CHAPTER 1: INTRODUCTION

1.1 Introduction

Many theories and strategies have been developed over the years on methods to outperform the stock markets. Some have resulted in some measure of success while others have been deemed failures.

Stock market investment has become very important in recent years for the following reasons. First of all, investing has taken on a global scale, as the world becomes smaller. Second, new stock markets are being formed and developed continuously over the years in emerging countries. Furthermore the existing stock markets have continued to grow, hence widening the level of investment opportunities. Third, an increasing number of individuals are taking a closer and proactive interest in stock market investment, due to an overall increase in the understanding of investment practices in general.

1.2 Purpose of Research

The purpose of this research is to evaluate whether the investment return provided by the Dividend-Yield Strategy is higher than the average market return. Although dividend investing has been in use for many years, it was Michael O'Higgins who popularised the Dividend-Yield Strategy in his 1992 book entitled "Beating the Dow". This strategy calls for a ten-stock portfolio consisting of the ten highest dividend-yield stocks in the Dow Jones Industrial Average Index ("DJIA") with a once-a-year annual readjustment to the portfolio.

\[\text{\footnotesize \cite{1}}\]

\[\text{\footnotesize O'Higgins M. (1991), Beating the Dow, USA; Harper Perennial Publishing.}\]
Studies conducted on the New York Stock Exchange ("NYSE") have shown that the Dividend-Yield Strategy outperformed both the DJIA and Standard & Poor 500 Index ("S&P500")\(^2\) consistently year after year. Therefore, the primary objective of this research is to evaluate whether the application of the same Dividend-Yield Strategy on the Kuala Lumpur Stock Exchange ("KLSE") will yield similar results.

1.3 Research Hypotheses

This research is premised on the following 2 hypotheses:

The null hypothesis is:

\[ H_0 : \text{Investment in the 10 highest dividend yield Kuala Lumpur Composite Index ("KLCI") composite stocks will outperform the main indicator of the Malaysia stock market, namely the KLCI.} \]

The alternative hypothesis is:

\[ H_1 : \text{Investment in the 10 highest dividend yield KLCI composite stocks will not outperform the main indicator of the Malaysia stock market, namely the KLCI.} \]

\[^2\] Harvey C. Knowles and Damon H. Petty (1992), The Dividend Investor, USA: Probus Publishing.
1.4 Significance of this Research

The findings of this research would be useful to the investing individual and also the investment organisations.

The investing individual will be interested to know whether such a simple investment strategy will allow them to form investment portfolios that provide greater investment returns on the stock markets.

John Markese when commenting on the individual investor said that "while selecting individual investments is challenging, the most difficult part of the decision process is putting a cohesive and rational portfolio that makes sense in terms of an individual's long-term financial goals and also make sense on an investment basis" ³.

Besides the investing individual, this research will also enable the investment organisations to compare the performances of their respective investment strategies (which are more complex, time-consuming and resource intensive) against the Dividend-Yield Strategy.

A study conducted by Barber and Odean ⁴, showed that out of 166 investment clubs in the USA, the average club lagged behind the performance of a broad-based market index by over 3% per year; earning an annualised geometric mean return of 14.1%, while the market index returned 17.9% resulting in 60% of the clubs under-performing the index. Therefore should the Dividend-Yield Strategy prove viable in this research, it is better for investment clubs to use the Dividend-Yield Strategy rather than their respective investment strategies.

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³ Extract from an interview with John Markese, President of American Association of Individual Investors.
⁴ Brad M. Barber and Terrance Odean, (1998), "Too Many Cooks Spoil the Profits: The Performance of Investment Clubs", a working paper from Graduate School of Management, University of California.
1.5 Scope of Research

For the purpose of this research, the investment universe consists solely of the component stocks of the KLCI. This is because the component stocks of the KLCI are representative of the different sectors and industries making up the Malaysian economy. This research will not include all the listed stocks in the KLSE (or any other sector within the stock market) as time and availability of resources constrict the scope of this research.

1.6 Organisation of the Research

The following chapter will review and discuss the relevant literature related to stock market investments, with the primary intention of allowing readers to gain a better understanding of investment theories and concepts prior to the presentation of the actual research. Chapter 3 consists of the details of the Dividend-Yield Strategy while Chapter 4 provides some explanation of the Kuala Lumpur Stock Exchange. Chapter 5 shows the research findings and finally Chapter 6 comprises of the conclusion and recommendations.

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5 Kuala Lumpur Stock Exchange (1986), Kuala Lumpur Stock Exchange Composite Index, (March), Malaysia.