CHAPTER 1

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1.1 Background of the Study

Unit trust is an investment scheme that pools money from many investors which is used to buy assets such as equities, bonds or other securities. The unit holders do not hold the funds directly. The professional fund manager is responsible for the performance of the portfolio. The returns on investment of unit holders is usually in the form of income distribution and capital appreciation which derived from the pool of assets supporting the unit trust fund. In the long run, the returns of unit trust fund are provided better returns at the acceptable level of risk compared to fixed deposit. In the other words, unit trusts are excellent for individual and corporate financial planning due to their affordability, liquidity and relatively low risk nature.

In the earlier stage started 1959, unit trust industry was considered the formation year. Only five unit trust management companies were established during this stage, with a total of 18 unit funds. Due to the little establishment and the public were not really interested in this new investment product, the sales of units of unit trust were characterised slow growth. This industry is regulated by several parties including Registrar of Companies, The Public Trustee of Malaysia, Bank Negara Malaysia and the Ministry of Domestic Trade and Consumer Affairs. In the 1970s, state government were sponsored unit trusts fund in order to encourage domestic household savings.

When Permodalan Nasional Berhad launched Amanah Saham Nasional (ASN) in 1981, it was significant development in the history of this industry. The total units subscribed by the public increased because of the ASN and the involvement of the government in this industry by formation of an Informal Committee to regulate the unit trust industry.

In the 1990s, this industry was a fastest growth in terms of the new management companies established and funds under management as well as the marketing strategies adopted by ASN and Amanah Saham Bumiputera (ASB). Besides that, the adoption of the regulations of Unit Trust Scheme Regulation in 1996 made the unit trusts household products in Malaysia. The total asset value of funds grew more than threefold from RM15.72 billion (end of 1992) to RM59.95 billion (end of 1996). In the end of 1999, concentration of funds within the pensions and provident fund industry, unit trust funds was covered 14.65%.

Starting to the 21st century, the unit trust industry was growing further with the liberalisation policy under the ten years Capital Master Plan from 2001 until 2010. This master plan was split into three phases. During the second phase of the master plan which started from 2004 to 2005, the unit trust funds have been allowed to invest in the overseas markets. Therefore, many unit trust management companies have started to launch many new funds especially the International Equity Funds.

Table 1.1: Total NAV vs Bursa Malaysia Market Capitalisation as at 31 December (in RM Billion)

Description	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Bursa Malaysia Market Capital	444.35	464.99	481.62	640.28	722.04	695.27	848.70	1,106.15	663.82	999.45
Net Asset Value	43.30	47.35	53.70	70.08	87.38	98.49	121.78	169.41	134.41	191.71
% of NAV/Bursa Malaysia Market Capital	9.74	10.18	11.15	10.95	12.10	14.17	14.35	15.32	20.25	19.18

Source: Extract from Annual Report of FIMM

Besides, the total Net Asset Value (NAV) of the unit trust funds have also been growing from RM43.30 billion in year 2000 to RM169.41 billion as at 31 December 2007. However, the strong growth has been affected during the financial crisis in 2008 and the total NAV drops to RM134.41 billion. By the end of 2009, the total NAV were up again and manage to achieve RM191.71 billion which is higher than 2008 as stated in the Table 1.1. It show that the unit trust industry is continue to grow and the number of management companies also increase to 39 and total number of launched funds are 565 by end of 2009. As for the for the private equity unit trust funds, the total NAV were increased from RM8,774.07 billion in year 2000 to RM25,739.08 billion in year 2007 (Table 1.2). However, it dropped to RM15,008.13 billion during the financial crisis in Year 2008.

Table 1.2: Net Asset Value by Types of Funds as at 31 December (2000-2008) (in RM Billion)

Categories	2000		2001		2002		2003		2004		2005		2006		2007		2008	
ETF-Equity	NA		NA		NA		NA		NA		NA		NA		22.02	(0.03)	486.48	(0.77)
ETF-Bond General	NA		NA		NA		NA		NA		564.90	(1.28)	515.57	(1.02)	505.60	(0.69)	536.42	(0.85)
Guaranteed/Protected	NA		NA		74.69	(0.35)	375.92	(1.30)	844.48	(2.22)	1,350.17	(3.06)	3,161.64	(6.23)	4,118.69	(5.65)	6,340.22	(10.04)
Islamic	1,409.60	(10.49)	2,116.12	(12.54)	2,880.23	(13.63)	4,297.77	(14.89)	6,008.09	(15.81)	7,758.10	(17.58)	7,309.08	(14.41)	16,554.86	(22.72)	16,947.04	(26.84)
Mixed Asset	1,744.30	(12.98)	2,162.22	(12.81)	2,732.85	(2.67)	3,845.46	(13.32)	4,137.27	(10.89)	4,466.34	(10.12)	5,284.49	(10.42)	7,816.09	(10.73)	5,120.24	(8.11)
Money Market	157.39	(1.17)	287.95	(1.70)	606.42	(12.93)	939.35	(3.25)	3,316.91	(8.73)	5,005.06	(11.34)	6,796.66	(13.40)	10,655.45	(14.63)	11,692.20	(18.52)
Bond	1,356.79	(10.09)	1,960.12	(11.62)	3,392.86	(16.06)	5,027.66	(17.41)	6,745.82	(17.75)	8,466.57	(19.18)	7,804.91	(15.39)	7,245.72	(9.95)	6,782.03	(10.74)
Equity	8,774.04	(65.27)	10,350.26	(61.33)	11,444.82	(54.16)	14,386.34	(49.83)	16,944.82	(44.60)	16,520.88	(37.44)	19,850.40	(39.13)	25,739.08	(35.33)	15,007.13	(23.77)
Others	NA		NA		NA		NA		NA		NA		NA		199.37	(0.27)	227.22	(0.36)
Totals	13,442.12	(100.00)	16,876.67	(100.00)	21,131.87	(99.80)	28,872.50	(100.00)	37,997.39	(100.00)	44,132.02	(100.00)	50,722.75	(100.00)	72,856.88	(100.00)	63,138.98	(100.00)

Notes:

1. Based on Lipper's fund investment objectives, these funds have been grouped into the following eight types:

(a) ETF-Bond & Equity : Includes both bond and equity ETF.
(b) Guaranteed/ Protected fund : Comprises Capital Guaranteed funds and Capital Protected funds.
(c) Money Market funds : Includes all money market funds.
(d) Mixed Asset funds : Includes Mixed Asset MYR Balanced funds, Mixed Asset Other Aggressive funds, Mixed Asset Other Conservative funds and Mixed Asset Other Flexible funds.
(e) Islamic funds : Includes Islamic Bond funds, Islamic Equity funds, Islamic Guaranteed/ Protected funds, Islamic Mixed Asst funds and Islamic Money Market funds.
(f) Bond funds : Include all bond funds invested in Malaysian assets and abroad.
(g) Equity : Include all equity funds invested in local markets and abroad.
(h) Others : Includes Target Maturity funds, Commodities funds, Hedge/ Fixed Income Arbitrage funds as well as funds yet to be classified.

2. The private sector fund classification may differ between the Securities Commission and Lipper.

3. The above excludes Real-Estate Investment Trusts as insufficient fund data were captured by Lipper as at end of 2008.

Source: Lipper Asia Ltd. Based on respondent private funds as categorised by Lipper Asia Ltd and adopted by members.

1.2 Purpose of the Study

Due to the liberalization in the capital market, it creates a wide range of unit trust funds available on the market, ranging from traditional Domestic to International Equity Funds. The International Equity Funds help the investors to further leveraging the advantage of the unit trust fund by diversifying it investment portfolio across geographical locations, sector and assets depending on the investment objective. Hence, it is giving the investors a simple and effective way of investing small amounts to gain bigger exposure in a portfolio of securities rather than concentrating an investment portfolio in one or two stock market. The wider the spread of investments, the less volatile the investment returns and able to diversify more systematic risk.

However, the International Equity Funds also enable the investment portfolio to expose to higher risk such as social, political, and economies of uncertainty in oversea stock market. In order to offer the best fund products to the end investor, some of unit trust management companies even outsourced the investment management of fund asset to a specialist portfolio management team. By doing so, they're able to assure the investors that they are getting the best money management team based solely and investment talent and allow fund providers to focus their resources on the distribution of the fund.

On the other hand, Domestic Equity Funds will have less uncertainty and make it easier to manage in comparative. Domestic Equity Funds will also enjoy the advantage of faster market information and it is vital to the fund performance. Besides, the Domestic Equity Funds will be less required to subscript for the additional market information from other channel which incurred additional management cost.

No doubt that the International Equity Funds are a good way of building an investment portfolio as it provides the consumer more choices in doing their investment. It also helps the investors to spread their money around to gain exposure to other stock market besides Bursa Malaysia. However, it also creates confusion and difficulty to the investors in determining which fund that will give them better returns as both of the equity funds are fall in the same equity category in unit trust funds.

Therefore, this study will examine the performance for both Domestic Equity Funds and International Equity Funds compare to several underlying portfolio benchmarks and provide empirical evidence on the fund excess returns and its beta coefficients. This study is important as the result will help the potential investors to do a better selection or choosing the appropriate equity fund that suitable to them. It is vital as unit trust funds as more people has been promoted to buy unit trust as part of their saving plan to prepare for the future financial requirement such as children education fees, retirement funds and etc. Besides, the unit trusts funds are become increasingly important component of individual savings for Malaysia markets.

Furthermore, as fund markets mature and investors become more sophisticated, the risk and returns expectations expand. The new category of fund such as International Equity Funds have received and increased demand as it is perceived to be able to provide better returns by diversifying its investment to various market.

1.3 Significance of the Study

In general, there are a lot of studies being done on the unit trust fund performance evaluation. However, most of the previous studies were based on the fund performance of the developed countries such as U.S. and Europe. It maybe because the unit trust industry in these countries has a longer history and the market is more mature. In fact, many evaluation techniques such as Jensen (1968), Sharpe (1966) and Treynor (1965) were developed based on the data from the develop countries. There are not many studies being done in the unit trust industry in the developing countries.

In this research study, the study provides new perspectives to the previous study by focus on the performance on the unit trust fund in Malaysia which is a developing country. Besides, this study also specifically focuses only the equity funds category as it normally represents a large portion of the Net Asset Value in this industry. This study also compares the fund performance among the equity funds itself instead of different funds type. Previous studies tend to do the comparison on the performance among different type of funds which has the different type of investment strategic and management fees. This study further divided the equity fund into Domestic Equity Fund and International Equity Fund for the performance comparison.

1.4 Research Questions and Objectives of Study

The general research question in this study is to examine whether Domestic Equity Funds and International Equity Funds in Malaysia manage to outperform the market indexes. Besides, this study will also would like to find the answer on which type of equity funds generally provide better excess returns as both of them are fall in the same type of fund.

Most of the research found is comparing various types of funds or measure its performance over time. The studies done by Ippolito (1989), Droms and Walker (1994), Grinblatt and Titman (1994), Dahlquist, Engstrom and Soderlind (2000), it more towards examine the relationship between the performance of the unit trust funds investment and its asset size, expenses ratios, portfolio turnover and management fees.

Ippolito (1989) and Droms and Walker (1994) were focus on either domestic or international unit trust funds while Grinblatt and Titman (1994) are more towards the application of various measuring technique. Dahlquist, Engstrom and Soderlind (2000) was also study the similar issue but based in the Swedish market. There are not many studies done in comparing the performance of the unit trust funds based on the same funds type and objective but investing in different market.

As for this study, it will like to find out to which extent the Domestic and International Equity Funds earn excess returns when compare with the equity market returns. It will be interesting to know whether the equity unit trust funds are able to provide excess returns or not as both Domestic and International Equity Funds can enjoy ability to diversify its stock portfolio and reduce the systematic risks that associate with the investment portfolio. Hence, the first two research question will be as below:

R1: Are Domestic Equity Funds provide excess returns when compare with the equity market indexes?

R2: Are International Equity Funds providing excess returns when compare with equity market indexes?

Besides, due to the both type of equity funds are investing in different market, the portfolio returns might be different. International Equity Funds will experience more risks and volatility. It will have a higher risk and uncertainly as there might be lack of market information or cannot receive the market information fast due to distance and etc. In return, International Equity Funds should provide higher excess returns compare to Domestic Equity Funds. Therefore, the third research question will be as below

> R3: Are International Equity Funds provide higher excess returns than Domestic Equity Funds when compare with the equity market indexes?

1.5 Scope of the Study

The scope of this study will focus on the yearly returns of the equity unit trust funds and the market indexes starting year 2005 to year 2009. The funds list will be limited to the approved private equity funds listed in the Securities Commission by early of year 2010. New funds which are less than three years were excluded in the scope of study. Besides, the funds are assumed to be well diversified and the fund manager will take necessary steps to manage the risk by taking greater care in stock selection. The study will not cover the fund performance and its fund characteristics or its management style.

As for the market returns, this study will limit to four market indexes for the comparison purpose. However, these selected market indexes are representing the market returns of different countries. There is be one domestic equity market represent by Bursa Malaysia Index and three international equity market represent by Morgan Stanley World Index, Morgan Stanley Asia Pacific ex-Japan Index and Morgan Stanley Europe, Australia and Far East Index.

1.6 Organisation of the Study

This study will begin with understanding on some underlying concept and definition used in measuring the performance of the unit trust funds. It is important as there are many type of measuring technique to measure the fund performance. After that, further study will be done on the Jensen (1968) equation where it will be used to measure the fund performance. Yearly fund returns will be selected across the unit trust management companies in order to prevent bias.

With the data collected, correlation between the fund returns and the market returns will be studied. Besides, individual fund performance will be compare with the market returns by using the measuring technique selected. Summary of the fund performance will then compare with other study. Lastly, this study will compare also the fund returns between Domestic Equity Funds and International Equity Funds.