CHAPTER 1:
INTRODUCTION

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1.1   Introduction

When it comes to investing, one can never deviate from its association of investing in stocks. It seems that the word investing always associate when trading stocks. However, in order to be successful in stock trading, the method has to be right. Several methods have been published in the market outlining the most effective ways on stock trading. On these methods, authors emphasis on the ability to select the right stock. The rationale is that when the stock selection is right - in terms of it price and time - it can yield a substantial amount of return. This is the attraction that most people have when it comes to investing.

However, in general, there are two type of investing: *value investing and growth investing*. This is accustomed with the definition of categories of stocks value stock and growth stock (Jenn et al, 2004).

Value investing can be defined by Ding et al. (2005) as purchasing stocks that sell well below its intrinsic value in relation to certain measures such as past or current earnings, dividends, historical prices, book assets, or cash flow, and any other measures that are deemed appropriate to indicate stock's intrinsic value.

The topic of value investing has been widely covered thorough through researches by academicians starting with the emphasis on US capital market. These academicians have concluded that the value investing method in US market would yield superior returns when analyze with the growth investing

method (Lakonishok et al.; 1994, Fama and French; 1992; 1996). Chan et al. (1995) extended the notion that the large variation that occur in returns for both value stocks (characterized by low book-to-market ratio) and growth stocks (characterized by high book-to-market ratio) are due to the rising critical preconception by investors and also due to agency problem that occur in investment made institutional investors.

This is further substantiated by the fact the value premium that comes from these stocks are prone to be susceptible to mispricing and therefore could be costly to arbitrage as mentioned by Phalippou (2008). Furthermore, Phalippou (2008) stated the existence of value premium in value stocks are actually determined in stocks with large ownership by individuals (individual ownership). Fama and French (2007a) done a research that showed the movement of stocks across numerous sizes, determined by market capitalization and also portfolio that consists of value stocks to identify their (value stock portfolio) returns in respect to the average stock returns. Fama and French (2007b) perceived that the capital gain gained from value portfolio is generated from the convergence in the price-to-book ratios from the mean reversion in the expected profitability returns whilst the growth portfolio showed a negative convergence.

In spite of this, the researches done on Asian stock markets were not empirically comprehensive. However, it is worthy to note that many studies indicate the existence of value premium in the Asian stock markets. Fama & French (1998) conducted a research on four (4) Asian markets namely Australia, Hong Kong, Japan and Singapore. They found the existence of

value premium in these countries. Arshanapalli et al. (1998) did another research on the same Asian markets with the additions of Malaysia in their studies. They found out that the results showed the proof of larger disparity between annual returns on both value and growth portfolio when compared to the Western (North America and European) counterpart.

Though previous researchers had shown the existence of value premium in the Asian markets, Ding et al. (2005) in his study on pre 1997 financial crisis stock markets discovered that there is zero premium existence in Indonesia and Taiwan. They also found negative premium in Thailand. However, the positive value premiums are shown to be present in Hong Kong, Japan, Malaysia and Singapore. Another study by Bauman et al. (1998) indicated that not significant value premium was found in Hong Kong and Singapore during the time of 1997 Financial Crisis.

Daniel et al. (2001), however, reported that the existence of value premium in Japan during their study was more prevalent that the ones on the United States during their studies from 1975 to 1997. They added that the results are in favor of large cap stocks with the emergence of value premium in those stocks.

Since then, many researchers have participated in carrying out research in the topic of superiority of value investing in country-level studies such as (Mukherjietal (1997) on Korea; Chan et al.(1991), Capaul et al.(1993), and Mian and Teo (2004) and Lihara et al. (2004) on Japan; and Yen et al. (2004)

on Singapore which explore the dynamics of results obtained from value investing on these countries.

1.2 Research Problem

Despite the fact that value and growth investing have been in the capital market's dictionary since the year 1939, and various researches have been done on the substance to verify the effectiveness of the strategies all around the world but unfortunately there was no empirical research done specifically on the Malaysian capital market alone i.e. country-level study. Research that was done on Malaysia was done in a manner of clustering Malaysia into a basket consists of different other countries. By portion of these countries, Malaysia's share only accounts approximately 0.7% (Jenn et al. 2004). Articles are written by professionals and published in the periodicals from time to time but thorough research was never been conducted on the topic of value and growth investing in Malaysia as such.

This may explains why there was non-existence of such fund provided by any mutual funds in Malaysia. This could be due to the fact the probability of the lack of knowledge on the topic. Therefore, this research is conducted with the intention to identify whether value premium exists in Malaysia as evidenced in other Asians capital market like Hong Kong and Singapore.

1.3 Research Objective

The purpose of conducting this research paper is to study the performance of growth stocks and values stocks in Malaysia. More specifically, it studies the performance of the stocks 5 years after its portfolio formation (for both value

and growth portfolios). In this research paper, I will intend to examine whether value investing would continue to generate superior returns by adopting various methodologies by previous researchers as to study the consistency of results obtained by others in relation to Malaysia's capital market. This study will represent an up to date look at the efficient markets hypothesis and to identify whether value investing is indeed a superior strategy.

1.4   Research Question

As the research paper intends to study the performance of value and growth stocks in Malaysia, the research paper provides several questions that can navigate the entire study to meet its objectives.

1. How Value Stocks and Growth Stocks perform in Malaysia?
2. Which performs better? Value Stocks or Growth Stocks?
3. What risk-adjusted performance measure says about Value & Growth Portfolio?
4. Is Value Investing method superior?

1.5   Significance of the Study

My interest is this particular topic is because Malaysia is a developing country that has ambition plan to become a developed country by the year 2020. Therefore, Malaysia's capital market will be the focus of investor in realizing that goal. Hence, Malaysia is poised to becoming the center for funds management in Asia (Jenn, 2004). Lai & Lau (2010) reported that the total value of funds under management in Malaysia was RM59.96 billion in 1996, but this figure had decline almost 50% due to the financial crisis to RM33.5 billion in 1997 and had rebound to RM98.49 billion in 2005. This shows the

level of confidence exhibited by investors in Malaysia is increasing. Therefore, the findings of my research project would impose direct effects to fund managers managing funds in Malaysia particularly to those concern with the method of selecting stocks.

The impact of my results would also have direct effects for stock analysts and also individual investors who are commonly known incline to make forecasts on the Malaysia stock market. This would make any value stocks over-reaction not likely to occur as compared to growth stock over-reaction. Lastly, my research project result would be useful to potential and existing researchers whose interests are in international comparisons between value investing and growth investing.

1.6   Scope of Study

The performance of the portfolio will cover from the time span of the year 2001 to 2010 involving public listed companies in Bursa Malaysia. The period was chosen as to exclude that dire situation that has beset the Malaysia stock market due to the 1997 Asian Financial Crisis that lasted from the year 1997 to the year 1999. The market regained her regularity afterward. Hence, it justifies that time span chosen for this research paper. The companies will be formed as a portfolio prior evaluating the post performance. The post performance of the portfolio will then be evaluated using multiple measures to determine the existence of value premium in Malaysia.

1.7   Organization of Study

Figure 1: Organization of Study

Chapter one: Introduction

This chapter presents the background information, the objectives of the study, research questions, significant of the study, and justification of the study.

Chapter two: Literature Review

This chapter presents the theoretical foundation of value and growth investing, previous researchers done on the topic from the West to East countries, the methodologies adopted to evaluate post-performance of the portfolio and understanding previous researchers' rationale of the outcome of their evaluations.

Chapter three: Methodology

This chapter discusses and explains the research framework, research methodology responding to the research design, source of data, sampling and data collection, and measurement of research variables, which applies in this study.

Chapter four: Data Analysis and Results

The data analysis is presented in this chapter, including a summary of the results, the analysis of the measurements used, the performance of value and growth investment analysis and interpretation.

Chapter five: Conclusion and Recommendation

This chapter covers the managerial implications, conclusion, recommendation, limitation of the study, and the suggestions for further study presented in this chapter.