

ASSESSMENT OF EQUITY LARGE CAP FUND MANAGEMENT: STUDY OF A COMBINATION OF PROACTIVE AND PASSIVE STRATEGIES

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ABSTRACT

Equity funds among the mutual funds have the ability to provide better returns but at the same time, the risk associated with these funds is greater due to volatile share prices. However, this risk can be reduced through diversification or investing in different shares. These funds are less expensive and have less liquidity as well. In context of active and passive funds, it can be stated that the total market return is based on both these types of funds. Overall the objective of the study is to evaluate the performance of active and passive strategies of investment in the equity large cap funds over the investment period of 10 years. The researcher has collected cross sectional data about the active equity large cap funds from the websites and data bases of Thailand related to finance. The analysis has been performed in context of descriptive statistics, correlation analysis and ranking of the funds. The mean annual return of the active funds was found to be 5.34% while the benchmark or passive funds was 4.90%. In context of risk adjusting performance, the active funds are found to outperform the passive funds as the sharpe ratio of active funds was 0.221 while that in the market is found to be 0.241. These values suggest that different active equity large cap funds have outperformed the passive benchmark.

Keywords: Equity Funds, Active, Passive, Large Cup Funds

Article Received: 18 October 2020, Revised: 3 November 2020, Accepted: 24 December 2020

1. Introduction

Mutual fund can be defined as the fund which takes the form of trust by a sponsor and its purpose is to increase money by selling these units to the general public associated with different schemes and regulations and the investment in different securities through these regulations and schemes. In other words, it can also be stated that the mutual funds are a kind of a professional firm in which different investors pool their investments in different securities such as stocks, bonds etc. The person who manages all these procedures regarding the mutual funds is known as portfolio manager and the job of this manager is to control and trade all the forms of securities that come under these funds, to have a look on the loss and gain in these securities and on this basis, accumulate the dividends and interests (Basu, 1977; Brown, Goetzmann, Ibbotson, & Ross, 1992; Dare, Orugun, & Nafiu, 2019). The ultimate receiver after the whole process is the one who had originally invested in the funds. In order to calculate the value of mutual fund share, also called as net asset value per share, the total fund value is

divided by the issued and outstanding shares, daily. The importance of mutual funds has therefore increased with the passage of time in context of the financial wellness of the investors in different regions of the world. As more and more people are investing in these funds, they have also contributed towards the economy of different countries (Carhart, 1997; Chan, Gup, & Pan, 1997). With the increase in awareness of these funds, it might be expected that the number of investors might increase further. As far as the equity funds are concerned, their main purpose is to provide appreciation regarding capital in long term. It has been estimated that the equity funds among the mutual funds have the ability to provide better returns but at the same time, the risk associated with these funds is greater due to volatile share prices. However, this risk can be reduced through diversification or investing in different shares. These funds are less expensive and have less liquidity as well. In context of active and passive funds, it can be stated that the total market return is based on both these types of funds. In other words, the market returns must be evaluated on the basis

of active and passive funds’ performance at the same time (Sharpe, 1991).

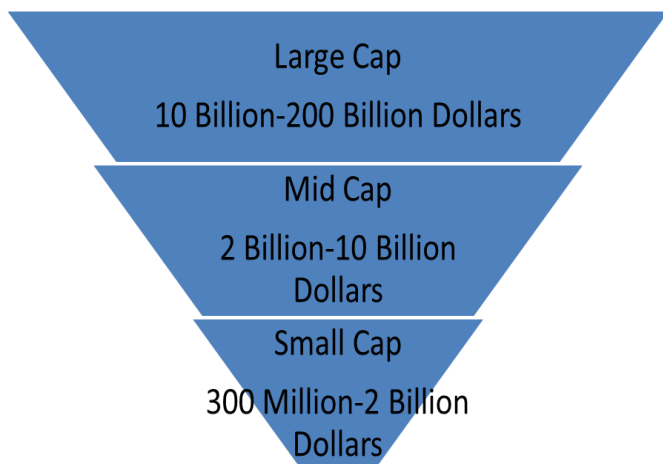


Figure 1: Small, mid and large cap funds (financial engines)

With the increase in awareness of the equity funds and investments in portfolios, it has become necessary to understand the active and passive strategies of investment in these funds. In the past, different studies have taken place with the similar motive and these studies have focused on different types of funds. However, the current study is focusing only on equity large cap funds. Overall the objective of the study is to evaluate the performance of active and passive strategies of investment in the equity large cup funds over the investment period of 10 years. This study will be very significant for the investors as they will have a clear picture the performance of different types of investment strategies i.e. active and passive and thus they will be able to make rational investment decisions.

Table 1: Return % on Large Cup Equity

Investment Period	Return %
3 Months	6.5
6 Months	12.9
Year to Date	12.9
1 Year	0.72
3 Years	14.38
5 Years	20.41
10 Years	12.33

2.1 Equity large Cap Funds

Different studies have been conducted in context of the subject of the current study. A study by (Trey nor, 1965) indicated a new way of showing performance results of the funds. The method used by the researcher to present the performance was through the line of characteristics in a graph. According to the study, if the line was steeper, the fund will have more risk and volatility. In this way, the researcher used several concepts and ultimately came up with the single line index called as Trey Nor Index. The return that is expected on a particular portfolio and the risk associated with that particular portfolio are in relation with each other and this concept was based on the modern portfolio theory (Fama & Miller, 1972; Read, 2012). The researcher utilized different related concept and ultimately came up with an index named as Sharpe Index. The researcher made an attempt to evaluate the performance of the portfolio and suggested that the risk associated with the portfolio or security is based on the ineffective management of the securities (Schädler, 2018). Another study was found in which the researcher tried to evaluate the performance of the shares on the basis of CAPM approach in context of small and large investors. The index that was used in the study was ET index and it was intended to understand the market behavior (Chukwu, Adeghe, & Aguwamba, 2019; Clifford, Amisshah, & Attuquaye, 2020; De Bondt & Thaler, 1985; Elton, Gruber, & Blake, 1996). On the other hand, the risk associated with the funds was evaluated by using different indexes such as Sharpe index and Trey nor index. Two different lines were used in the study in order to study and understand the risk and return relationship (Sewell, 2011). These lines included capital market line and security market line. The former was used in context of large investors while the latter was used for small investors (Barua & Varma, 1991). Another study of similar context suggested that the small investors usually choose mutual equity funds for investment purposes because these funds target the small investors who do not have enough knowledge about the stock markets well but are interested in investing in some securities. In

2. Literature Review

addition, the choices and selection criteria of small; investors differs as well (Nilayam). A study by Fuller, Han, and Tung (2010) was aimed to evaluate the performance of mutual funds by using BSE SENSEX in the form of market surrogate. The results of the study suggested that in case of mutual funds, the average rate of return is was much lower as compared to the market return. A study by Grinblatt and Titman (1992) was aimed at evaluation of the performance of the mutual funds in context of the comparison of the returns through the securities having relatable constraints and risks. In this regard, the researcher used a risk return relationship so that the funds can be compared that had different levels of risks associated with them. The total return in the study was distributed in returns due to varied types of risks such as investor risk, manager risk etc. A similar study by Hendricks, Patel, and Zeckhauser (1993) suggested that the equity funds might be appreciated more in the near future. The researcher pointed out that the investors must have the clear idea about what is their purpose of investment before they finalize the scheme or fund they are going to invest in. In this regard, it was found out that the diversified portfolio was much safer to invest and the index funds were the better option when there were so many uncertainties in the market (Altaf, Hameed, Nadeem, & Arfan, 2019; Shukla, 2004). All the aforementioned researches were based on the performance evaluation of the equity fund using different indexes and different strategies (Pástor & Stambaugh, 2002; Philips, Kinniry Jr, Todd Schlanger, & Hirt, 2014).

2.2 Active and Passive Investment Strategies

In context of the active and passive strategies of investment are concerned, various studies have considered these subjects in the past literature. It has been found out as per most of the studies that the active strategy shows lower performance as compared to the passive strategy but at the same time there are researchers that have stated that active strategy is better than the passive one (Crane & Crotty, 2018; Fichtner, Heemskerk, & Garcia-Bernardo, 2017; Isik, 2017; Womack, 1996). Thus there exists in conflict between these two strategies

that which shows better performance. This context has been considered in different themes in the past such as investment period, hot hands performance consistency, geographic factors and finally the costs associated with transactions. As per the investment period context is concerned, the literature has suggested that the passive strategy shows much better performance as compared to the active one. In this regard, Grinblatt and Titman (1989) conducted a study in which the mutual funds for the period of 1975 to 1984 were considered in quarterly context and the collected data was used in order to find out the returns associated with the mutual funds based on risks and also to explore the performance of the active and passive strategy. The results of the study suggested that active management showed abnormal performance especially in case of the growth funds and those that had less asset values associated with them (Sushko & Turner, 2018). Another researcher carried out the similar study in which 10 years mutual funds data was used and the performance was evaluated through four index model. The study showed the similar results that active management of mutual funds had not shown superior performance and this performance had the range of -1.9% to -0.6% (Gruber, 1996). The exact similar context of study i.e. 10 years mutual funds was used by Blanchett and Israelsen (2007) and the researcher found the similar results that the active management of funds did not show better performance in a consistent way. As per the study of Brinson, Hood, and Beebower (1995), the passive management of funds showed better returns and good performance and this completely depends upon the index used by the researcher. The study by (Fama & French, 2010) indicated that the active fund managers might improve their stock picking skills in order to perform better than the passive ones and there is definitely a possibility of this aspect. However, the evidence of the good performance of active managers is not much known in comparison with the passive managers. Wermers (2000) carried out a study in which 1200 funds were examined in context of their returns by the utilization of CRSP index. The results of the study

indicated that the performance of mutual funds is better than the index used by 1.3%. In the same way, another study by Phillips 2014 suggested that active investment is a better option. The researcher used 2800 funds that were being invested actively and examined them on the basis of three decades. In one decade, it was found out that 635 of the equity funds showed better performance than the portfolio returns. Malkiel (2003) carried out a study in which it was suggested that there is correlation between the long term performance of active fund and the better performance of passive funds.

3. Methodology

As the researcher has collected the data for analysis purpose in the form of share prices and their performances, therefore it can be stated that the researcher has used deductive approach and quantitative method of research. The researcher has collected cross sectional data about the active equity large cap funds from the websites and data bases of Thailand related to finance. The analysis has been performed in context of descriptive statistics, correlation analysis and ranking of the funds. This shows that the data analysis has also used the deductive approach. For analysis purpose, the researcher has developed the hypothesis based on the fact that a parameter value is true and this hypothesis is supposed to be verified through analysis. In this regard, the null hypothesis suggests that the alpha value or abnormal return value is equal to zero or less than that and in the opposite way the alternative hypothesis indicates that the alpha value is not equal to zero.

As far as the sample of the study is concerned, the current study has used five equity large cap funds of Thailand. Among these five funds, four i.e. BKIND Fund, BUALUANG SIRIPHOL Corporate Governance, BUALUANG Thai Equity CG Fund and BUALUANG SIRIPHOL Corporate Governance RMF are managed by BBL Asset Management Company while one fund i.e. K Thai Equity CG RMF is managed by Kasikorn Asset Management Company. Thus the sample size of the study is 5 and all the funds are equity large cap funds. The next step was to collect the share prices

of all these funds for ten years investment period (Cremers, Ferreira, Matos, & Starks, 2016). The measurement of return can be calculated through the following formula:

$$R = \frac{CP_t - CP_{t-1}}{CP_{t-1}}$$

In this equation, CP_t shows the closing price of security and CP_{t-1} shows the original closing price of security for preceding time period. The mean return can be calculated by arithmetic and geometric return as follows;

$$R_{mean} = \frac{R_{M1} + R_{M2} + R_{M3} + \dots + R_{Mn}}{N}$$

$$R_G = \sqrt[n]{R_1 * R_2 * R_3 * \dots * R_n}$$

In this equation, R_{mean} is the average return per n and R_G is the geometric return per n. In the same way, average annual return is calculated through;

$$AAR = \sum_{K=1}^N \frac{R_{MTn} - TER_{Yn}}{N}$$

After all these calculations, it must be noted here that such studies contains different biases related to the collection of data, sampling techniques, data description (Anadu, Kruttli, McCabe, Osambela, & Shin, 2019; Ates, 2019; Barry, 2020; brahim, 2020; Heath, Macciocchi, Michaely, & Ringgenberg, 2018). Therefore, it is recommended by the researchers to resolve such issues so that accurate and authentic results regarding the comparison of active and passive strategies of funds investment can be obtained.

4. Results and Analysis

The table 1 of the study shows the return values of all the active equity large cap funds both in case of daily annualized and yearly returns. As far as the daily return is concerned, its value is $ra1=5.34\%$ and this value has been calculated by annualizing the daily return values. On the other hand, the yearly value of return is found to be $ra2=5.06\%$ and this value has been calculated by the division of

total return period by the total number of investment years. If these active values are

compared with the passive benchmark, it comes out that the active values show better performance.

Table 2: Descriptive statistics of returns for all active equity large cap funds

	Daily returns	Yearly returns
Arithmetic mean	0.03%	5.06%
Annualised arithmetic mean	5.34%	-
Logarithmic mean	0.02%	2.12%
Annualised logarithmic mean	2.32%	-
Median	0.04%	8.93%
Min.	-10.42%	-47.03%
Max.	13.45%	38.32%
Variance	0.19%	4.88%
Standard deviation	1.76%	20.87%
Annualised standard deviation	22.09%	22.34%
Kurtosis	10.39	2.42
Skewness	-0.04	-1.36

In table 2, the alpha values regarding the active equity large cap funds have been presented and these values have been created throughout the time period of investment. The alpha value can be referred to as the subtraction of passive funds from the active ones. This alpha value is measuring the mean holding investment period and these values are insignificant. As far as the comparison of active

and passive funds is concerned, it has been found out that the active funds show better performance on daily and yearly basis but they show almost similar result to the passive funds on weekly and monthly basis (Burhanuddin, Osman, & Raju, 2020a; Cateia, 2019; Hameed, Nadeem, Azeem, Aljumah, & Adeyemi, 2018; Ul-Hameed, Mohammad, & Shahar, 2018).

Table 3: Alpha of active and passive returns

	Daily	Weekly	Monthly	Yearly
Arithmetic mean	0.00%	0.02%	0.04%	1.21%
Annualised arithmetic mean	0.46%	0.43%	0.41%	-
Logarithmic mean	0.00%	0.00%	0.02%	0.61%
Annualised logarithmic mean	2.11%	0.23%	0.12%	-

The total or cumulative returns in case of both active and passive returns have been reported in table 3 in context of five time periods. In this case too, the measurement of mean investment period is

measured and the values are statistically insignificant. The comparison has shown that the active returns have been out performed by the market except in case of 10 years.

Table 4: Cumulative returns of active funds and passive market

Active Funds				
6m	1y	3y	5y	10y
8.87%	6.65%	23.43%	65.46%	36.98%
Benchmark				
6m	1y	3y	5y	10y
10.32%	12.62%	32.41%	75.83%	34.54%

The table 4 shows all the five funds taken as sample in context of their ranking so that the better funds can be pointed out. The basis of the rankings is mainly in terms of average holding period return,

Sharpe ratio, Treynor ratio, Information ratio and Jensen’s alpha. The values of the returns as well as ratios along with their rankings for five equity large cap funds can be seen in table 4.

Table 5: Risk-adjusted performance measures and rating analysis

Name of Funds	Total average return	Sharpe ratio	Treynor ratio	Information ratio	Jensen’s alpha (non-regression)
	Value	Rank	Ratio	Rank	Alpha
BKIND Fund	17.01%	1	0.684	2	-0.264
BUALUANG SIRIPHOL Corporate Governance	21.31%	4	0.373	5	-0.132
BUALUANG Thai Equity CG Fund	11.51%	2	0.421	4	-0.198
BUALUANG SIRIPHOL Corporate Governance RMF	12.76%	5	0.483	3	0.143
K Thai Equity CG RMF	9.49%	3	0.664	1	0.004

Descriptive statistics regarding all the equity large cap funds taken for the study have been reported in the table 5 such as average returns standard deviation etc. The basic purpose of the table is to explore that how the funds are performing in the market. The values of presents return, risk, risk-adjusted performance, and implied cost of equity etc. for the funds can be seen evidently in the table.

Table 6: Descriptive statistics and risk-adjusted performance of Equity Large Cap Funds

	All Equity Large Cap Funds
Number of funds	5
Average return	4.86%

Standard deviation	22.32%
Beta	0.652
Sharpe ratio	0.221
Treynor ratio	0.095
Tracking error	1.67%
Information ratio	-6.131
Required cost of equity	4.372%

5. Discussion and Conclusion

5.1 Discussion

In the current study, the researcher collected data from the equity large cap funds of Thailand and the purpose of the collection of data and this study was to compare the outcomes or performances of the active funds and the passive funds of Thailand. The

researcher has applied different techniques and approaches for this purpose and all the techniques show distinct comparison of active and passive funds. The mean annual return of the active funds was found to be 5.34% while the benchmark or passive funds was 4.90%. In context of risk adjusting performance, the active funds are found to outperform the passive funds as the sharpe ratio of active funds was 0.221 while that in the market is found to be 0.241. These values suggest that different active equity large cap funds have outperformed the passive benchmark (Chukwu, 2019; Elton, Gruber, & de Souza, 2019). This result is especially evident based on the risk adjusting performance values. According to the accounting of costs, the results have shown that alpha value of the active funds has been balanced by the expenses. In case of regression results, the same inferior results have been found. There is no evidence found which can make it clear that the alpha value is not equal to zero. This results leads to the fact that the null hypothesis has been rejected in the study.

5.2 Conclusion

As the researcher has used two different benchmarks in the study, an issue has been faced by the researcher in context of the selection of these benchmarks. It must be noted and kept in mind that the performance of active or passive funds cannot be evaluated on the basis of one single index. In other words, the researcher had used some other index or some other benchmark; it might have resulted in some other results. However, the results of the study have suggested that active funds might outperform the passive funds but this outperformance totally depends upon the value of the benchmark or where the threshold value of benchmark exists. As different approaches have shown different results, therefore it is recommended that the researchers must review the literature in detail. In other words, it has been found out that according to some researchers, active funds show better performance but other researchers do not agree with this stance and they insist that active funds do not show better performance (Allegrucci,

2020). These conflicts of opinions might be effectively resolved by using different methodologies, using different time periods of data collection, different measurements regarding the performance of funds. The benchmark selection might also play an important role in this context. An interesting trend in the equity market is that despite knowing that most of the active funds do not perform well in the market, people still invest in the active funds. The reason behind it might be that these people are well aware of the certain studies or evidences that have shown that active funds outperform in the market (Fama & French, 2010; Gruber, 1996).

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