



CHAPTER I INTRODUCTION

Mutual Funds have been a part of the Thai equity market for a long time. Whilst being an institutional investor, it bridges the relationship with retail investors as an investment proxy. Thailand, recovering out of recession, has experienced a boom in the equity market. The Stock Exchange of Thailand (SET)'s market capitalization has grown from 1.2 trillion baht to nearly 5 trillion baht over the last 5 years period from year 2000 to 2004. Assets under management of domestic mutual funds total just 660 billion baht and only 79 billion is under pure equity funds, accounting for 1.6% of market capitalization. The majority of retail investors still prefer direct investment in a proportion much higher than in developed markets. Due to less significance in the role of the mutual fund industry, little research has been done on the mechanics on the Thai mutual fund market. However, the mutual fund industry has recently gained much attention under the campaign "Letting money work through mutual funds" and has developed in becoming a common channel of investment for an average citizen. With clearer understanding and information, perhaps investors in Thailand could better utilize this alternative channel of investment. As for the growing asset management industry, mutual fund companies are main beneficiaries from knowing the rationale in investor behavior and adapt accordingly to the clients' needs.

The main objective of mutual funds is management fees which increase with maximization in amount of assets under management. But with so many funds to choose from, mutual funds need to put some effort in attracting investors in. Each individual investor would have his/her own reason in selecting that fund, probably because they have heard of and have trusted in that particular funds or fund managers. Maybe because of the fund's historical track record and the fact that investors feel safer to put money with someone who has already proven to be a winner. Or maybe some other reason I can think of such as referral from their local banker. Or investors might be indifferent and simply pick the fund with the lowest expense ratio. The study of fund flows and linking flows with certain characteristic information would help better

understand the behavior of investors in some of the criteria they use in deciding which fund and why they choose to invest in.

In 1999, Lu Zheng introduced the term "Smart Money" explaining that the strategy of investing in funds where the money flows into can earn abnormal return for investors. From an investor's stand point, if there is a proven strategy that following the flow of money could realize greater than normal returns, any rational investor would be tempted to do so. It would be interesting to find out whether the Smart Money effect exists in Thailand, how long would it last, and whether it is possible to form a trading strategy to capitalize on this returns.

This study would further explore this phenomenon particularly with the Thai equity market, unlocking one of the interesting discoveries of mutual fund investment.

1.1 Objectives of the study

1.1.1 To study the behavior of investors choosing funds to invest based on the fund's past returns or fund specific information.

1.1.2 To study the impact of inflow/outflow of investment and whether following the flow could be Smart Money earning excessive returns.

1.1.3 To study aggregate mutual fund flows and its relationship with market returns and market timing.

1.2 Scope of the study

The scope of this study is limited to non-industry specific, public equity funds registered in Thailand that existed during year 2000 to 2004.

The scope is also restricted to open-end funds as measuring flows is not possible for closed-end funds.

1.3 Limitations

Availability of public information on mutual funds only dates back to middle of year 2000. This limits the study period to only four years. The longest period length for

regression analyses can only be done at the monthly level. Insufficient data points for yearly regressions.

1.4 Contributions

This paper thoroughly analyzes Thai equity funds from the investor behavior perspective. Mutual fund managers can better understand customer needs and deliver accordingly. Investors would have better understanding of the characteristics of funds and know what to expect. It gives investors more confidence in investing in equity funds. It also helps develop the Thai stock market and The mutual fund industry as a whole.

1.5 Organization of the paper

This paper is organized as follows. Chapter II discusses the relevant literature. Chapter III walks through hypotheses and explains methodologies. Chapter IV discusses the results of investor behavior in Thai equity funds. Chapter V concludes.