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Bachelor Thesis

Active management and mutual fund return in the Swiss equity market

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Executive Summary

Mutual funds are an investment vehicle which pools money of their clients' and diversifies their risk. They have become a very common investment type, even for retail clients. Following the high demand for funds, financial advisors have made it their expertise to select the best performing funds on the market. Researchers analyzed fund performances and other attributes to identify indicators for superior future performance.

The results on this subject have been ambiguous. Many studies were not able to identify an outperformance of actively managed funds over their index or even over a passively managed fund. However, some studies found evidence of performance persistence, revealed that some managers are skillful and that funds that performed well in the past continue to perform well in the future.

Following the indication of persistence in mutual fund performance, researches were looking for fund characteristics that predict good future fund return and tried to identify funds with superior performance.

Cremers and Petajisto (2009) claimed that they have identified a new measure, active share, which predicts fund performance. Examining US mutual funds between 1980 and 2003, they revealed a positive relationship between active share and fund returns. Additionally they have reported the strongest persistence of winner funds among funds with the highest active share. This thesis investigates this relationship considering mutual funds that invest in Swiss equities during the period of 2001-2015. The sample consists of 183 actively managed funds, of which 35 have an active share of less than 20%. Therefore they are labeled as index-funds and are not taken into consideration for the calculations. The methodology is derived from the study of Cremers and Petajisto (2009), dividing the funds into quintiles based on their active share. Every month, the equal-weighted excess return of the funds in a given quintile is calculated and afterwards the times series average for each quintile over the sample period is considered.

The results do not reveal any significant outperformance of high active share funds over low active share funds. When considering the historical relationship of one-year excess returns and active share, there is a slight outperformance of the highest active share

quintile over the lowest active share quintile before the deduction of fees. The difference is only 0.14% per year and not significant. For net returns, this difference almost vanishes. The highest active share quintile outperforms the lowest active share quintile by 0.02% per year.

This thesis further examines the relationship of excess return over the subsequent year and active share, identifying the strongest outperformance among the results in this thesis. Funds in the highest active share quintile outperform the funds in the lowest active share quintile by 0.54% per year. However, the difference is still not significant. After the deduction of fees, it reverses to an underperformance of -0.17% per year for funds with high active share over funds with low active share. Combining prior one-year excess return with excess returns over the subsequent three years-period, there is only persistence apparent in net returns, indicating that winner funds stay winner funds within each quintile.

The analysis of active share in Switzerland shows that most analyzed funds have an active share between 20% and 60%. They are considered closet indexers and do not deviate enough from the benchmark to achieve a significant outperformance. In this study, closet indexers are part in four out of five quintiles which leads to no significant relationship between active share quintiles and fund performance. The funds in quintile five have an average active share of 85% and, on average, outperformed their benchmark gross fees. After deduction of costs, these funds had a negative excess return. Since none of the results are statistically significant, active share cannot be considered as a sole indicator for outperformance in the Swiss market.