thailand provides a valuable scenario for analysis of developing economies experience with an emerging capital market that has undergone a full business cycle.

In the period prior to 1992, the mutual fund industry in Thailand was monopolised by The MFC Asset Management Public Company Limited. which launched the first equity fund in 1977. During the period, 1977 to 1991. The Mutual Fund Public Company Limited established a further eleven equity funds. of which seven were still operating by the conclusion of 1991(Association of Investment Management Companies 1999). The monopolistic nature of the mutual fund industry in Thailand ceased in 1992 when the Thai parliament passed new securities law entitled 'The Securities and Exchange Act B.E. 2535', which led to the creation of 7 new mutual fund licences. By the end of 1992, the mutual fund industry had grown dramatically with the eight licensed companies operating 37 mutual funds. The following four years witnessed significant growth in the number of mutual funds and by the end of 1996, 205 funds were in existence. (Securities and Exchange Commission 1993, 1996: and Association of Investment Management Companies 1999).

In 1997, Thailand was subject to a severe financial crisis during which the economy collapsed. This perilous situation was considered to be the worst recession in modern Thai economic history (Hataiseree 1998). Total market capitalization declined 56 percent during 1996-1997, and by end 1997 Thai equity market capitalisation fell to 44 percent of its 1996 value. A further large decline of a 42 percent was occurred between 1999 and 2000.

In addition, the SET index reached its highest level on 4 January 1994 at 1,753.73 points. The sharp decline of the index started in January 1996, with the index hitting its lowest level at 207.31 points on 4 September 1998, an 88 percent decline from its high (Securities and Exchange Commission 1994, 1996, 1998, 1999, and 2000). The severe drop in Thai equity market capitalization and the SET index reflected a significant negative impact on the performance of Thai equity funds during that period.

**Figure 1.1 SET Index during January 1992 – December 2004**




Source: The Stock Exchange of Thailand

Due to the substantial volatility of the Thai stock market, as evidenced by the financial crisis, the ability of fund managers to select appropriate stocks during upswings and downswings of market has become a greater concern to investors. regulators and fund managers themselves. Since the Thai fund industry is relatively new, the issue of fund manager's selection and market timing ability is of great significance to the progress and development of the Thai fund industry and the economy.

### *1.2 Aims of the Research*

The primary aim of this study is to examine equity fund managers in Thailand whether they are superior stock selectors or market timers. The secondary aim is to examine relationship between the market timing measures whether results are sensitive to the timing measures.

The verification of the primary aim in this study would involve investigation of the following matters:

(i) Selectivity performance during 1992-2004;

(ii) Market timing performance during 1992-2004;

(iii) Selectivity performance on nine overlapping periods (five years each) beginning in January 1992 and ending in December 2004.

(iv) Market timing performance on nine overlapping periods (five years each) beginning in January 1992 and ending in December 2004.

## *1.3 Expected Benefit*

### *1.3.1 Statement of Significance*

This study is expected to make significant contribution with practical implications for Payap University, including the following market participants in Thailand:

(i) ***Payap University:*** This research is expected to provide a contribution of knowledge for several subjects in Finance discipline.

(ii) ***Fund managers:*** This research is expected to provide a contribution to fund managers, which will enable Thai fund managers to evaluate their abilities as stock selectors or market timers, and, as a consequence, contribute to the efficient development of Thai fund industry.

(iii) ***Investors:*** Investors will require information which will enable the performance of the fund and the fund managers to be evaluated, including market timing ability.

(iv) ***Regulators:*** This study is expected to provide a framework for regulators of financial markets, which will enable regulatory bodies including the Securities and Exchange

Commission (SEC) of Thailand to review policies and practices of fund management in Thailand[1].

(vi) ***New market participants:*** The research is expected to provide information to future financial market entrants. It will provide data which selectivity and market timing performance during a period of volatile economic activity.

(vii) ***Analysts and researchers:*** Participants in capital markets utilise information provided by market analysts and researchers. This research is expected to provide new information to enable the evaluation of selectivity and market timing performance.

This research study will not only be significant to all of the above mentioned market participants in Thailand, but also to market participants including regulators in financial markets of other emerging markets.

### *1.3.2 Contribution to Knowledge*

According to Kritzman (1986), and Reilly and Norton (2006), market timing performance study should extend over several years and cover at least a full market cycle which allows examination ability of equity fund manager during rising and declining markets.



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[1] For example, the Securities and Exchange Commission (SEC) of Thailand has a rule of maintaining proportion of assets in each mutual fund type.

Therefore, studying this issue requires a review period long enough to include significant variations in economic activity.

This research will provide a longitudinal study of the fund selection and market timing of equity fund performance and look insight into the nine overlapping periods (five year each) to obtain another perspective on the value of fund performance information that have not been previously researched in Thailand and therefore is expected to close this important gap in the finance literature. The time frame study is 13 years, 1992-2004.

### *1.4 Research Questions*

Three research questions associated with the two main aims above are described in this section

The primary aim of this study is to examine the selectivity and market timing performance of equity funds. This aim leads to Research question 1.

**Research question 1:** Are equity fund managers during the period 1992 - 2004 superior stock selectors?

**Research question 2:** Are equity fund managers during the period 1992 – 2004 superior market timers?

In addition, since the two market timing (Treynor and Mazuy, and, Henriksson and Merton) estimate market timing performance using different procedures, it is important to consider whether market timing performance results are dependent upon which of the measures is used. This issue generates Research question 3.

**Research question 3:** Is the market timing performance of equity funds dependent upon which of the Treynor and Mazuy, or Henriksson and Merton measures is used to measure performance?

### *1.5 Overview of the Research*

Following this chapter, Chapter two reviews the literature related to selectivity and market timing performance. The review includes selectivity and market timing definitions. Empirical results from previous studies of selectivity and market timing performance are also reviewed. In addition, unpublished working papers on market timing performance in Thailand are reviewed.

Chapter three presents the research methodology. Three null hypotheses associated with the three research questions are set. This chapter also details the methods of investigating the hypothesis tests. Data collection method, sample selection, methods for evaluating market timing performance, and statistical tests of hypotheses are discussed.

Chapter four reports the empirical results of the hypothesis tests conducted on selectivity and market timing performance during the 13-year period 1992-2004. In addition, the relationship between market timing performance measures is reported.

Chapter five presents a summary of this research study. This chapter includes conclusions and discussion, along with the implications of the research. This chapter also discusses the limitations and possible future directions for market timing performance studies in Thailand.

### *1.6 Summary*

This chapter provides a brief introduction to the background to research problem. It also introduces the aims of this research study, as well as the issues that will be examined. This chapter also provides expected results, including the significance of this study concerning selectivity and market timing performance in Thailand and the contribution to knowledge. In addition, the structure of this research report is also outlined. The next chapter will provide a review of the literature on the market timing performance.