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Investment decision for higher returns through smart thinking

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Abstract
Market efficiency means the security prices should reflect all the information. Block trading occurs when a large number of stocks are suddenly placed on the market for sale. This causes imbalances in the supply and demand in the market, as well as being perceived by the market as negative information. There are several empirical studies by Scholes (1972), Kraus and Stoll (1972), Grier and Albin (1973), Carey (1977) and Hess and Frost (1982), which investigated the effect of the sudden sale of a large number of stocks in the market. They found that there is a significant drop in price, but after a short period stock price rebounds to its prior level.

Keywords: Bonus shares, investors, profit, share market, India

1. Introduction
There is a large amount of literature available which have highlighted the impact of investment style on fund performance. Asset Management Companies offer a variety of Mutual Funds to cater to wide ranging investor needs. Some fund managers believe that companies whose revenues and earnings are growing faster than the market consider it to be a good investment and they purchase these stocks at a premium to the average stock price because they expect the company's competitive advantage to be maintained and the fund managers are considered to follow growth strategy. Some fund managers believe that companies whose share prices have been pushed too low relative to their intrinsic value consider it to be a good investment and they purchase these stocks at a discount with the expectation that the market will reward their early insight by bringing the stock back to its fair value over time and the fund managers are considered to follow value strategy. Some fund managers attempt to generate above average returns (over the market return) by investing in small companies whose potential is yet to be realized by the market. These companies are often under followed and therefore, promise good returns to those who do the work early enough to identify the value before the rest of the market.
The 'style' is particularly used to elucidate the difference between one investment processes from the other. The Value and Growth style definitions are becoming very popular these days because they present contra viewpoints, for example, if a stock falls out of favour with a value manager due to its lofty valuation, and the stock may soon find favour with a growth manager. In the equity markets, we observe that rarely one single investment style dominates the other due to the fact that market can be driven by either growth companies or value companies depending upon a host of factors including macro economic conditions. We present the relevance of style investing from three different perspectives, notably from the perspective of investors, from the perspective of the functioning of financial markets and from the perspective of academic researchers.
(1) Style investing is relevant to investors because it enables them to organize and simplify their portfolio allocation decisions. Transparency may increase because the categorization leads to asset classes with the same kind of characteristics. Mutual fund managers can identify themselves with one style and fulfill the joint needs of individual investors into one fund.
(2) From a more general perspective of the proper functioning of financial markets, it is also important to understand style-based investment strategies. For example, positive feedback trading may result in destabilizing markets, because it may lead institutions to buy overpriced

stocks and sell under priced stocks, thereby moving market prices further away from fundamental values.

(3) Style investing is also an important phenomenon from the perspective of academics. The classical school of financial economics seeks to understand financial markets with models where investors are fully rational. The optimal combination of assets is derived within frameworks such as Modern Portfolio Theory (MPT) and Capital Asset Pricing Model (CAPM). These frameworks take only two dimensions of the return distributions, notably mean and variance, into considerations while making a choice between securities.

Several style classifications have arrived over the last two decades to exploit market anomalies. Some classifications are more obvious than other classifications. Well-known classifications are those based on industries or countries. Although the style classification based on countries already existed, the objective was to facilitate diversification rather than generating excess returns. Momentum and contrarian strategies require classifications of stocks based on past performance. Stocks that generated high returns in the past are called winner stocks and stocks that generated low returns in the past are called loser stocks. When an investor buys winner stocks he follows a momentum strategy and an investor that buys loser stocks follows a contrarian strategy. De Bondt and Thaler (1985) form portfolios of the best and worst performing stocks over the previous three years and find that the loser portfolio outperformed the winner portfolio over the long run. Jegadeesh and Titman (1993) form winner and loser portfolios over the previous six to twelve months. Another classification is based on ratios of specific stock fundamentals to the stock's market price. Examples of such stock ratio's are: book value-to-price, earnings-to-price, dividend-to-price, and cash flow-to-price. A stock with a low market price relative to the specific fundamental is called a value stock and a stock with a high market price relative to the specific fundamental is called a growth stock. Different managers have different styles of investing. Although the approach to investment and the levels of risk taken may vary between funds and fund managers, essentially the following four main types of investment styles observed in practice.

1.1 Passive Investment Style

With most of the equity mutual funds failing to yield returns higher than the market return over a five year period, some fund managers feel that simply investing in a market index fund may produce potentially higher long term results due to market efficiency. In other words, all the information available about a company is reflected in its current stock price, and it's impossible to forecast future stock prices. Rather than trying to guess the market movements, they buy the entire market via index funds. The most common passive investment strategy is to invest in a market index fund based on a popular Benchmark Index of the market, such as the Standard and Poors 500 Index etc.

1.1.1 Active Investment Style

Some fund managers believe in their ability to outperform the overall market by picking stocks they believe may perform well and argue that managed funds do not always underperform the market. They opine that the small cap market is less efficient since smaller companies are not followed as closely as larger blue chip firms. Hence, a less efficient market should favour active stock selection.

Growth investors expect company earnings to increase by 15 percent to 25 percent. Stocks of growth companies tend to have high price to earnings ratios (P/E) since investors pay a premium for higher returns. These companies tend to be found in newer industries. Because of their focus on expansion through reinvestment they generally offer minimal dividends. The result is that growth stocks tend to be more volatile and therefore more risky. Value investors look for bargains. A value investor is primarily attracted by asset oriented stocks with low prices compared to underlying book, replacement or liquidation values. Value stocks also tend to have lower P/E ratios and potentially higher dividend yields. The share prices of these companies do not truly reflect their worth, either as a result of being out of favour with the market or because their business has not been properly researched. These companies tend to pay out high dividends and will be found in the more established industries.

1.1.2 Blend Investment Style

Some fund managers choose not to lock themselves into any one investment style as attempts to pick the right style at the right time can be risky and hence they tend to blend growth and value styles. Returns on growth stocks and value stocks are not highly correlated. This means that an increase or decrease in one type usually has little effect on the other. Empirical evidence suggests that investing in a portfolio that blends different styles will reduce risk and improve long term returns. There is ample evidence that a fund's investment style has become deeply ingrained in how the fund itself is identified and the returns it ultimately produces. A leading provider of independent mutual fund investment information, routinely classifies funds into the cells of a 3 x 3 grid defined by firm size (small-, mid-, and large-cap) and fundamental attributes (value, blend, and growth) for the purpose of performance evaluation.

1.1.3 Size-based Investment Style

Some fund managers use the size of a company as the basis for investing. Empirical studies of stock returns suggest that smaller is better. On an average, the highest returns have come from stocks with the lowest market capitalization (common shares outstanding times share price). But since these returns tend to run in cycles, there have been long periods during which large cap stocks had outperformed smaller stocks. Small cap stocks also have higher price volatility, which translates into higher risk. Some fund managers choose the middle ground and invest in midcap stocks seeking a trade off between volatility and return. In doing so, they give up the potential return of small cap stocks.

1.2 Investment Strategies

Contrarian investment strategy is followed under the assumptions that a typical herd behavior leads to overreaction to information and hence, the stocks which have gone up/down recently is over-valued/under-valued. By taking opposite position on such stocks, contrarian expects profit when the market turns rational. On the other hand, momentum investment strategy is followed when it is found useful to follow the crowd and be a part of it. If the

markets are efficient, then both strategies fail. These both strategies are discussed as:

1.2.1 Contrarian Strategy

Contrarian Strategy essentially means doing reverse of what the market does. Hence, under contrarian investment strategy, past losers are bought and past winner are sold. Contrarian strategy requires an active intervention of a portfolio manager in the form of portfolio rebalancing. Hence, contrarian strategy of investing in capital markets is an active portfolio management strategy. One reasonable explanation of investor overreaction is that the investors tend to overweigh the most recent information and tend to under weigh past information. Since the future performance is determined by all events including past and most recent ones, this overreaction distorts the price and a gradual correction takes place when further analysis happens. Contrarian investors believe that they can make profit by taking opposite view whenever market moves on a big scale on either side.

1.2.2 Momentum Strategy

Momentum Strategy believes that markets are slow to react and if a stock is strengthening, it would increase further. It is believed that market is cautious and price does not adjust to information instantaneously. On the other hand, if a stock is weakening, it will go down further because market takes time to readjust to the information. In other words, it takes time for the crowd to form and intensify the action. Momentum strategy wants to exploit such slow movements in the trend. Under the momentum strategy, past winners are bought and past losers are sold.

A momentum investor purchases stocks that are outperforming their industries or the market and sells them when they perform badly. There are two theories propounded for momentum strategies: one is based on human behavior and another based on capital market efficiency. Behaviorists say that momentum profits are due to market inefficiency and result from stock prices' irrational reactions to information and investors' herding behaviour. The market efficiency camp, on the other hand, led by Jegadeesh and Titman (1993), argues that time varying common factors and/or determining lead to the existence of intermediate term momentum profits. In this way, under certain conditions, people systematically make errors in judgment or mental mistakes. These mental mistakes can cause investors to form biased expectation regarding the future which, in turn, can cause securities to be mispriced.

It may be summarized from the above that investment style is an important driver of risk and return and ignoring it may not reflect the true performance of fund managers. It perhaps goes without saying that the decision process an investor undertakes before entrusting his or her assets to a professional money manager is at once multifaceted and extremely complex. At the heart of this judgment, however, is the inherent belief that the investor will be better off with professional management than if he or she had allocated the assets directly. Whether due to better, less costly information or superior investment skill, it is axiomatic that an investor will ultimately benefit from external management if the incremental returns produced exceed the costs of acquiring the manager's services. Not surprisingly, then, the investment performance of professional fund managers has been a topic that has stimulated a considerable amount of attention in both the academic and practitioner communities for several decades.

Therefore, it can be stated that the getting the highest level of stock market efficiency is not a straightforward process as there are many anomalies existing at the market place. In consideration of various aspects discussed, the present study has focused on the examination of stock market efficiency in India with specific reference to Bombay stock exchange.

3. Results of Jarque-Bera Test

As depicted in Table-1, for the year April 2000 to March 2001, the mean returns has the highest value during March quarter for Group A which is based on lowest E/P ratio, whereas the median value is almost same during each quarter. The mean values are more dispersed in March quarter which is determined from the standard deviation. Positive asymmetrical trend increased from June quarter to the end of the March quarter which shows the existence of more positive values. The increasing kurtosis values show more peaked distribution starting from June quarter to March quarter.

Table 1: Descriptive Statistics for All Quarters during 2000-01 (Group-A)

Quarters	Mean	Median	Std. Div.	Skewness	Kurtosis	Jarque Bera statistic	Jarque Bera probability
June 2000	0.2224	0.1818	0.2168	2.3851	12.7500	358.3600	0.0000
Sept. 2000	0.2490	0.2203	0.2813	4.1937	28.3752	2172.4990	0.0000
Dec. 2000	0.2218	0.1828	0.2628	4.6697	32.5995	2930.2040	0.0000
March 2001	282110	0.2000	0.4796	6.5242	50.9215	7502.9760	0.0000

Source: Data compiled from CMIE Prowess Database

For Group B, the March quarter has reported highest mean returns which is based on highest E/P ratio as shown in table 2. It has also shown highest median value. Fourth quarter is also showing greater magnitude of the deviations of the values from their mean. In the first quarter, observations are negative asymmetrical which turned into positive asymmetrical in September, December and March quarters. The curve is more peaked in quarter December than the other quarters. But it is interesting to notice that the Jarque-Bera statistic reported non-normal distribution in case of June and September quarter indicating some changes in the market behaviour.

Table 2: Descriptive Statistics for All Quarters during 2000-01 (Group-B)

Quarters	Mean	Median	Std. Div.	Skewness	Kurtosis	Jarque Bera statistic	Jarque Bera probability
June 2000	0.0495	0.0486	0.0268	-0.0233	1.9634	2.1534	0.3407
Sept. 2000	0.0583	0.0580	0.0347	0.0762	1.9596	2.2111	0.3310
Dec. 2000	0.0553	0.0494	0.0380	1.1647	5.3212	21.6302	0.0000
March 2001	0.0742	0.0581	0.0614	1.4967	4.8662	24.8880	0.0000

Source: Data compiled from CMIE Prowess Database

Table 3 has shown the comparison of Group-wise (A and B) mean returns with the BSE-Sensex Index return for the period 2000-01. The table reported the results of t-Test: Paired Two Sample for Means stating the significance of difference in the mean returns. It is observed that t-stat is greater than t critical two-tail value, therefore, null hypothesis is rejected i.e. the funds managers are able to systematically outperform the markets and assets prices are aligned in capital markets to the underlying risk return characteristics.

Table 3: Comparison of Group-wise Quarterly Mean Returns with Index Returns during 2000-01

Quarters	Group-A			Group-B		
	Mean	Index	t-Stat	Mean	Index	t-Stat
June 2000	0.2224	0.0334	16.6931**	0.0495	0.0334	4.4587**
Sept. 2000	0.2490	0.0458		0.0583	0.0458	
Dec. 2000	0.2218	0.0493		0.0553	0.0493	
March 2001	0.2821	0.0534		0.0742	0.0534	

Source: Data Complied from CMIE Prowess Database.
** Significant at 5 percent level of significance.

As shown in the table-.4, during April 2001 to March 2002 in Group A, September quarter is showing highest mean, median and standard deviation. Positive asymmetrical trend increased from June quarter to the end of the March quarter which shows the existence of more positive values. The increasing kurtosis values show more peaked distribution starting from June quarter to March quarter except in December quarter. The Jarque-Bera statistic indicates non-normal distribution pattern in each quarter because of having zero probability.

Table 4: Descriptive Statistics for All Quarters during 2001-02 (Group-A)

Quarters	Mean	Median	Std. Div.	Skewness	Kurtosis	Jarque Bera statistic	Jarque Bera probability
June 2001	0.2869	0.1869	0.5593	7.1607	57.7351	9736.4530	0.0000
Sept. 2001	0.3623	0.2463	0.8340	7.5141	61.5531	11115.2000	0.0000
Dec. 2001	0.2684	0.1645	0.4873	6.3323	48.5727	6805.0000	0.0000
March 2002	0.2536	0.1314	0.7311	7.7168	63.7449	11948.0800	0.0000

Source: Data compiled from CMIE Prowess Database

As reported in table 5, first quarter shown highest mean value, standard deviation, skewness and kurtosis values and September quarter only median value in Group B. Highest the returns, highest the risk phrase can be observed in the performance of June quarter. But the distribution of mean returns of all the quarters were found as normally distributed. These results are also verified by the findings of Jarque-Bera statistic because of having zero probability. As reported during the period 2001 to 2002, in Group A, mostly highest values are concentrated in September quarter while in Group B, highest values were reported in June quarter.

Table 5: Descriptive Statistics for All Quarters during 2001-02 (Group-B)

Quarters	Mean	Median	Std. Div.	Skewness	Kurtosis	Jarque Bera statistic	Jarque Bera probability
June 2001	0.1199	0.0656	0.2826	6.3164	42.5300	3444.4300	0.0000
Sept. 2001	0.1020	0.0784	0.0875	2.0964	8.9363	105.6403	0.0000
Dec. 2001	0.0819	0.0711	0.0623	1.8026	6.7969	54.8294	0.0000
March 2002	0.0741	0.0585	0.0583	1.9737	7.7955	77.1584	0.0000

Source: Data compiled from CMIE Prowess Database

Table 5 depicted the significance of difference in mean returns of Group A and B with the BSE-Sensex Index return. Like previous year, t-stat is greater than t critical two-tail value during the year 2001-02. Therefore, t-stat is significant and null hypothesis is rejected in Group A, i.e. the funds managers are able to systematically outperform the markets and assets prices are aligned in capital markets to the underlying risk return characteristics. However in Group B, t-stat is less than the t critical two-tail value, hence, null hypothesis is accepted in Group B i.e. the funds managers are unable to systematically outperform the markets and assets prices are misaligned in capital markets to the underlying risk return characteristics.

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