FUNDAMENTALS THAT PREDICT MUTUAL FUND PERFORMANCE

A CASE OF FUND MANAGERS IN KENYA

BY

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DECLARATION

This project is my original work and has not been presented in any other University for the award of any degree.

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DEDICATION

This research project is dedicated to my parents Mr. and Mrs. Moses Gitagia whose tireless efforts to support me and continual goodwill has enabled me to reach this far.

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ABSTRACT

The mutual fund industry has developed rapidly over the past 20 years; this can be attributed to the various advantages associated with mutual fund as opposed to other investment vehicles. Survival of the fund is solely determined by its performance in the market; this is determined by growth of fund investments and amount of periodic returns to investors for growth and value funds respectively. Kenyan fund market is still at its nascent and of late it has not been performing as well as compared to other developed fund markets in the world. Despite this, little research has been carried out to determine the reasons for poor performance and especially in studying the fundamentals that determine the fund performance. The purpose of the research was to study the fundamentals that predict mutual fund performance in Kenya. The essentials studied in the research included; Investment styles, fund characteristics, behavioral patterns, managerial capabilities and managerial capabilities. The research findings will be of utmost importance to the fund managers, investors, government and also academic fraternity. The study involved all the registered fund managers in Kenya which according to RBA stands at 16. The research design was descriptive and the researcher will employed census method of study where 2 questionnaires were issued to each registered fund manager; one to investment manager and the other to fund administrator. 27 questionnaires out of 32 questionnaires issued were duly completed and returned. The data collected was first subjected to descriptive statistics including frequencies, percentages, means and standard deviations. Inferential statistics was also used in the study; in this case, Pearson's moment correlation coefficient was used to determine the magnitude of relationship between variables. The research established a positive relationship between fund performance and investment style, fund characteristic, managerial capabilities and persistence of returns. There is negative relationship between fund performance and behavioral patterns. The research recommends that the various fund regulators comes up with the necessary policies and laws to regulate the industry and also training of fund managers and investors on the funds best practice to improve performance.

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SPSS Statistical software of social sciences

GDP Gross domestic product

FMA Fund Managers Association

DEFINITION OF TERMS

Mutual fund: An investment vehicle formed by a number of persons who come together to pool their resources which are invested in a wide array of securities.

Fund performance: The overall returns from all the securities invested by a given fund

Growth funds: These are funds formed with a sole intention of achieving high capital growth as opposed to periodic returns.

Value funds: These are funds formed with an intention of giving high periodic returns to the investors.

Investment styles: This is the market capital of typical fund holding (size dimension) and the fundamental attributes of that holding (value-growth dimension).

Fund characteristics: This are attributes defined by turnover, load fees, advertising, annual charges, fund ownership, managerial tenure, education, industry concentration and competition, fund age, share classes, total net assets, regulations, clientele type, distribution fees and some other expenses.

Reward Variation ratio: This represents the reward investors reap for bearing additional risk.

Managerial capabilities: This is the expertise displayed by managers in picking securities and timing the market.

Behavioural characteristics: characteristics displayed by investors and fund managers in deciding whether to purchase securities or dispose securities.

Persistency of returns: A measure of consistency of returns from one year to the other

CHAPTER ONE

INTRODUCTION

1.1 Background of the study

The regular global economic melt down has led to almost half of the worlds population to live on less than two dollars a day and about 535 million working people, surviving on less than a dollar a day. With this, there is common consensus that there is need to reach the poorest of poor by encouraging them to pool their resources and cooperate out of poverty (ICA, 2009). The changing economic conditions make investor come up with new alternatives to their investment. These alternatives consist of a mixture of numerous investment vehicles which are mainly formed by various types of mutual funds (Melih, 2010).

Investopedia (2012) describes a mutual fund as a company that brings together a group of people and invests their money in stocks, bonds, and other securities. Each investor owns shares, which represent a portion of the holdings of the fund. There is a wide array of benefits associated with investing in mutual funds. This comprises; Simplicity of investment, diversification, benefits of economies of scale, lower transaction costs, lower commission costs, divisibility, liquidity, professional management among others. (www.commerceandindustry.co.ke).

According to Fund Managers Association (2012), the mutual fund investors rely on fund managers who they entrust in investment of their pooled resources. The terms Fund Manager, Investment Manager, Asset Manager, Wealth Manager and Portfolio Manager are used interchangeably. These refer to the person(s) responsible for implementing a fund investment strategy and managing its portfolio trading activities. Fund managers are paid a fee for their work which typically is a percentage of the fund's average assets under management. Fund Managers thus offer important professional input and direction in creating value for investors and any portfolio of investments often pension funds, mutual funds or insurance funds in accordance with stated goals of the funds. To perform, the Fund Manager primarily liaises with the custodian of the Fund. The Fund Managers would not hold client assets in their name but rather these are registered and controlled by

an independent third party i.e. the custodian Bank. According to retirement benefits Authority (RBA), there are 16 registered fund Managers.

USA is the world leader in the mutual fund industry with asset base approximating $11.6 trillion under management by the end of year 2011. Total net assets decreased $199 billion from year-end 2010, as gains in bond and hybrid fund assets were more than offset by declines in equity and money market fund assets. Demand for mutual funds remained weak in 2011, with net withdrawals from all types of mutual funds amounting to $100 billion. The mutual fund industry in Africa is among the lowest in the world accounting for 13% when combined with Asia pacific. (Investment company fact book, 2012)

The mutual fund performance is one of the most addressed topics in fund literature. This comes with recognition that various characteristics affect fund performance either positively or negatively (Melih, 2010) .The investigation of performance has evolved from the examination of benchmarking and modeling issues to analyses of other factors that may impact performance. Most research has documented investment styles which include the size dimension and fundamental attributes of that holding as affecting fund performance. Other factors affecting fund performance include fund characteristics and behavioral patterns, managerial abilities and persistence of return patterns (Oliver, 2009)

Fund performance is measured in terms of capital growth and periodical returns for growth and value funds respectively. The survival of the fund is solely determined by its performance in the market, that is, persistent increase in capital for growth funds and constant returns for value funds. This performance mainly depends on the investment managers' ability to outperform the market through choosing appropriate investment style. This requires stock picking and market timing abilities of the fund managers (Melih, 2010)

1.2 Background of the Kenya Mutual Funds

According to Kenya's blue print vision 2030, the key goal in the area of financial services is to raise savings and investment rates from 17 % to 30 % of gross domestic product (GDP). This is through: increase in bank deposits, reducing population without access to financial services from 85% to 70 % and raising stock market capitalization from 50% to

90% of GDP (Vision 2030 research team). Mutual funds being financial instruments are without doubt one of the key instruments to play pivotal role in support of this noble vision.

In Kenya like any other country in the world, an increasing number of investors are relying on mutual funds as investment and retirement vehicles (Melih 2010). According to the retirement Benefits Authority website, there are 16 registered fund managers in Kenya. in the year 2010, fund managers association of Kenya was set up as a self regulatory initiative. Eligibility to the association was spelt out in its Memorandum and Articles of Association. The main objectives of FMA is to make representations to Government on various matters including Legislation, regulation, policy and taxation which affect the business and professional interest of members. Thus, FMA may make representations to Government ministries, statutory bodies such as the Retirement Benefits Authority (RBA) and the Capital Markets Authority (CMA), Stock Exchanges and international institutions on matters affecting business or professional interests of members.

The mutual fund market is greatly unexploited in Kenya and research on their performance is greatly deficient. Further, Melih (2010) observes that the current literature on fund markets, though growing, is still not sufficient. It is against this background that the research will be undertaken with a sole objective of studying each of the determinants of fund performance and how they may impact the growth of Kenyan fund market and comparing the findings with other global mutual fund market.

1.3 Problem Statement

Despite the documented benefits associated with investing in mutual funds, the mutual fund industry in Kenya is not fully developed. According to FMA (2010), the mutual fund performance in Kenya as measured by periodical returns of the funds and capital growth of investors funds is low as compared to mutual funds in other parts of the world. The mutual funds are not as common as other investment securities including equity securities, government securities and corporate securities among others (FMA, 2010) this is despite the advantages associated with mutual funds as compared to other securities. In

fact, Africa combined with Asia pacific mutual fund market account for only 13% of the world mutual fund market. This is far much lower compared to USA alone, accounting for 49 percent of the $23.8 trillion in mutual fund assets.

Since the seminal work of Sharp (1966), various research studies have documented various determinants as affecting the mutual fund performance. For example ,the works of brown et al (2009), Rawkoski and Wang (2009), Duan Hu and Mclean (2008) and Cohen et al (2008) document investment style, fund characteristic, managerial capabilities and persistency of returns respectively, as affecting mutual fund performance. Little attempts have been carried out to determine the characteristics of these fundamentals in Kenya and hence the reasons for poor performance of mutual industry in Kenya.

Therefore the research endeavored to come up with the current trends regarding mutual fund industry and especially the extent to which the various fundamentals affect the mutual fund performance in Kenya.

1.4 Purpose of the study

The overall objective of the research was to study the factors that determine mutual fund performance in Kenya.

1.5 Objectives of the study

i) To determine how the various investment styles employed by fund managers affect fund performance.

ii) To establish how the various mutual fund characteristics affect fund performance.

iii) To determine the effect of behavioral patterns of fund investors on mutual fund performance in Kenya.

iv) To establish how the managerial capabilities of mutual fund managers affect mutual fund performance.

v) To determine how the persistency of mutual fund returns in Kenya affect the mutual fund performance.

1.6 Research questions

i) How does an investment style employed by fund managers in Kenya affect fund performance?

ii) How does the various mutual fund characteristics depicted by various funds in Kenya affect mutual fund performance?

iii) How does a behavior pattern portrayed by mutual fund investors in Kenya affect mutual fund performance?

iv) How does a managerial capability as shown by fund managers in Kenya affect mutual fund performance?

v) How does persistency of returns affect mutual fund performance in Kenya?

1.7 Significance of the study

The data on fund characteristics and style will help the managers to come up with funds with the best characteristics, that is, with increasing returns and capital growth for value and growth funds respectively. The behavioral pattern displayed by the investors will help investors in understanding their weaknesses and hence help in improving their rationality in investing. Fund managers will also benefit from this set of data in coming up with marketing policies and extension programs to both potential and existing investors. The data on managerial capability will be of importance to investors in determining the kind of fund managers to invest their pool of funds. Data regarding persistency of return will be important to both fund managers and investors in determining the possibility of predicting stock returns from past performance. The overall research will help Kenya in achieving millennium development goals (MDGs) and Vision 2030 and in particular increasing maket capitalization and also access to financial services. The research findings will also help different fund managers in investing funds for the employees contributing for their retirement, this comes with realization that, most people are relying on mutual funds as a way of investing for their retirement.

1.8 Scope of the study

The study examined the registered funds in Kenya. The essentials examined under the study included investment styles, fund characteristics and behavioral patterns, managerial capabilities and persistency of mutual fund returns in Kenya.

1.9 limitations of the study

The limitation of the study was the fact that the population studied was small and thus uncooperative respondents in the study had a significant effect on the findings. To overcome this, the researcher sought to get an introduction letter from the fund managers Association (FMA) outlining the essence of research in the fund industry.

CHAPTER TWO
LITERATURE REVIEW

2.1. Introduction

This chapter describes the global mutual fund market and the Kenyan fund market including the regulation. The chapter also reviews the theories and concepts related to investment style, fund characteristics and behavioral patterns, managerial capabilities and persistence of returns. The conceptual framework of the research will also be discussed in this chapter.

2.2 Theoretical review

The theoretical review will entail the history of mutual funds, their nature and also their characteristics in Kenyan market. The theoretical review will also provide some theories related to mutual fund performance and in particular the way the manager's capability affect the fund performance.

2.21 History of Mutual funds

The investment company concept dates to the late 1700s in Europe, according to K. Geert Rouwenhorst in The Origins of Mutual Funds, when "a Dutch merchant and broker...invited subscriptions from investors to form a trust...to provide an opportunity to diversify for small investors with limited means." The emergence of "investment pooling" in England in the 1800s brought the concept closer to U.S. shores. In 1868, the Foreign and Colonial Government Trust formed in London. This trust resembled the U.S. fund model in basic structure, providing "the investor of moderate means the same advantages as the large capitalists...by spreading the investment over a number of different stocks."

The biggest mile stone in mutual fund is when the British fund model established a direct link with U.S. securities markets, helping to finance the development of the post–Civil War U.S. economy. The Scottish American Investment Trust, formed on February 1, 1873, by fund pioneer Robert Fleming, invested in the economic potential of the United States, chiefly through American railroad bonds. Many other trusts followed that not only targeted investment in America, but also led to the introduction of the fund investing

concept on U.S. shores in the late 1800s and early 1900s. The first mutual, or "open-end," fund was introduced in Boston in March 1924.

The stock market crash of 1929 and the Great Depression that followed hampered the growth of pooled investments until a succession of landmark securities laws, beginning with the Securities Act of 1933 and concluding with the Investment Company Act of 1940, reinvigorated investor confidence. Renewed investor confidence and many innovations led to relatively steady growth in industry assets and number of accounts.

2.22 The nature of Mutual Funds

Mutual funds' investment objectives and structures are highly incongruent on a global basis and range in dimension, style, risk and price. For instance, Money Market (Treasury Bills etc.), Bond/Income, Balanced, Equity, International, Specialty (ethical, regional etc.) and Index Funds represents the most safe to the riskiest financial instruments. (Melih, 2010). The most common funds include equity funds, global funds, balanced funds, bond funds, income funds specialty funds and index funds.

Mutual funds offer a great deal of advantages to its investors such as the following; Diversification, Professional Management, Liquidity, Economies of Scale, Ease of Investment Process, Fund Disclosure/Well Regulated, Divisibility and Convenience. On the other hand, as with any other investments, there are some caveats that mutual fund investors should be aware of, namely "Having No Guarantee by the Federal Deposit Insurance Corporation or any other agency, Diversification Penalty, Potentially High Costs and Tax Impact" (Yahoo Finance, 2009).

2.23 The mutual fund Market

According to the investment company Fact book (2012), the U.S. mutual fund industry remained the largest in the world at year-end 2011 with $11.6 trillion in assets, Total net assets decreased $199 billion from year-end 2010, as gains in bond and hybrid fund assets were more than offset by declines in equity and money market fund assets. Demand for mutual funds remained weak in 2011, with net withdrawals from all types of mutual funds amounting to $100 billion. Investor demand for certain types of mutual funds appeared to be driven in large part by the low interest rate environment, volatility

in the equity market, and the slow pace of the economic growth. In 2011, money market funds continued to experience outflows, although at a slower pace than in the previous two years. Net withdrawals from equity funds picked up in 2011—their consecutive year of outflows. While inflows to bond funds were still strong, they slowed from their record high in 2009. Hybrid funds remained popular with investors, with inflows increasing again in 2011.

2.24 The Kenyan mutual fund Market

The mutual fund story in Kenya dates back to 1902 when a pioneering agent sold the first policy in the country. In the late 20's, an office was opened to sell life cover and invest in government stocks and property loans. Mutual fund origins, however actually date back to 1845 when nine Cape Town businessmen led by newspaperman, politician and philanthropist John Fairbairn met in a small office to found the Mutual Life Assurance Society of the Cape of Good Hope. Their objective was to provide financial security for the members just over 100 to begin with by mobilizing their long-term savings, which upon death would pass to their heirs.

A century later, the company had expanded throughout the rest of South Africa. That was the stepping stone for its growth to other countries, making it a global financial services leader. Mutual fund in Kenya demutualised within the group in 1994 and in 1999, South Africa followed suit when policyholders approved demutualization and mutual fund was listed on the Johannesburg Exchanges. Today mutual fund manages assets over 419 billion US dollars around the world and has more than ten million clients.

Mutual fund is one of financial service groups in Kenya, offering a comprehensive range of products and services and playing a leading role in Kenya's increasingly sophisticated business arena. Old Mutual Kenya is part of an international group with origins dating back to 1845. The organization has grown from a supplier of life assurance products to a leader in both asset management and the provision of unit trusts. The success of the brand is credited to a heritage and reputation built over many years and an international affiliation that enables it to have its finger on the pulse of the wider "global village (Sited in http://www.Kenyamutual.gov.ke/oldmutual/131-oldmutulal.pdf).

The fund industry in Kenya is regulated by Capital Market Authority (CMA), provisions of the Central bank of Kenya (CBK), Retirement Benefits Authority (RBA), stock exchanges and international institutions. Fund Managers Association (FMA) was also set up in the year 2010 as a self regulatory initiative.

2.25 Effects of educational background

A substantial amount of evidence suggested that an individual's prior educational experience could be a predictor of occupational performance. Higher education increases the knowledge and the skills set needed to systematically search for new opportunities (Hambrick & Mason, 1984), and the ability for tolerating ambiguity and handling complexity (Dollinger, 1984). Wiersema and Bantel (1992) suggested that education is positively associated with high capacity for information processing and tolerance for ambiguity. Golec (1996) analyzed the fund managers' age, tenure, and whether or not they had a MBA degree and concluded that younger managers with MBA degrees, who have longer tenure at their funds, had better risk-adjusted performance, but found no significant relationship to age.

2.26 Effects of experience

One area that previous studies did not focus on was fund managers' international studying experience. Black, Gregersen, and Mendenhall (1992) argued that managers with previous international assignment experiences can help their companies achieve global competitiveness, because managers are able to learn and transfer knowledge about foreign markets and competitors. Sambharya (1996) further argued that international experience is a proxy for the reduction of uncertainty.

2.27 Effects of managers' gender

Women are typically stereotyped as being less competent and effective managers than men (Oakley, 2000). Powell and Ansic (1997) also suggested that men and women use different strategies when making financial decisions. Moreover, they suggested that the strategy differences may reinforce stereotypical beliefs that females are less able financial decision makers. On the other hand, Lundeberg et al. (1994) found that both men and women are overconfident, but men are especially overconfident when incorrect. Studies also suggested women are less confident about investment decisions (Barber & Odean,

2001; Estes & Hosseini, 1998). Researchers also found the risk characteristic may differ due to the gender difference.

Bliss and Potter (2002) evaluated whether gender affects fund manager performance and concluded that women fund managers both domestic and international hold portfolios with marginally more risk than men. Moreover, measures of raw return showed that female fund managers outperform their male counterparts at domestic equity funds, but not at international funds.

2.28 Effects of managers' tenure

Managers' tenure is the length of time a professional money manager has been working as a fund manager. Managers' tenure stands for the expertise and experience. Hence, Adrangi, Chatrath, and Shank (2002), and Goetzmann and Ibbotson (1994) suggested that tenure is beneficial to performance. However, longer tenured top managers are likely to have narrower past experiences and knowledge base, which will result in a limited search for alternatives (Pfeffer, 1983). Consequently, longer tenured managers will engage in less information gathering and analysis (Miller, 1991). Moreover, managers' tenure has been associated with reduced learning and increased inertial responses (Virany et al., 1992).

Lemak and Satish (1996) studied 313 mutual funds and found that longer-term fund managers produced more stable returns than shorter-term fund managers, because longer-term fund managers construct less volatile portfolios. Therefore, they concluded that the relationship between managers' tenure and performance, in terms of return, is negative. Fortin and Michelson (1999), and Porter and Trifts (1998) also found that fund managers' experience is not an advantageous factor in fund performance. Peterson et al. (2001) examined cross-sectional data over a nine-year span from 1992 to 2000, and further amplified that mutual fund managers with longer tenures construct less risky portfolio and lead to lower portfolio returns. Costa and Porter (2003) also found that the experience or tenure of mutual fund managers does not imply expertise. However, they did not suggest a negative relationship between performance and managers' tenure. In

Taiwan's mutual fund market, Hsu (2001) found that mutual fund managers' tenure positively related to fund size and negatively related to fund's turnover ratio.

2.29 Mutual fund performance

To analyze the relations between managers' characteristics and performances, the theoretical literature regarding the technologies in measuring fund performances needs to be discussed. In making an investment decision, return is a critical factor to take into account. However, investors who are risk-averse may consider the risk factor more important (Reilly & Brown, 2000). These investors are looking for low risk and higher return, when investing in mutual funds. Therefore, the theoretical measuring techniques for mutual fund performance include the risk, the return, and the risk-adjusted return. (Brigham & Ehrhardt, 2004; Haslem, 2003; Reilly & Brown, 2000).

2.3 Empirical review

The empirical review of this study will entail the previous studies and documentation related to mutual funds and especially as it regards style performance, fund characteristics, managerial capabilities and persistency of returns.

2.4 Factors affecting mutual fund performance

As the mutual fund industry has developed rapidly over the past 20 years, there has concomitantly evolved a rich plausible academic literature encompassing numerous topics such as mutual fund performance, persistence and market timing etc. One of the most frequently addressed topics in the by researchers is that of mutual fund performance. While earlier studies paid more heed to straightforward performance measures, benchmarking and structure of funds, this focus on performance dimension has shifted from performance-based studies to style-based studies which also present information regarding fund characteristics, managerial skills and behavioural patterns over time. It is evident that the importance of these evolving factors is increasing day by day.

2.5 Investment Styles Along with Mutual Fund Performance

One of the most interesting developments in the field of assets management during the past few decades is how investment styles and their characteristics are defined and what role they play in the determination of future returns (Melih, 2010). The outstanding features of investment styles includes; the market cap of typical fund holding (size

dimension) and the fundamental attributes of that holding (value-growth dimension). The fund manager's selection of a particular style has an impact on the fund performance. The magnitude of this performance is greatly dependent on this selection process which can contain either a style-consistent or a style-drift manner. (Brown, Harlow and Zhang, 2009).

According to Melih (2010), many studies in the academic literature pay particular attention to style investing along with mutual fund performance. Investment styles may be classified into three distinct categories, namely style characteristics, style diversification and style consistency, and style performance.

2.5.1 Style Characteristics

The factors that determine style characteristics includes market cap and fundamental attributes of fund holdings, style popularity, value/size premium, book-to-market ratio, cash flow-to-price ratio, liquidity provision and informed trading in style portfolios, self-designated benchmarks of style portfolios and gender differences are the style characteristics taken into account in this studies. Fama and French's (1993) study provides a solid foundation for these concepts.

Fama and French's (1993) study lies at the heart of style investing. From the existing literature, most of the studies employ Fama and French (1993) three-factor model in order to evaluate mutual fund performance. They build six distinct portfolios on the basis of size and book-to-market ratios. (S/L, S/M, S/H, B/L, B/M and B/H) For instance, S/L refers to small-cap stocks with low book to market ratios, whereas B/H is defined as large-cap stocks with high book to market ratios. Next, they adopt Jensen's time series approaches and perform regressions of monthly returns of stocks & bonds on the returns to a market portfolio of stocks and mimicking portfolios for size, book to market equity and term structure risk factors in returns.

Small and mid-cap female managers are more risk-averse than their male counterparts and male managers pursue a more active style investing by taking more active bets, since females do not take additional risk and prefer to move in line with market trends. Hence, female managers follow more stable style investing trends than their male counterparts

(Niessen and Ruenzi ,2009). Popularity of a stock is linked with the popularity of a style which varies considerably over time (Massa and Zhang ,2009). Growth stocks played a dominant role in the late 1990s while value stocks are very common at the earlier and later stages. Alteration in style popularity prior to merger deeply affects the bidder (Brown et al.,2009). The specific style characteristics include:

2.5.2 Style Diversification and Style Consistency

Style drift and style independence are closely related to the concepts of style diversification and consistency as all these concepts are about changing/holding the structure of the style portfolio (Brown et al. (2009) . Ainsworth, Fong and Gallagher's (2008) studied the relationship between style consistency and institutional portfolios. In order to examine style consistency of fund holdings, they perform regressions of net active style drift on lagged disaggregated net drift. These regressions are based on Carhart, and Fama and French's multifactor models. They also run regressions of style drift on fund performance, fund risk and fund turnover.

As noted by Ainsworth et al. (2008), extra drifting between growth and value oriented stocks may result in higher transaction costs. Therefore, since a fund manager owns a blended portfolio, reducing exposure to funds with high levels of style drift would serve a useful purpose. As corroborated by Massa and Zhang (2009), value funds were found to produce higher average annual returns than growth funds during the 1990s, whereas the reverse is true for the period after 2000. The evidence further suggests that small-growth funds have higher expense and turnover ratios than large-value funds, and large-cap funds possess more style consistency than do mid or small-cap funds. Style consistent funds are very likely to generate greater performance over time. Brown et al. (2009) assert that investment style consistency makes a profound impact on future performance.

2.6 Fund characteristics and behavioral patterns

Except for the studies that evaluate only mutual fund performance, the most recent figures indicate that fund characteristics and behavioral patterns of mutual fund investors are also in the limelight. Mutual fund flows help identify the investment decisions of individuals and therefore these decisions' impact on the potential constraints of fund managers. Some of the (irrational) trading behaviors of individuals demonstrate "over

confidence, excessive trading, disproportional buying of attention-grabbing stocks, the tendency to sell winning stocks earlier and holding on to loser stocks over a longer period" all of which generate negative investment performance in general (Rakowski and Wang, 2009).

According to Melih (2010), one aspect of behavioral patterns is noise trading which has four distinct types; there is a positive correlation between volatility imposed by noise-trading sentiment and expected returns and this effect grows as the number of traders increases. Noise traders have poor timing skill and some forms of herd behavior. Inevitably, expected return would be lower than predicted (Friedman-Effect). Third, noise traders' returns increase if they adopt a bullish approach to that stock (Hold-More effect). And finally, as a market becomes increasingly bullish, traders pump more money in the risky asset. Consequently, the price soars as long as demand rises and this would cause traders to generate lower returns (Price-Pressure Effect). (Beaumont et al., 2008)

2.6.1 Fund Characteristics

Fund characteristics play a vital role in explaining the differences in performance across mutual funds. Fund characteristics includes such characteristics such as turnover, load fees, advertising, annual charges, fund ownership, managerial tenure, education, industry concentration and competition, fund age, share classes, total net assets, regulations, clientele type, distribution fees and some other expenses.

2.6.2 The Impacts of Fund Fees and Expenses on Mutual Fund Performance

Fees may include fund flows, load fees, annual charges, accounting, administrator, advisor, board of directors, distribution, legal, professional, registration, organizational and transfer agency fees etc. the research by Sharp (1966) forms the backbone of the respective concepts by developing a performance measure that leads other studies in this field.

Sharp (1966) is the first study that deals with the following question; what is the magnitude of the relationship between fund performance and expense ratios? He first develops a new measure called "Reward to Variability Ratio" to assess fund performance and then relates R/V represents the reward investors reap for bearing additional risk. "R/V: Fund's Average Annual Return-Interest rate. On the basis of the tests conducted to

find out whether expense ratios explain the differences in performance, Sharp (1966) concludes that low expense ratios are related to superior performance. This evidence lends support to the view that capital markets are efficient.

Carhart (1997), support to the findings suggested by Sharp (1966). Expenses, turnover and load fees are negatively correlated with fund performance. In addition, Carhart (1997) reports that load funds perform worse than no-load funds. Carhart (1997), Fletcher and Ntozi-Obwale (2008) document that trusts charging higher loads generate better performance than those charging lower loads. They document that fund characteristics such as loads and annual charges are closely linked with fund performance. Therefore, the findings indicate that funds with low annual charges perform better than funds with high annual charges and trusts charging higher loads generate better performance than those charging lower loads.

Barber, Odean and Zheng (2005) find no evidence of a relationship between fund flows and operational expenses, and therefore reinforce the finding presented by Elton et al. (1996). Front-end loads or commissions are negatively correlated. Funds with higher marketing expenses rather than those with any other higher operational expenses are very likely to be bought by investors (Barber et al. 2005). Barber et al (2005) demonstrates convincingly that investors exhibit an immediate reaction to the changes in front-end load fees and commissions and distribution fees have a positive impact on mutual fund flows. Proportion of funds charging operational expenses have skyrocketed and the number of funds charging front-end load fees has declined dramatically. (Melih 2010)

According to Ivkovic and Weisbenner (2009) and Beaumont et al. (2008), daily fund returns are found to be positively influenced by the past flows. However, there seems to be no such a relationship for monthly data. The findings further indicate that domestic bond funds are more mature with greater turnover, smaller size, lower fees and loads as opposed to the international and domestic equity funds. There is a positive relationship between individual fund-level flows and distribution fees. In addition, Ivkovic et al (2005), suggest that front-end loads are negatively correlated with fund flows.

Bergstresser, Chalmers and Tufano (2009), reinforce the evidence presented by Barber et al. (2005) and Rakowski and Wang (2009) by suggesting that fund flows are found to be positively related to distribution fees. They investigate the differences in fund characteristics between broker-sold funds and directly-sold funds and assess their performance. Bergstresser et al. (2009) find that a broker-sold fund underperforms directly-sold funds.

2.6.3 The Impacts of Other Key Characteristics on Mutual Fund Performance

Other key characteristics of mutual funds consist of advertising, regulations, education, fund total net assets, fund age, fund classes, objective type (equity vs. money market), clientele type (institutional vs. retail), managerial tenure, industry concentration and competition and share classes (Melih 2010). The findings of Ramos (2009) play a crucial role in this concept by shedding light on a recent sample period. Ramos (2009) demonstrates that there is no any relationship between fund age and fund performance. In addition, Ramos (2009) also subscribes to the view that advanced industries impose larger initial and redemption charges.

Ramos (2009) also argue that lower average size of funds, larger distribution costs, lack of inspection from regulators and media, and less "investor-driven" competition may be cited as the reasons for the gap in fees. Small national markets with low economies of scale charge lower fees and larger markets with greater economies of scale are associated with higher fees. Countries with superior judicial systems have lower fees (Khorana et al. 2009). In stark contrast, Ramos (2009) finds insignificant relationship between fees and investor protection.

Khorana, Servaes and Tufano (2009) Conducted multivariate analyses of mutual fund fees as a function of numerous fund characteristics, the results indicate that index funds are the cheapest across all fund types in terms of management fees, total expense ratios and total shareholder costs in the countries of analyses. Contrary to the findings of Ramos (2009), Khorana et al. (2009) provide evidence. In another related concept placing emphasis on the fund characteristics, Korkeamaki, Puttonen and Smythe (2007) found that only 32% of fund families in the sample seem to advertise.

2.64 Behavioral Patterns

This behavioral patterns includes excessive trading, liquidity and valuation motivated trading, overconfidence, diversification, disproportional buying and selling, the tendency to sell winning stocks earlier and holding on to loser stocks over a longer period. Hence, it also brings momentum and contrarian strategies, noise trading and herding behaviors into focus. Importantly, this category is further classified into 4 distinct segments. We begin the review of this category with the studies investigating herding behaviors and excessive trading patterns first.

2.65 Herding Behaviors and Excessive Trading Patterns

Herding behaviors refers to the individuals mimicking the actions of a larger group without planned direction. On the other hand, excessive trading can simply be defined as excessive buying and selling of stocks. Hong, Kubik and Stein (2005) examined the impact of word of mouth diffusion of opinions on trading behaviours of mutual funds and present some evidence on Local Investor Relations (LIR). It further lays stress on career concern-type herding behaviours. Running OLS regressions, the findings indicate that fund managers located in the same city are involved in word of mouth communication with others by exchanging ideas regarding the stocks in which they invest.

There is a negative correlation between managerial incentives and the choice to invest in bubble stocks (Dass, Massa and Patgiri 2008). High- incentive funds with low levels of bubble stock. Hong et al. (2005), Dass, Massa and Patgiri (2008), in another study, also build on this strand of the literature by bringing herding behaviours of the fund managers into focus and by examining the fund performance and managerial incentives On the basis of the findings

As in Dass et al. (2008) and Hong et al. (2005), Beaumont, Daele, Frijns, Lehnert and Muller (2008) also examine the effects of herding behaviours in a relatively similar concept. They focus on the ways investor sentiment influences the returns and volatility on preferred indices and point out the salient effects of noise trading on financial markets. Employing a generalized autoregressive conditional heteroskedasticity model, the findings indicate that investor sentiment has a profound impact on volatility figures.

Volatility rises sharply as investor sentiment becomes bearish. Moreover, there is a positive correlation between stock returns for indices and sentiment-based fund flows.

Additionally, Niessen and Ruenzi's study (2009) is a major step forward in this strand of the literature. It displays the relationship between excessive trading and fund performance, and underlines the impact of fund managers' characteristics on funds' success. It also brings gender discrimination and stereotyping into focus. Apart from employing Carhart, and Fama and French multifactor models, this study develops a new measure called "Appraisal Ratio" to assess fund performance. Carhart (1997), Switzer and Huang (2007) and Mazumder et al. (2008) all document that excessive trading may dilute returns and impose additional costs.

2.66 Diversification and Managerial Ownership

Managerial ownership refers to the ownership stake of a fund manager in a mutual fund. On the other hand, diversification can simply be defined as spreading investments .Pollet and Wilson (2008) provide a more comprehensive analysis of the respective concept as their study throws light on a relatively larger time period. As the fund grows in size, fund managers seek to increase their ownership shares instead of forming novel investment ideas. On carrying a comprehensive analysis of the relationship between diversification and family-fund size, Pollet and Wilson (2008) document that diversification is positively correlated with performance after controlling for the fund size.

In line with Pollet and Wilson (2008), Khorana, Servaes and Wedge (2007) extend this strand of the literature by displaying the relationship between expected fund performance and managerial ownership. Running appropriate regressions along with objective adjusted returns, four-factor alphas and board characteristics, they show that the average stake of a fund manager is modest and managerial ownership is positively correlated with fund performance. They further state that board characteristics such as board size and director compensation have nothing to do with future performance.

2.67 Liquidity and Valuation Motivated Trading Patterns

Fund manager who purchases securities when there are heavy outflows is very likely to be motivated by the valuation belief. On the other hand, if there are heavy inflows, this fund manager is very likely to deal with excess liquidity by purchasing stocks. Motivation plays a vital role in the assessment of trade performance and "valuation-motivated buys" produce higher performance than their benchmarks (Cici and Gibson 2007). In sharp contrast, "liquidity-motivated buys" underperforms benchmarks, thus indicating that mutual fund managers are unable to beat the market since they are compelled to pump additional cash from inflows.

Alexander et al. (2007) observe that "valuation-motivated sells" fare poorer than their benchmarks while "liquidity-motivated sells" outperform, thus suggesting that mutual fund managers are forced to sell their stocks which they would have preferred to hold longer on valuation belief. The structure of open-end funds sometimes encourages managers to carry out trade only for liquidity reasons (Melih, 2010) Hence, the managers should concentrate on the benefits of liquidity trading in order to offset the costs linked with front and back-end loads, redemption fees etc.

2.68 Favoritism and Tournament Strategies

Favoritism refers to developing strategies in order to improve the performance of high value funds at the expense of low value funds. In this respect, families favour those more likely to raise family profits. Gaspar, Massa and Matos (2006) shed light on a distortion in the behavioural patterns of fund managers at the family level and by examining the sources of favouritism. They depict family specific incentives rather than fund-oriented incentives and test whether there are differences in returns between funds within the same family and funds within separate families, and whether families pursue a cross-subsidization strategy or risk-sharing by conducting multivariate regressions.

Fund families actively follow family strategies of improving performance of high value funds at the expense of their low value funds. This practice is more likely to occur in the fund families where more incentives are offered. Its also evident that there is a positive relationship between favouritism and preferential allocation of deals across funds

(Gaspar, Massa and Matos (2006) . They further demonstrate this relationship by revealing that high value funds are allocated to more under priced Initial Public Offerings and by the amount of opposite trades carried out. Future research should also devote attention to the strategies and coordinated behaviours of fund families rather than only to fund strategies and it should illustrate their equilibrium effects on financial markets (Melih, 2010)

2.9 Managerial capabilities and fund performance

Having superior skills is crucial to managers, enabling them to boost their fund performance and to beat their competitors. Managers' success is greatly dependent on the dominant market conditions and selected benchmarks because managers may underperform t is certainly true that the extant academic literature also attaches great importance to fund managers' skills to time the market and to select the securities with superior expected performance. Therefore, this section is classified into three distinct categories.

2.91 Stock-Picking Ability

Stock-picking is the ability to select stocks which will maximize returns on investments and limit the risks involved. Kacperczyk, Sialm and Zheng (2005) focus on the industry concentration of actively managed mutual funds. Using both factor-based (Carhart) and holding-based performance measures, they conclude that stocks bought have a tendency to generate better performance than those sold. On the basis of the buy and sell decisions of mutual funds, Kacperczyk et al. (2005) demonstrate convincingly that superior performance of the trades of the concentrated portfolios stems from the greater returns achieved by stocks purchased.

Consistent with Kacperczyk et al. (2005), Duan, Hu and McLean (2008), in a similar study, provide evidence that stocks bought by funds outperform stock sold by funds, thus indicating that fund managers possess stock-selection ability. Kosowski et al. (2006) support the results reported by Kacperczyk et al. (2005) and Duan et al. (2008) . They suggesting that superior/poor performance of the US fund managers is not entirely determined by luck. Kosowski et al. (2008) examine the impact of stock-selection skill on mutual fund performance by implementing various bootstrap strategies for monthly fund

returns using a number of conditional and unconditional performance models. The findings indicate that highly ranked funds possess stock-picking ability, whereas variation in low ranked funds can be explained by the differences in costs, thus managers exhibit no skills in this case

Cuthbertson, Nitzsche and O'Sullivan (2008) observe that only approximately 10% of best performing funds possess stock-picking ability. As a consequence, this finding does not lend support to the above-mentioned studies underlining the presence of stock-picking ability. Cuthbertson et al. (2008) further add that there is evidence of persistence amongst poor performing funds rather than amongst past-winners. The majority of funds perform poorly due to the bad skill they possess rather than being purely unlucky. Besides, when it comes to the outperformance of UK mutual funds in general, apparently most of them are better off due to luck.

Kosowski et al. (2006), Duan et al. (2008) and Kacperczyk et al. (2005), Frazzini and Lamont (2008) find no evidence of stock-picking ability. The findings suggest that due to the active reallocation across funds, stocks with higher flows underperform stocks with low flows so that high flows estimate low subsequent returns. (Dumb Money Effect) The reasons why this effect occurs lie in the fact that individuals have a tendency to give excessive weight to growth stocks, and pick stocks that generate lower performance in comparison with their benchmarks. Reminiscent of Frazzini and Lamont (2008), Keswani and Stolin (2008) findings reveal that fund inflows are more persistent than fund outflows and UK fund investors chase the funds with higher returns. While fund inflows are smart, money taken out does not seem to be smart or, to put it another way, new money outperforms old money so that new money is smarter.

2.92 Market-timing Ability

In a comprehensive study, Cuthbertson, Nitzsche and O'Sullivan (2007) throw light on different aspects of market timing such as private timing information and volatility timing. Performing both conditional and unconditional tests, they note that only 7 funds with significant timing have genuine market-timing ability so that they use publicly available information plus their unique skill sets and only 7% of funds are able to time volatility and take positions accordingly. On the other hand, the vast majority of funds

(77%) demonstrate negative market timing. Cuthbertson et al. (2007) further suggest that market timing ability is negatively correlated with fund age. In this respect, better market timers generally tend to be shorter-lived funds.

Another relevant aspect to consider is that small-sized funds possess insignificant positive timing while general equity and income funds exhibit significant positive timing. According to Matallin-Saez (2009), as the time length increases, the degree of timing rises too. Only over a 6-month period, 33 out of 79 funds seem to have negative timing ability. In addition, Matallin-Saez (2009) throws light on passively managed fund portfolios to ensure whether there is evidence of timing. The buy-hold strategy has positive timing ability in the long run despite the fact that most of the mutual fund investors do not advocate this strategy in general.

2.93 Active/Passive Investing along with Market-timing and Stock-picking Abilities

Active investing refers to the ongoing buying/selling actions taken through market-timing and stock-picking. Passive investing can simply be defined as index tracking or a buy-and-hold strategy. Jensen (1967) forms the backbone of other related studies published subsequently. There is very little evidence of fund managers with genuine timing and picking abilities, fund managers possess insignificantly positive selectivity skill and they do not appear to possess equity and bond timing skills, as the timing coefficients are usually negative rather than positive (Jensen 1967)

In a different vein, Christoffersen and Sarkissaian (2009) complement the extant literature by working on better learning and networking possibilities of different cities that affect fund performance and by discussing productivity and ability measures across separate regions at great length. As in Swinkels and Rzezniczak (2009), Giamouridis and Sakellariou (2008) and Jensen (1967), they compare the returns attributable to the market-timing and selectivity abilities of managers. Employing Treynor, Fama and French, and Carhart multifactor models, they present evidence that funds based in financial centres perform significantly better than funds in other places

Giamouridis and Sakellariou's (2008) reinforce the findings by Christoffersen and Sarkissaian (2009) by suggesting that better stock-selection rather than market-timing is

the reason why there are differences occurred in returns across separate centres. The authors further note that managers in financial centres are more skilled individuals. However, having more experienced managers is the main reason for superior returns of financial centres. They add that staying in the same fund for a long time enhances the performance of managers mostly in financial centres. In this case, New York seems to provide the managers with better learning possibilities.

Importantly, active investing is a subject of considerable debate. Glode (2009) in a related study aims to provide explanations for why actively managed funds underperform passive strategies. For instance, Comer at al. (2009) and Jensen (1967) document that actively managed equity funds underperform passive investment strategies, net of fees. Kostovetsky (2009), in another related study, aims to identify the abilities of fund managers and sheds light on the impact of brain drain on mutual fund performance. Conducting multivariate regressions (Carhart, 1997) and a series of robustness checks, Kostovetsky (2009) provides evidence that hedge funds generate greater return to ability compared to mutual funds due to their flexibility.

2.94 Mutual Fund Performance and Persistent Return Patterns

Factors such as active/passive investing, mutual fund inflows/outflows, managerial abilities, fund expenses, benchmarking and fund classes are all taken into account. Kosowski (2006) focuses on the impact of liquidity and flows on mutual fund performance in recession and expansion periods diversified equity funds fare significantly better than their benchmarks in recession periods. Consequently, he asserts that when performance matters most to investors, negative performance is attributable to expansion periods. As the results point to the underperformance of mutual funds in expansion periods, future research should pay more heed to the relative performance of both individual and institutional investors in expansion periods in order to throw some light on the sources of poor performance (Melih 2010) .

In line with Kosowski (2006), Coval and Stafford (2007), in another study, also place emphasis on mutual fund performance by examining the costs of asset fire sales in open-ended mutual fund markets and the incentives for liquidity provision during adverse market conditions. Running cross-sectional regressions along with unconditional

multifactor models, the findings suggest that the widespread selling by financially distressed funds results in transaction prices which are even lower than the fundamental value (Asset fire sales). Interestingly, funds with greater inflows continue to purchase more of their existing holdings while the funds suffering from large outflows lessen their existing positions.

Cohen, Frazzini and Malloy (2008) also build on this strand of the literature by examining the dissemination of information across numerous education networks and its impacts on actively managed fund performance. The results indicate that stocks connected to educational networks outperform the stocks without connection and this outperformance is not accompanied by higher levels of risk. Moreover, Cohen et al. (2008) find that fund managers have a tendency to underweight connected stocks and instead decide which connected stocks to hold because it is considered to be suboptimal to invest more in them due to the fact that this may lead to more undiversified holdings.

Following Sensoy (2009), Chen and Chen (2009) formulate two separate types of concurrent management and offer explanations regarding risk choices and fund flows following the concurrent management. Employing multifactor models, they find that mutual fund managers starting hedge funds outperform their mutual fund peers, whereas hedge fund managers starting mutual funds fare badly compared to their hedge fund peers. Reminiscent of Chen and Chen (2009), Agarwal, Boyson and Naik (2009) shed light on the performance of hedged mutual funds as opposed to conventional mutual funds while accounting for regulations and managerial incentives.

2.95 Persistence-based Studies

Sharp (1966) is the first study evaluating persistence in mutual fund. This study is complementary to that performed by Treynor who developed "Treynor Index". It incorporates the volatility of fund returns and explores new relationships between capital theory and alternative performance measures. Using Reward-to-Risk ratio and Treynor Index, Sharp (1966) provides evidence of persistence for both high and low-ranked mutual funds over the sample period in his study. Sharp (1966) states that this result does not explain the source of differences in performance and there is no assurance that past performance is the best predictor.

Malkiel (1995) provides evidence that equity mutual funds perform worse than the market after deducting the management expenses so that they are not able to cover expenditures incurred. As regards the persistence, Malkiel (1995) presents evidence of persistence in fund performance only in the 1970s, whereas this persistence largely disappears following this period. There is also convincing evidence of persistent return patterns during the 1970s. On the other hand, as in performance persistence, this outperformance also fails to exist over the 1980s.

As in Sharp (1966) and Malkiel (1995), Elton, Gruber and Blake (1996) also investigate persistence in fund performance. However, in stark contrast to the above-mentioned findings, they find strong evidence of persistence in the long run. In this broad study, they seek to answer the following questions; is past performance a good predictor of future performance in the long run? Which factors can explain the differences in performance? The findings suggest that stock-picking skill and expenses partially account for the differences together.

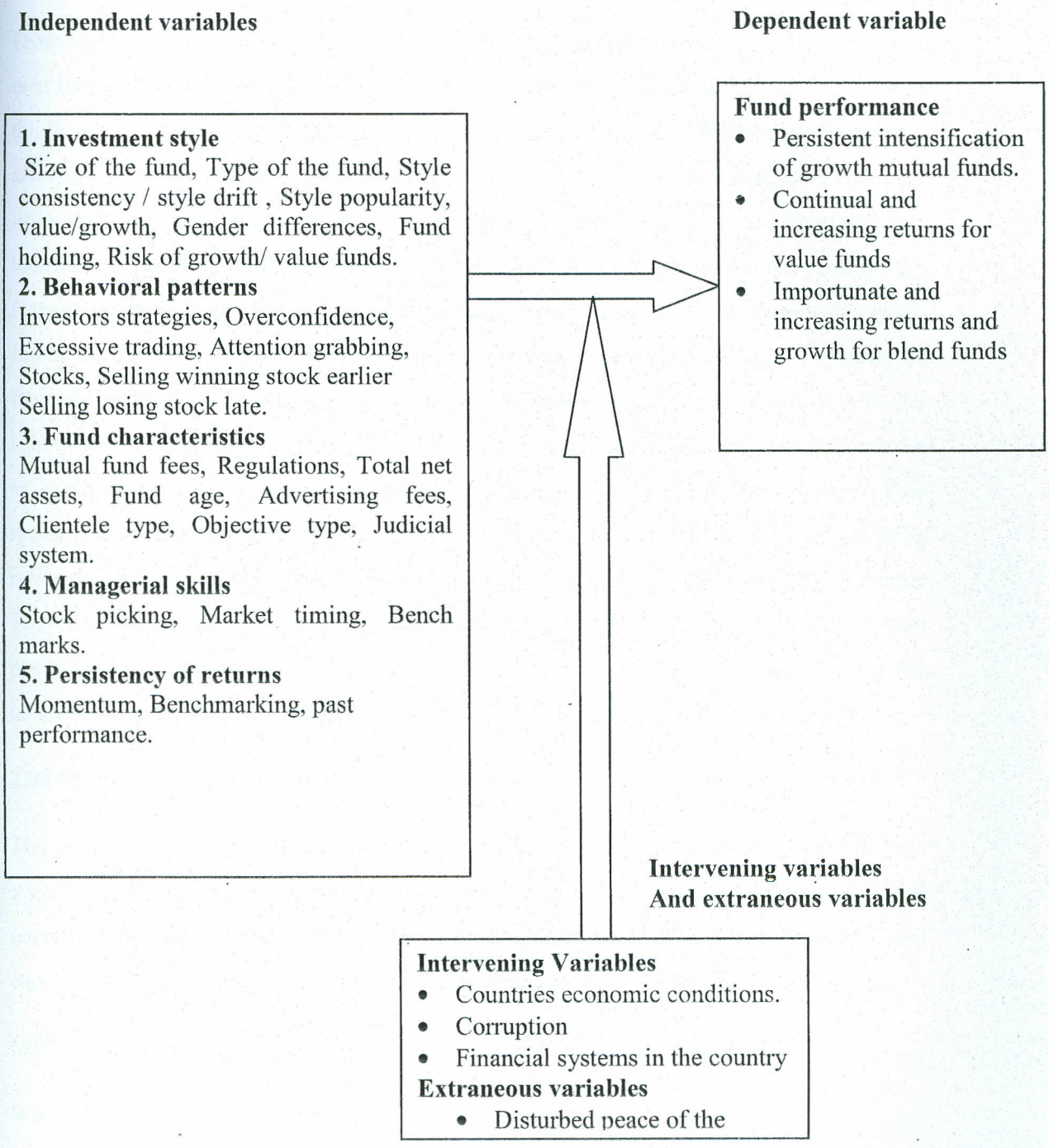
Past performance is found to be a good predictor of future performance both in the short and in the long run even after excluding the high expense-funds from the sample. In this respect, a portfolio can be formed to persistently beat the passive portfolios. However, the majority of the related studies provide contrary evidence that passive strategies outperform active strategies. There seem to be only two studies, Glode (2009) and Swinkels and Rzezniczak (2009) that defend the findings of Elton et al. (1996) by concluding that active investing outperforms passive strategies.

Bauer, Koedijk and Otten (2005) analyse the differences in performance between ethical and conventional mutual funds and investigate whether this difference persists over time. Employing multifactor models that account for style and risk factors, they find no significant difference in performance between conventional and ethical mutual funds. Besides, ethical mutual funds seem to have underperformed their conventional counterparts at the beginning of the 1990s. With numerous arguments for and against performance persistence, Birnbaum, Kallberg, Koutsoftas and Schwartz (2008), findings

indicate that the reaction of institutions to past performance is surprisingly different to the reaction of retail investors.

According to Birnbaum et al, institutions seem to react less positively (negatively) to the over (under) performance. Fama and French (2008) further investigate whether mutual funds have private information to enhance their performance and whether there is persistence in fund performance in the long-run. They find that mutual funds underperform their benchmarks on average and there are funds with good private information to generate better performance.

Figure 2.0 Conceptual Framework



2.97 Gaps in the literature

From the above discussed literature, it is evident that the mutual fund industry in Kenya is at its nascent stage. It is also clear that there is concomitantly evolved rich literature in the fund industry and especially on fund performance. Several factors have been found to affect the mutual funds in different ways. Throughout the literature, it is evident that very little attempts have been carried out in trying to determine how the fundamentals identified affect the fund performance in Africa and particularly in Kenya. Further, the researchers have employed quantitative methods based on financial statements of certain funds and no attempt has been made to get information regarding various fundamentals from different fund managers despite the fact that they are the ones entrusted with the role of investing investor's funds. It is also evident that the mutual funds in Kenya are not as common as other securities despite their advantages over the other securities. This raises the question on their performance given the fact that investors are assumed to be rational and will always go for any investment so long as there are high returns. Therefore the research seeks to fill these gaps by studying the various fundamentals that predict mutual fund performance in Kenya and relate the findings to other studies in order to determine the suitability of Kenyan fund market.

2.98 Model to be used in the study

The model to be used in the study entails searching of any relationships between variables as applied by Melih (2010). He sought the relationship between fund performance and factors including; investment style, fund characteristics, managerial capabilities and persistence of returns. He conceptualized the following model:

MFP= f (IS+FC+FCBP+PR+MS)

Where MFP= Mutual fund performance

F= function

IS= Investment Style

FCBP= Fund characteristics and behavioral pattern

PR= Persistency of returns

MS= Managerial skills

CHAPTER THREE

RESEARCH METHODOLOGY

3.0 Introduction

This chapter provides the methodology to be used in the research. It covers the design, target population, sampling techniques, instrumentation, data collection and data analysis procedures.

3.1 Research Design

In this study the researcher adopted a descriptive survey design. A descriptive survey research study was preferred since it has the dimension of investigating possible relationships between two or more variables (Mugenda and Mugenda, 2003). The descriptive survey design is ideal since it is concerned with making accurate assessment of the inference, distribution and relationship of the phenomenon (Edwards, 2006)

3.2 The target population

The population of interest in this study was all the registered fund managers in Kenya. According to the retirement benefits Authority of Kenya, there are 16 registered fund managers. The schedule for all registered fund managers, their location and the contact persons is available at the retirement benefits Authority of Kenya website. The target population of the study was all investment managers and fund administrators of registered funds

3.3 Sampling techniques

To increase the accuracy of data collected in this research, the researcher adopted census method of study. Census refers to data collection about everyone or everything in a group or population and has advantages such as accuracy and detail. This method was chosen because the target population was small and hence a sample selected from such population would be meaningless (Mugenda and Mugenda, 2003). In this case, two questionnaires were issued to all registered fund managers in Kenya; one to the investment manager and the other to the fund administrator.

3.4 Instrumentation

The type of data used in the research study was primary data. Two questionnaires were distributed to each of the registered fund managers. The researcher used two questionnaires in order to ensure reliability of data collected. The questionnaire contained both open ended questions as well as close ended questions. Questionnaires were chosen because of their simplicity of administration and high reliability as advocated by Babbie (1993). The items on the questionnaire were developed on the basis of the objectives of the study. The questionnaire contained three sections; part A, B and C for background information, investment style, fund characteristics and behavioral pattern, managerial skills and persistence of returns respectively.

3.5 Reliability and validity of the instrument

According to Mugenda and Mugenda (2003), reliability refers to a measure of the degree to which a research instrument yields consistent results or data after repeated trials. The instruments were pre-tested for their reliability with a sample of 2 registered fund managers; in each fund 2 questionnaires were issued making a total of 4. A number of 2 registered fund managers was chosen for pre-test because according to Mugenda and Mugenda (2003), a sample for pre-test should not be very large and normally the pre-test sample should be between 1% and 10% of the target population. Consistency of reliability alpha coefficient was then used to test the reliability whereby a coefficient of 0.70 or more was acceptable as advocated by Fraenkel & Wallen (2009). A high alpha coefficient (0.7 and above) implies that the items correlate highly among themselves, that is, there is consistency among the items in measuring the concept of interest (Fraenkel &Wallen, 2009).

The sample for pre-test was also used to test data validity. The validation of the instrument was aimed at ensuring the instrument was measuring what they were intended to measure (Kathuri & Pals, 2007). The researcher also utilized the finance experts in the Department of Accounting and Finance, Kenyatta University in order to ensure face and content validity of the instrument.

3.6 Data Collection Procedures

Upon receiving authority letter from graduate school, Kenyatta University, the researcher contacted the Fund Managers Association (FMA) in order to get introduction letter which was utilized to solicit cooperation from fund managers. The researcher got in touch with the contact persons in each of the organization in order to determine the appropriate time to issue the instrument. The researcher then prepared a schedule for visits to meet the respondents. The questionnaires were hand delivered to the fund managers so that any clarification regarding the instrument was sought easily. The instrument was self-administered where the registered fund managers were required to complete the questionnaires themselves.

3.7 Data Analysis

The questionnaires were edited for completeness and consistency before processing. Editing helped in detecting errors and omissions and which were corrected to ensure that maximum data quality standards were achieved. Data was then coded to enable responses to be grouped into categories. Coding involved assigning numbers so that the responses could be grouped into number of classes or categories. Data analysis was then carried out using the Statistical Package for Social Sciences (SPSS).The data collected was first subjected to descriptive statistics which included frequencies, percentages, means, and standard deviations. Inferential statistics was also very important for the study, in this case Pearson's moment correlation coefficient was used to determine the magnitude of relationship between two variables. A positive relationship means that an increase in one variable leads to an increase in another variable and vice versa.

3.8 The model to be used in the study

The theoretical basis for developing this conceptual framework is the documented relationship between mutual fund performance and certain characteristics (Melih, 2010) This can be represented as:-

MFP= f (A +IS+FC+FCBP+PR+MS)

Where MFP= Mutual fund performance

A= constant

F= function

IS= Investment Style

FCBP= Fund characteristics and behavioral pattern

PR= Persistency of returns

MS= Managerial skills

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.0.0 Introduction

This chapter presents the analysis of data collected through the questionnaire. The results were interpreted and discussed in relation to the research questions raised in chapter one. The study sought to study the fundamentals that predict mutual fund performance. The researcher aimed to study all the registered fund managers in Kenya which were sixteen in number. The responses were tabulated and subsequently presented by use of bar charts and pie charts. The data was also used to determine descriptive statistics and inferential statistics.

The findings were presented based on research questions as stated in chapter one, that is;

i) To determine how the various investment styles employed by fund managers affect fund performance.
ii) To establish how the various mutual fund characteristics affect fund performance.
iii) To determine the effect of behavioral patterns of fund investors on mutual fund performance in Kenya.
iv) To establish how the managerial capabilities of mutual fund managers affect mutual fund performance.
v) To determine how the persistency of mutual fund returns in Kenya affect the mutual fund performance.

4.1.0 Response rate

A total of 32 questionnaires were issued, out of the questionnaires issued 27 were returned duly filled as presented in the table below. 3 questionnaires were rejected for failing reliability test while 2 questionnaires were never returned by the respondents.

Table 4.1.0: response rate

	Frequency	Percentage
Responses	27	84.3%
Non responses	5	15.7%

Total issued	**32**	**100%**

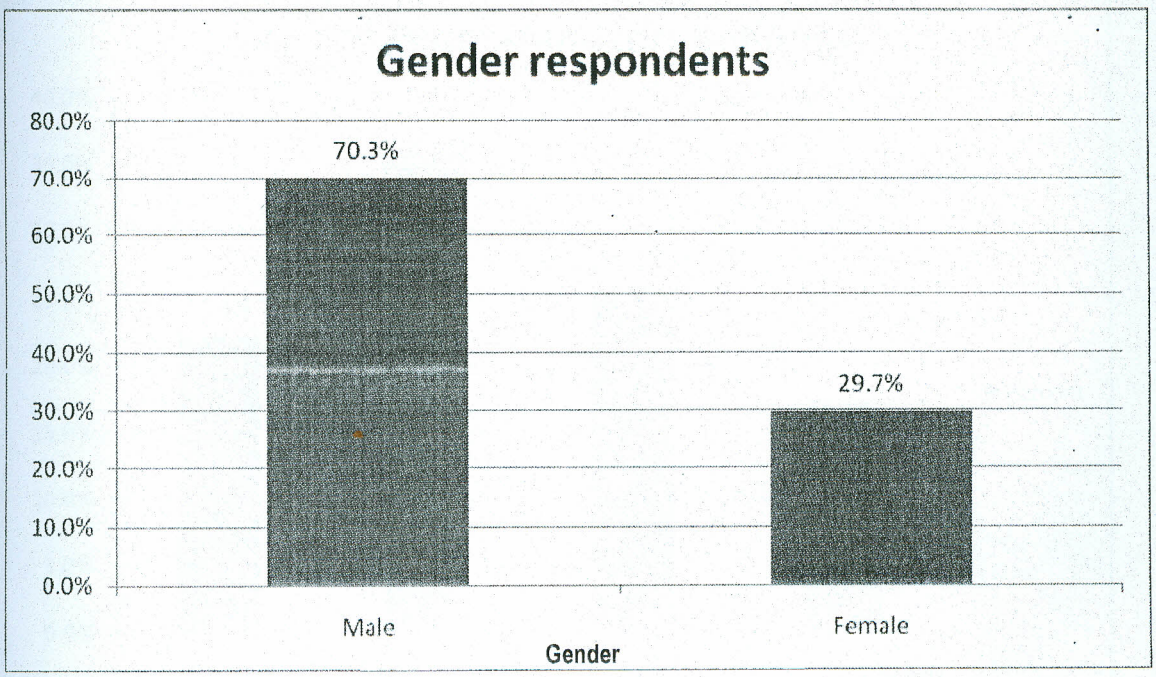
4.1.1 Biographical information of the respondents.

Information on gender, age, academic qualification and experience was sought. 70. 3% of the respondents were found to be female while 29.7%. This implies that most fund managers are male and as such they are likely to take active strategies in investing the investors' funds as opposed to their female counterparts who are likely to take passive strategies in investing shareholders funds

Table 4.1.1 Gender of the fund managers

Gender		
	Frequency	Percent
Male	19	70.3
female	8	29.7
Total	27	100

Figure 4.1.0 The gender of respondents



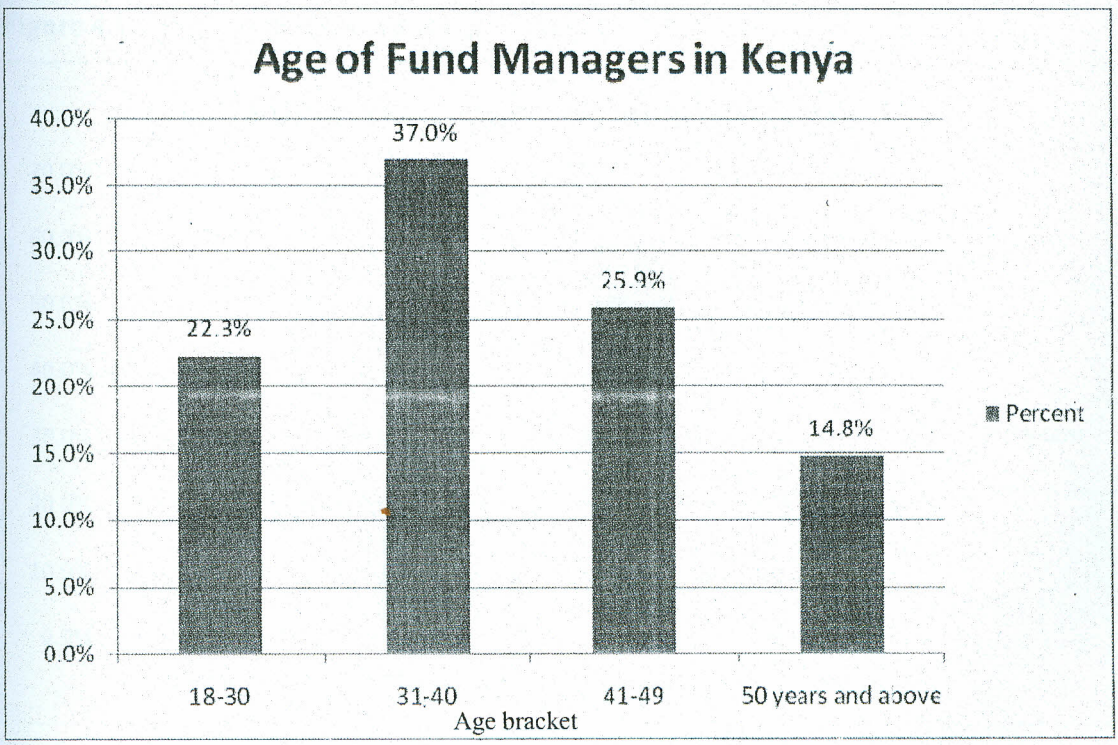
4.1.1 Age bracket

Information on the age of fund managers were sought table 4.1.1 shows the frequency distribution of the results. The study showed that most of the fund managers in Kenya lie below 40 years of age. This makes most fund managers young and as such they lack experience and are likely to undertake active strategies which adversely affect the fund market.

Table 4.1.2 Age bracket

age bracket			
	Frequency	Percent	Cumulative Percent
18-30	6	22.3	22.3
31-40	10	37.0	59.3
41-49	7	25.9	85.2
50 years and above	4	14.8	100.00
Total	27	100	

Figure 4.1.1 Age brackets of the fund managers



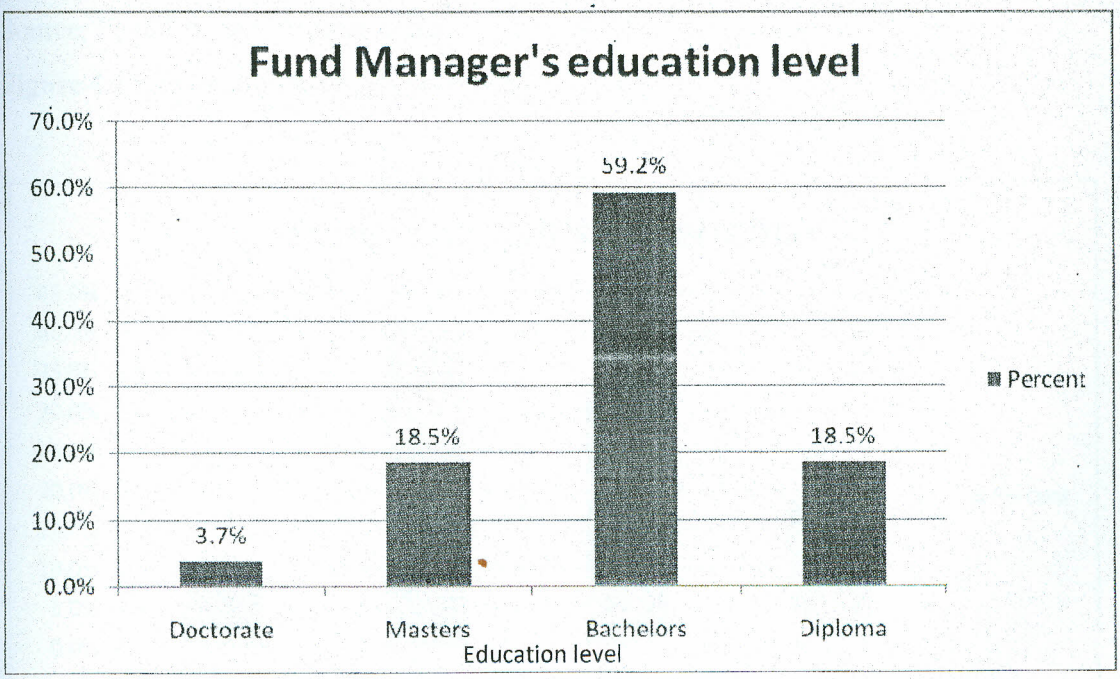
4.1.2 Academic qualifications

Information on fund managers' academic qualifications was sought. Table 4.1.2 shows the information. All the fund managers were found to have at least some level of education ranging from diploma to doctorate. Most of the respondents were found to have a bachelor's degree. The literacy level of fund managers in Kenya highly favors the growth of the fund market.

Table 4.1.3: Highest education level

Highest education level			
	Frequency	Percent	Cumulative Percentage
Doctorate	1	3.7	3.7
Masters	5	18.5	22.2
Bachelors	16	59.2	81.5
Diploma	5	18.5	100%

Figure 4.1.2 fund managers' education level



4.1.3 Fund managers experience

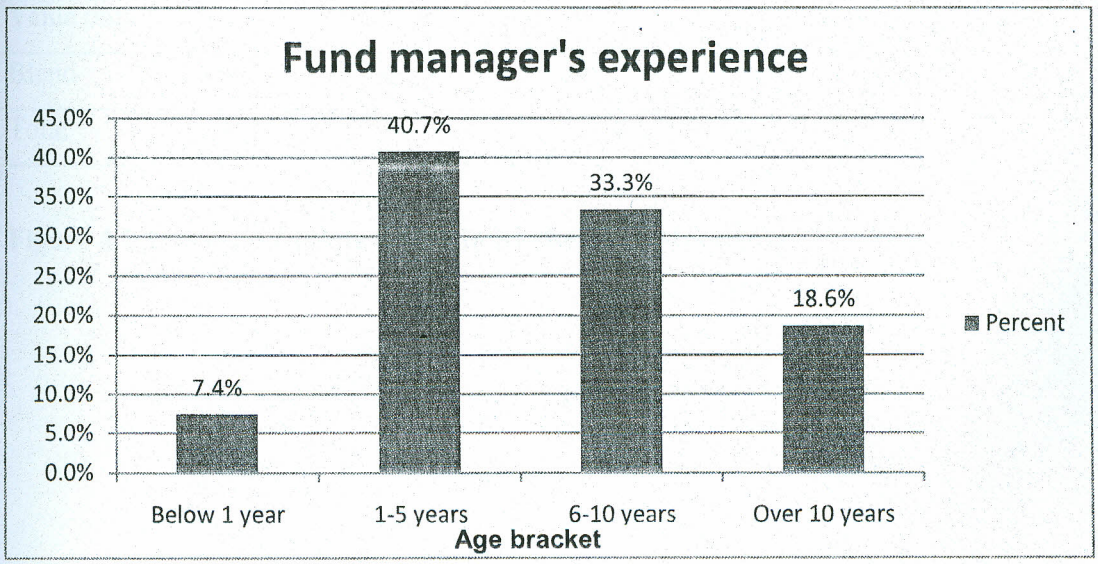
Information on the fund managers' experience was sought. The research findings indicated that while some of the managers accounting for 7.4% were found to have less than one year experience most of the managers accounting for over 90% have over one year experience. 48.1% of the respondents were found to have experience of less than five years. This may be attributed to a high number of young fund managers in Kenyan market; this experience though adequate, may negatively affect the fund market. Table 4.1.3 shows the frequency distribution of the results.

Table 4.1.4 Fund managers experience

Fund Managers experience			
	Frequency	Percent	Cumulative Percent
Below 1 year	2	7.4	7.4
1-5 years	11	40.7	48.1
6-10 years	9	33.3	81.4
Over 10 years	5	18.6	100
Total	27	100	

Source; Fund Managers Questionnaire

Figure 4.1.3 fund managers' experience



4.2.0 Investment style and fund performance

Information on the various investment styles employed by fund managers in Kenya was sought under the following areas:

1. The type of fund
2. Average value of the fund
3. Frequency of change in investment style
4. Method of assessing fund performance
5. Types of securities invested the fund managers have invested in.
6. Frequency of disposing investments
7. Methods of buying and disposing stock

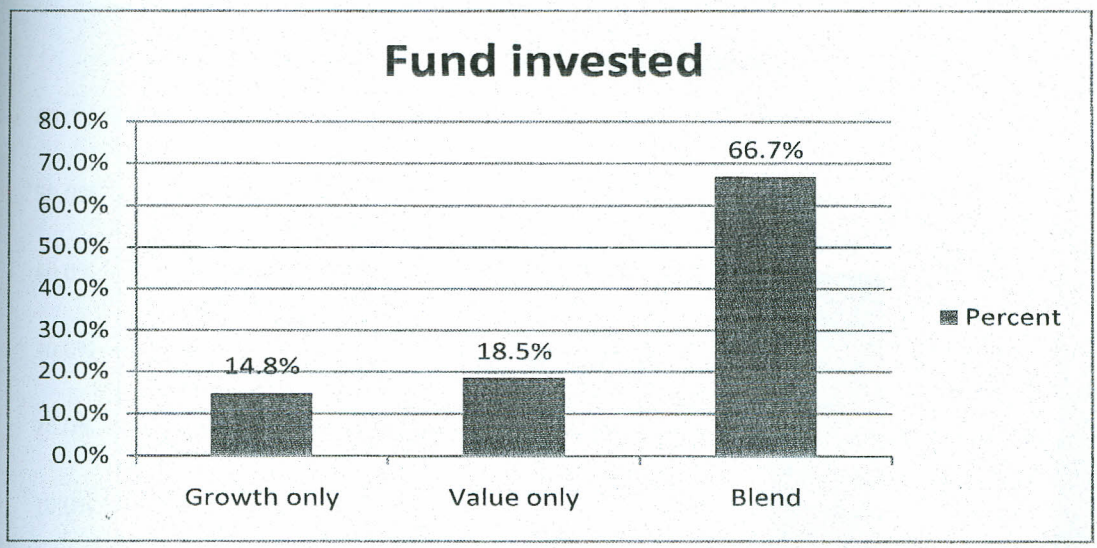
4.2.1 Type of funds

The researcher sought to determine the types of fund the fund managers have invested in. results indicated that most fund managers in Kenya invest in the blend of both growth and value funds accounting for 66.7%. This makes it favorable for the fund market to perform well in Kenya. The results are as presented by Table 4.2.1

Table 4.2.1 Types of funds

Type of fund	Frequency	Percentage	Cumulative percentage
Growth only	4	14.8	14.8
Value only	5	18.5	33.3
Blend	18	66.7	100
Total	27	100	

Figure 4.2.1: type of fund invested in by the fund Managers



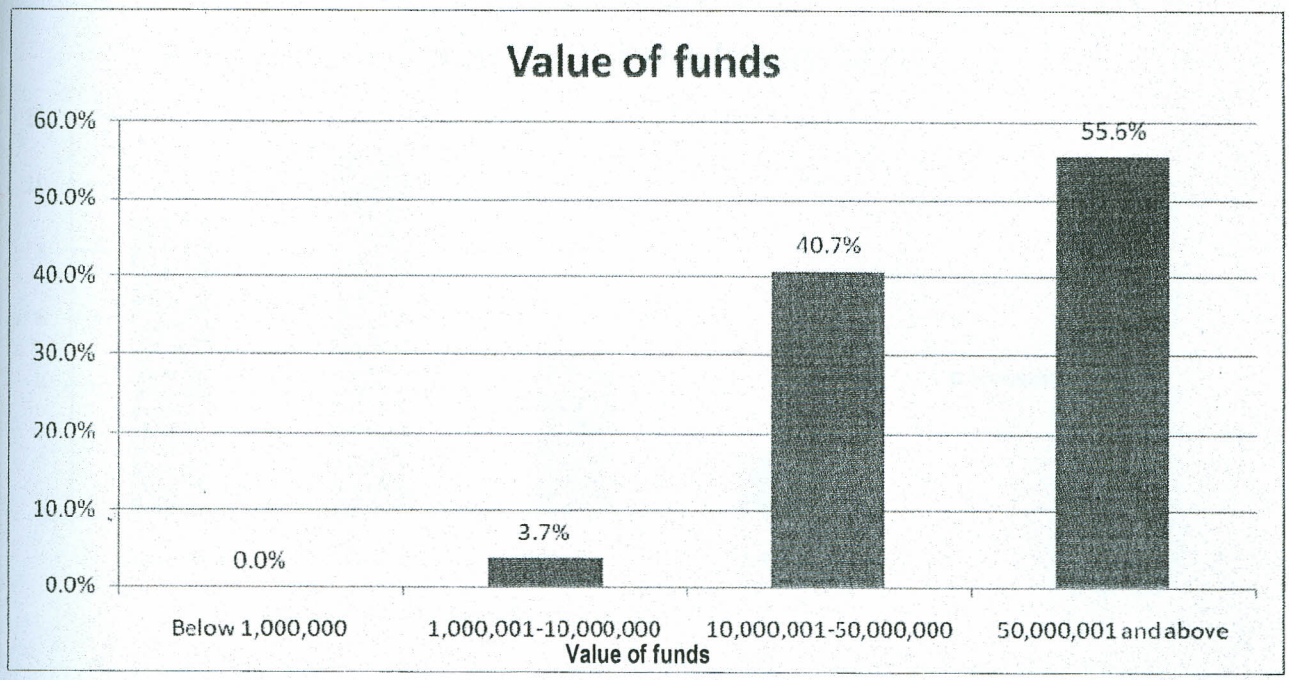
4.2.2: Average value of the fund

Information regarding the average value of the funds invested in was also sought and the researcher established that most funds in Kenya lie under medium fund, this may adversely affect the fund performance because small growth funds have been found to perform better than large and medium funds. The following table summarizes the findings

Table 4.2.2 value of the funds

Value of the fund (Ksh)	Frequency	Percentage	Cumulative percentage
Below 1,000,000	0	0	0
1,000,001-10,000,000	1	3.7	3.7
10,000,001-50,000,000	11	40.7	44.4
50,000,001 and above	15	55.6	100
Total	27	100	

Figure 4.2.2: value of the funds invested in by fund managers



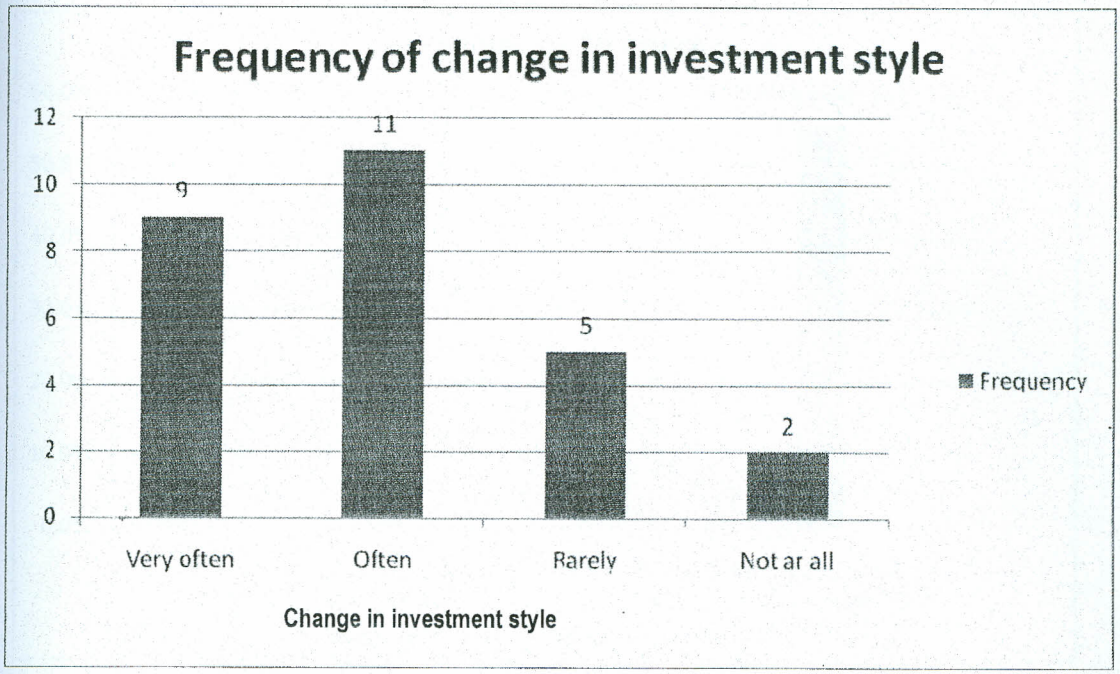
4.2.3: Frequency of change in investment style

Information regarding Frequency of change in investment style was sought. 74% of the fund managers were found to change their investment styles. This style drifts have been found to negatively affect the fund performance and as such the Kenyan market may be negatively affected. The following table summarizes the findings

Table 4.2.3 frequency of change in investment style

Frequency of Change	Frequency	Percentage	Cumulative percentage
Very often	9	33.3	33.3
Often	11	40.7	74
Rarely	5	18.5	92.5
Not at all	2	7.5	100
Total	27	100	

Figure 4.2.3: frequency of change in investment style



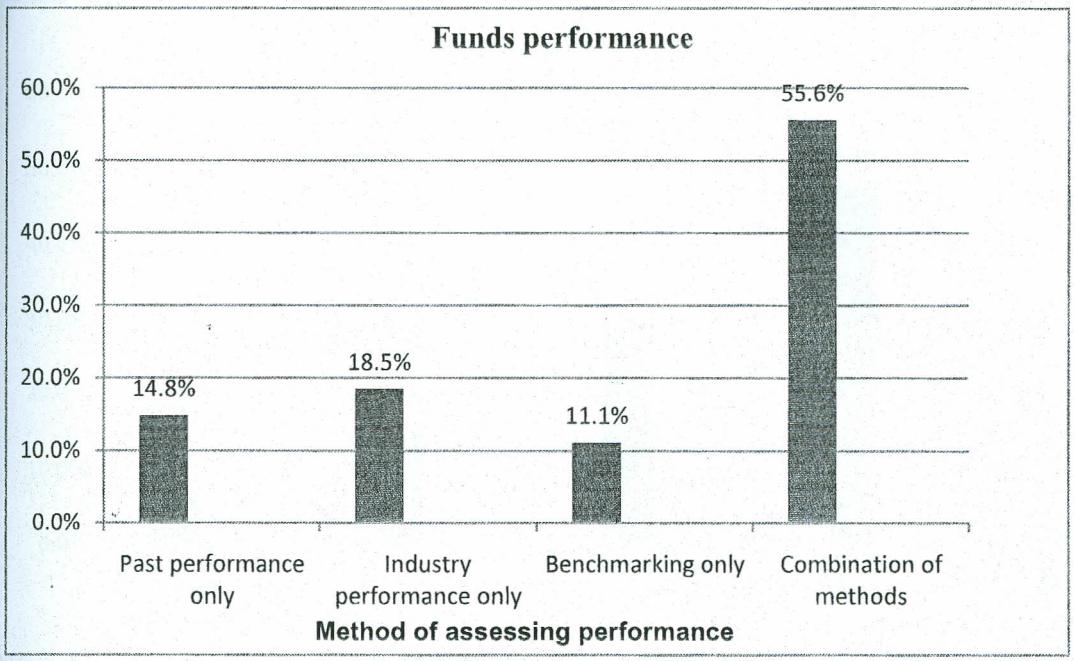
4.2.4: Method of assessing fund performance

The researcher sought to determine the methods used by fund managers to assess their fund performance. Most fund managers accounting for 55.6% were found to use combination of methods. Use of combination of methods to predict the market has been found to have a positive correlation with fund performance. this may favor the Kenyan fund market. The table below shows the result obtained.

Table 4.2.4 Method of assessing fund performance

Method of assessing performance	Frequency	Percentage	Cumulative percentage
Past performance only	4	14.8	14.8
Industry performance only	5	18.5	33.3
Benchmarking only	3	11.1	44.4
Combination of methods	15	55.6	100
Total	**27**	**100**	

Figure 4.2.4: method of assessing fund performance



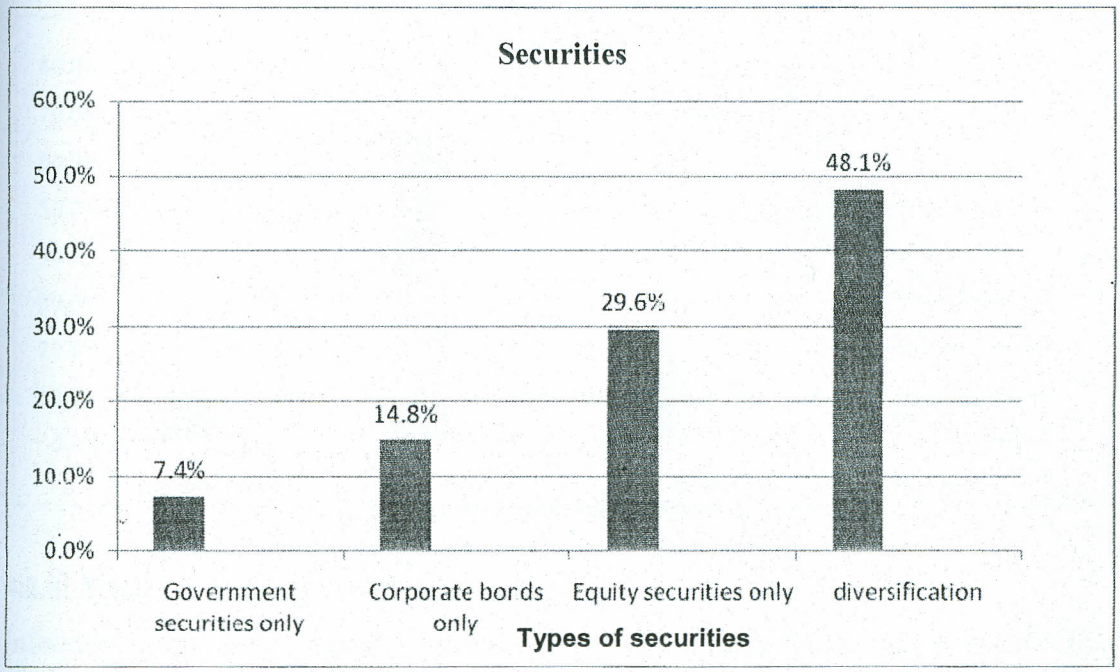
4.2.5: Types of securities fund managers have invested in.

Information regarding types of securities the fund managers have invested in was sought. Most fund managers were found to diversify the risk by investing in several securities. This is shown by a high of 48.1% .Diversification have been found to be one of the best methods of mitigating risk and hence high performance the following table summarizes the findings

Table 4.2.5 Types of securities fund managers have invested in.

Method of assessing performance	Frequency	Percentage	Cumulative percentage
Government securities only	2	7.4	7.4
Corporate bonds only	4	14.8	22.2
Equity securities only	8	29.6	51.8
diversification	13	48.1	100
Total	**27**	**100**	

Figure 4.2.5: types of securities fund managers invest in



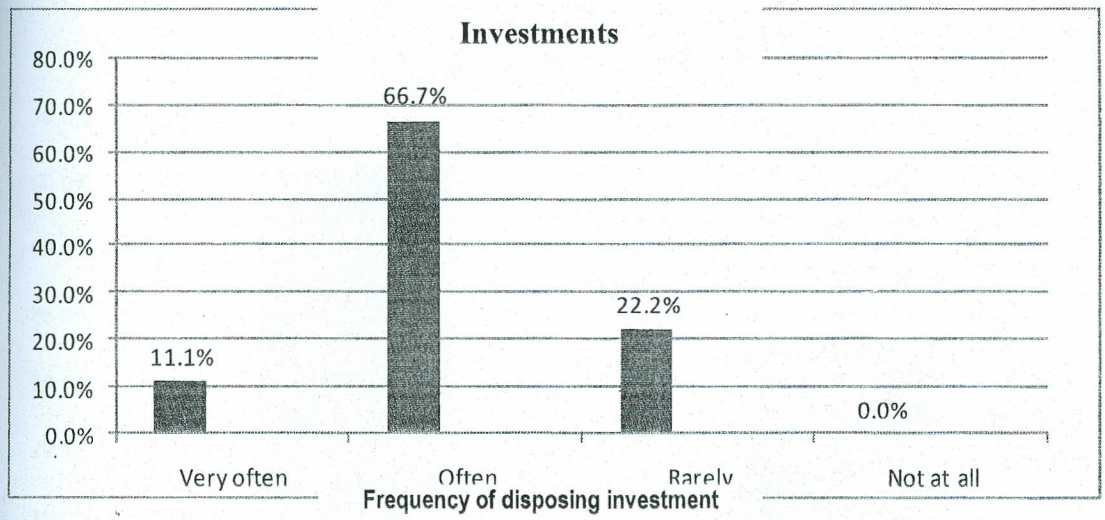
4.2.6: Frequency of disposing investments

Information regarding Frequency of disposing investments was sought and the following table summarizes the findings. Most fund managers were found to frequently dispose investments. This implies that there is high probability of better performance of fund market since high turnover is related to great fund performance.

Table 4.2.6 Frequency of disposing investments

Method of assessing performance	Frequency	Percentage	Cumulative percentage
Very often	3	11.1	11.1
Often	18	66.7	77.8
Rarely	6	22.2	100
Not at all	0	0	
Total	**27**	**100**	

Figure 4.2.6: Frequency of disposing investments



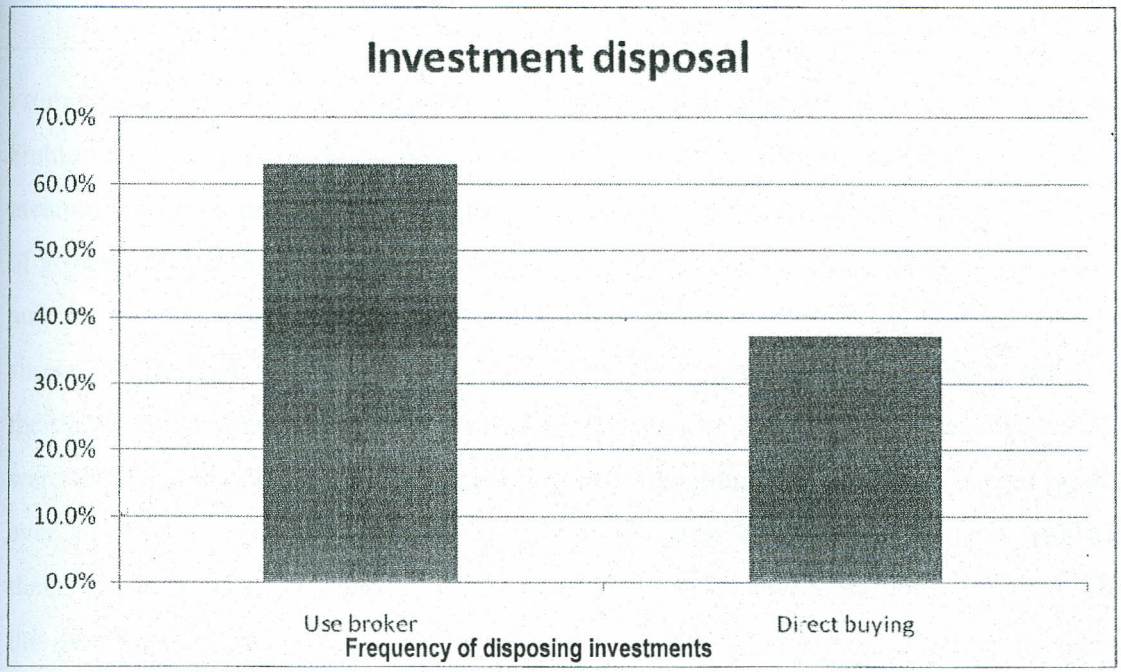
4.2.8: Method of buying and disposing stocks

Information regarding Frequency methods of buying and disposing stock was sought. The researcher established that most stocks are bought through the help of a broker. This gives an opportunity to utilize the expertise of registered brokers in buying and selling of stocks. Therefore the Kenyan fund market stands a chance of better performance by utilizing the brokers. The following table summarizes the findings

Table 4.2.8 Frequency of disposing investments

Method of assessing performance	Frequency	Percentage	Cumulative percentage
Use broker	17	62.9	62.9
Direct buying	10	37.1	100
Total	**27**	**100**	

Figure 4.2.7: Frequency of disposing investments



4.2.9 Investment style measures of dispersion

Table 4.2.9 measures of dispersion for investment styles

	The type of fund	Average value of the fund	Frequency of change in investment style	Method of assessing fund performance	Types of securities invested in.	Frequency of disposing investments	Methods of buying and disposing stock
Mean	2.67	2.92	1.55	1.00	1.6	2.5	1.9
Median	3.0000	2.0000	3.0000	4.0000	4.0000	3.0000	4.0000
Mode	4.00	2.00	4.00	4.00	4.00	4.00	4.00
Std. Deviation	1.01202	1.15272	1.35860	1.00261	.97195	1.00342	1.6720
Variance	1.02418	1.32875	1.84579	1.00523	.94469	1.6342	1.77561
Skewness	-.362	.924	-.012	-.493	-.751	.763	-.234
Std. Error of Skewness	.236	.236	.236	.237	.236	.236	.236

Kurtosis	-.823	.107	-1.297	-.822	-.039	-.102	.106

From the above measures of dispersion, it is clear that most of the investment styles highly favor the fund market in Kenya; this is shown by the mean, median and modes. A mean of 2.67 on type of fund shows that on average, most fund managers invest in blend of growth and value fund, most funds were found to be of mid capital as shown by mean and mode of average value of fund of 2.92 and 2.00 respectively. On average and as shown by mean of 1.55 and mode of 3.00, most fund managers were found to dispose their investments frequently. Methods of assessing performance and securities invested in were found to be combination of methods and combination of securities as shown by an average of 1.00 and 1.6 respectively. Most fund managers were found to buy and dispose their securities by use of brokers; this is shown by a mean of 1.9 and mode of 4.00. All this investment styles favors the fund market in Kenya. The standard deviation ranges from 9% to 16.7%, this may be interpreted to mean that most responses were found to be within a small range, that is not very highly dispersed making the data more reliable. This has further been shown by measures of skewness and kurtosis.

4.3.0 Fund characteristics and fund performance

Information on the various fund characteristics displayed by various funds in Kenya were also investigated. The various characteristics studied under the proposed study included:

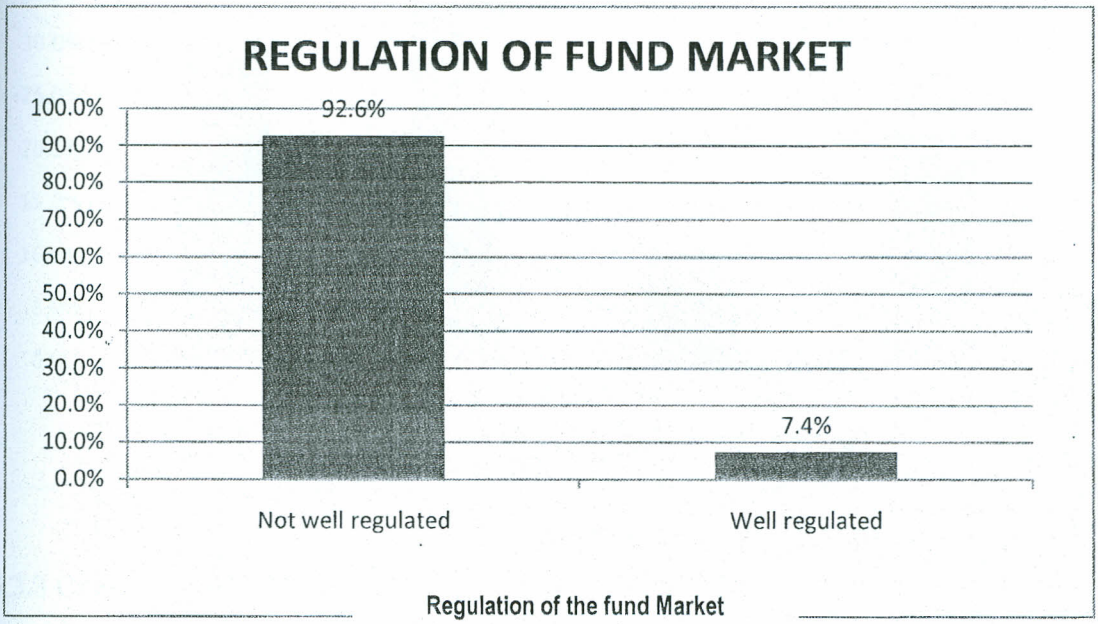
1. Regulation of fund industry
2. Average age of the funds
3. Clientele type
4. Average net assets
5. Judial systems
6. Advertising expenses and management fees
7. Charging of commissions

4.3.1 Regulation of the fund industry

The researcher sought to determine whether fund market is well regulated or not. 92.6% (25 respondents) felt it is not well regulated while 7.4% (2 respondents) felt that it is well regulated. Poor or lack of fund industry regulations affects the fund performance

negatively. Therefore absence or poor regulations of the fund industry in Kenya is likely to affect the fund performance negatively.

Figure 4.3.1: regulation of fund market



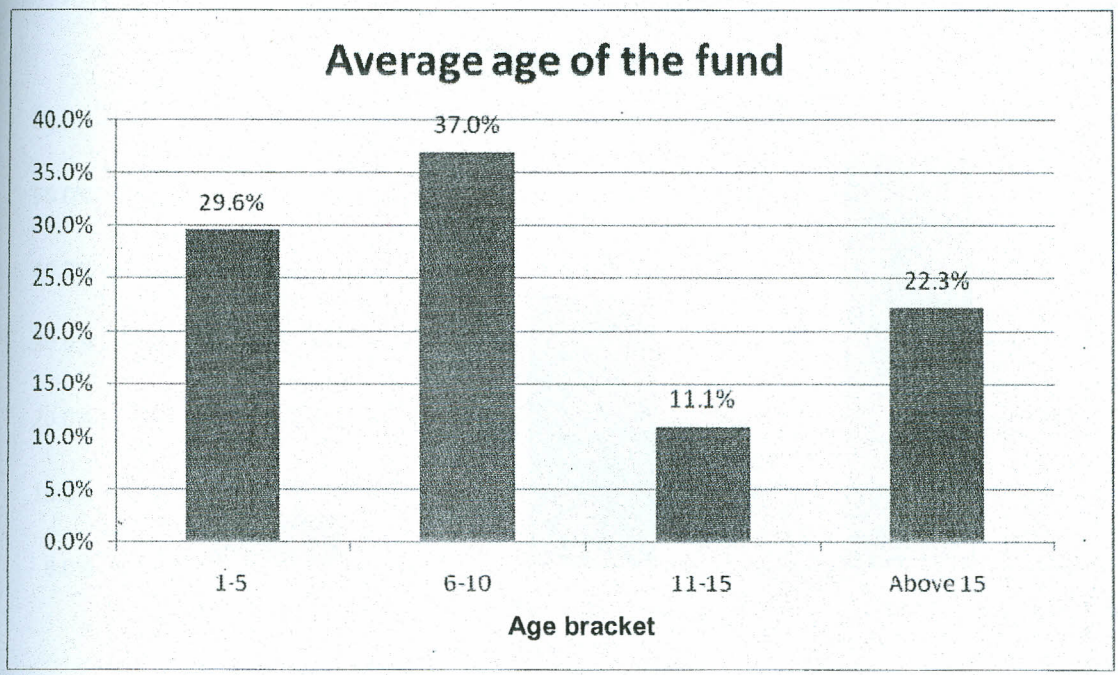
4.3.2 Average age of the fund

Information regarding average age of the fund was sought. Most funds were found to be of 10 years and below. This makes the Kenyan fund market generally young as compared to developed markets elsewhere. Young funds have been found to be more active as they try to outperform the market. This may make them lose much investment attributable to active investment strategies. The following table summarizes the findings

Table 4.3.2 Average age of the fund

No. of years	Frequency	Percentage	Cumulative percentage
1-5	8	29.6	29.6
6-10	10	37.0	66.6
11-15	3	11.1	77.7
Above 15	6	22.3	100
Total	27	100	

Figure 4.3.2: average age of the fund



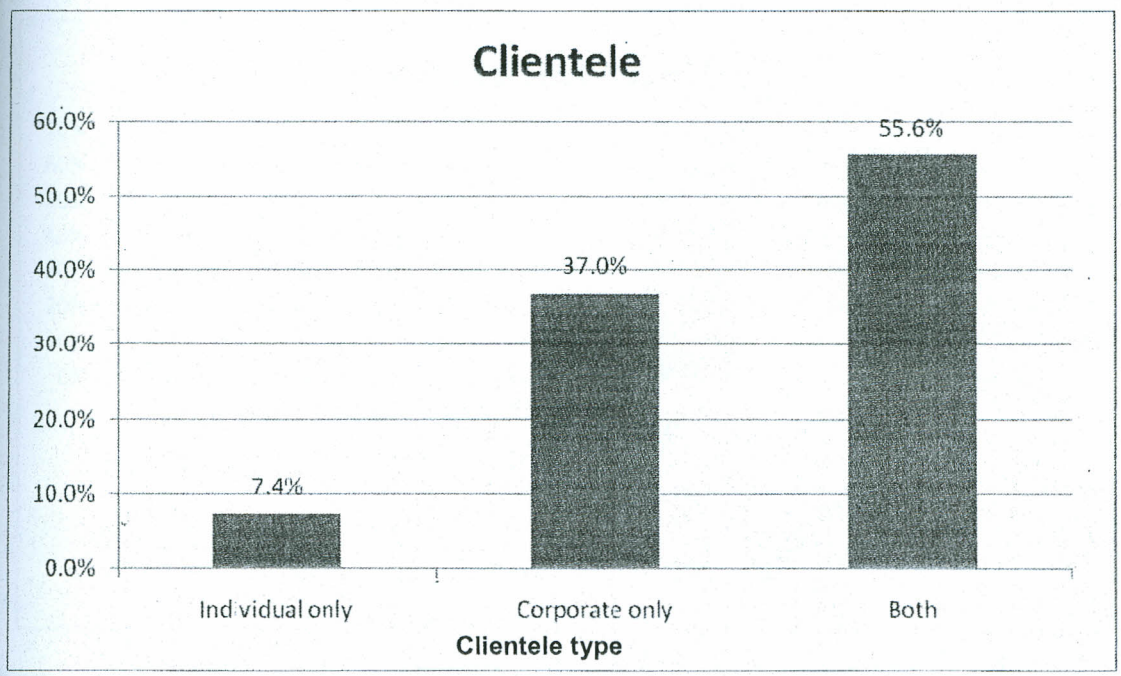
4.3.3 Clientele type

Information regarding clientele was sought. The researcher established that most fund managers serve both the corporate as well as the individual customers. This implies that the fund market in Kenya stands a better chance to perform the market given the fact that the fund managers serving both the individual and corporate customers have been found in most occasion to outperform the market. The following table summarizes the findings

Table 4.3.3 Clientele type

Clientele type	Frequency	Percentage	Cumulative percentage
Individual only	2	7.4	7.4
Corporate only	10	37	44.4
Both	15	55.6	100
	27	100	

Figure 4.3.3: clientele type



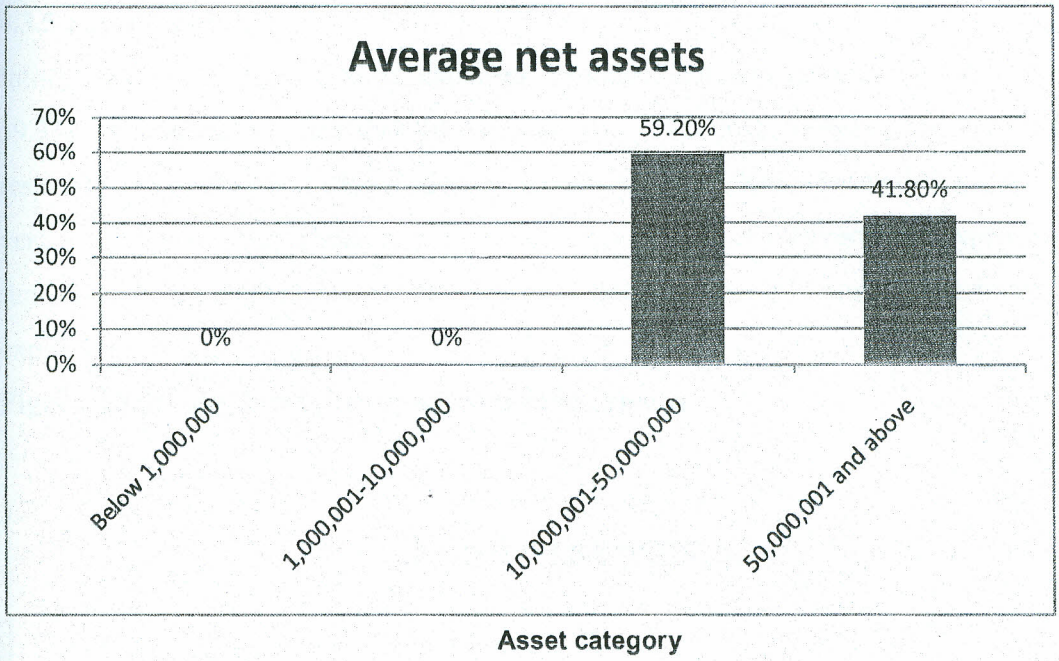
4.3.4 Average net assets

Information regarding average net assets was sought. The net assets were found to range from medium to high. This is necessary to take investment opportunities available. This implies that given the level of resources invested in assets, the fund market stand a better chance of performing very well. The following table summarizes the findings

Table 4.3.4 Average net assets

Average net assets	Frequency	Percentage	Cumulative percentage
Below 1,000,000	0	0	0
1,000,001-10,000,000	0	0	0
10,000,001-50,000,000	16	59.2	59.2
50,000,001 and above	12	41.8	100

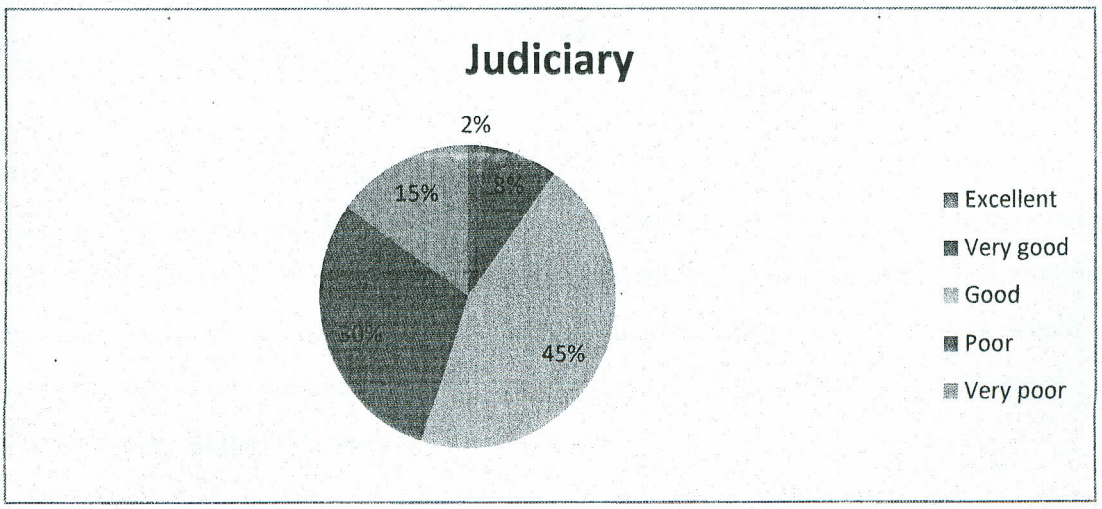
Figure 4.3.4: average net assets



4.3.5 Judicial system

Information regarding the opinion of fund managers regarding Kenyan judicial system was sought. 2% of the respondents felt that the system was excellent, others totaling to 8%, 45%, 30% and 15% were of the opinion that it was very good, good, poor and very poor respectively. This implies that most fund managers have confidence in judiciary. This is vital for performance of the fund market and as such the Kenyan fund market stands a chance of good performance.

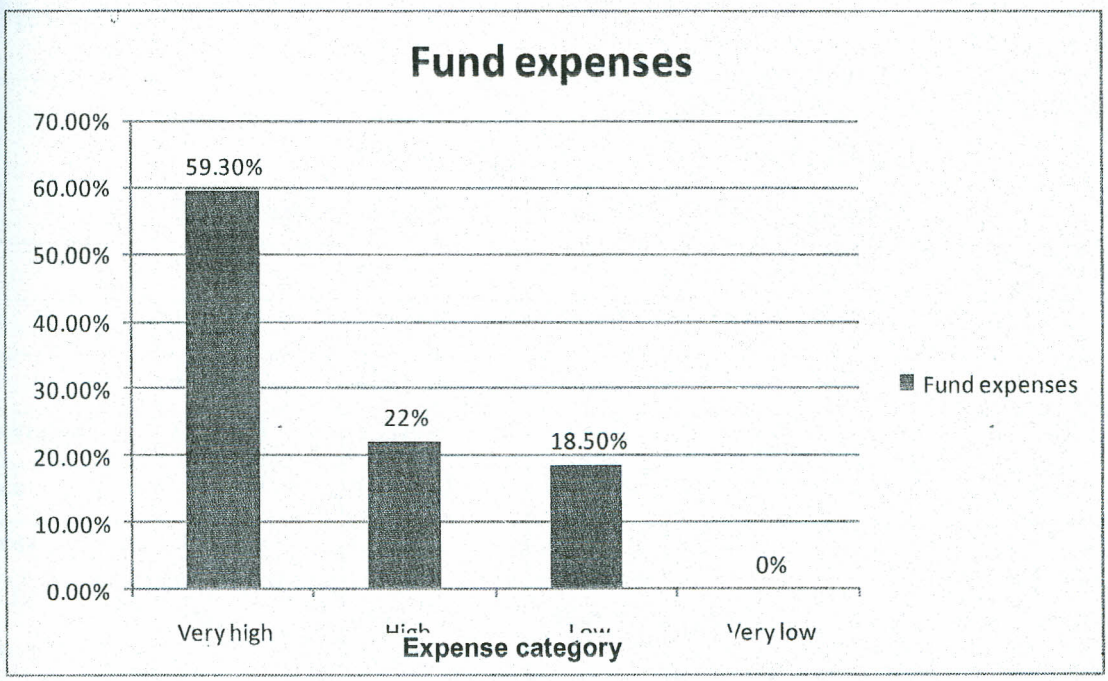
Figure 4.3.5: judicial system of the country



4.3.5 Fund expenses

Information regarding the fund expenses (management and advertising) was sought. 59.3% (16 respondents) felt that the expenses were very high, 6 respondents (22.2%), 5 respondents (18.5%) and 0% of the respondents felt that they were very high, low and very low respectively. There is positive correlation between advertising expenses and fund performance. This makes Kenyan fund market favorable since most incur high expenses.

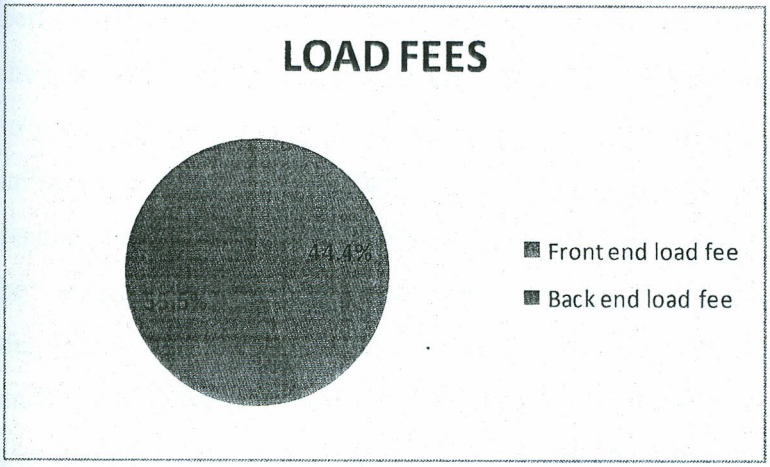
Figure 4.3.5: Graphical presentation of fund expenses



4.3.6 Method of charging load fees

Information regarding charging load fees was sought. 44.4% (12 respondents) charge front end load while 55.6% (15 respondents) charge back end load fees. Fund charging back end load attract more investors and as such the Kenyan fund market which is dominated by fund managers charging backend load has high chances of performance.

Figure 4.3.6: method of charging load fees



Measures of dispersion

	Regulation	Average age of funds	Clientele	Average net assets	Judicial systems	Expenses	Load fees
Mean	1.0685	2.806	1.867	2.0683	3.0086	3.0608	2.3606
Median	4.0000	3.0000	3.0000	4.0000	3.0000	3.00	4.00
Mode	**4.00**	2.00	2.00	4.00	4.00	4.00	3.00
Std. Deviation	**1.10303**	1.20970	1.26172	1.05716	1.07775	1.3643	1.0067
Variance	1.21667	1.46337	1.59194	1.11758	1.16154	1.86131	1.0134
Skewness	-1.820	.308	.000	-.584	-.081	-.684	.-1.720
Std. Error of Skewness	.236	.236	.236	.236	.236	.235	.233
Kurtosis	2.839	-.933	-1.252	-.451	-.944	-.833	1.823
Std. Error of Kurtosis	.467	.467	.467	.467	.467	.467	.467

The research found out that most characteristics of Kenyan fund market favors the fund performance, the mean, mode and median shown in the table above clearly shows; clientele type with mean, median and mode of 1.4, 4.0 and 4.0 favors both corporate and individual clients, average age of the fund was found to be between 6 and 10 years as shown by a mean of 2.8, expenses with mean of 3.0 means that the fund expenses were found to be high which means that the fund industry stands a better chance of good

performance since high advertising expenses have been linked to high fund performance. the load fees with mean of 2.3 means that, most fund charge end load fees, this is related to good fund performance. However, the regulation of fund industry was found to be unfavorable as shown by mean of 1.06 which shows that the fund industry as not well regulated this affects the fund performance negatively. The judicial system was found to be very good as shown by mean, median and mode of 3.00, 3.00 and 4.00 respectively this means that the judicial system in Kenya highly favors the fund performance. In understanding the level of dispersion, standard deviation and variance from the mean was also computed, the dispersion was found to be between 10.0% and 12.6%, this can be interpreted to mean that, the response from the responded were reliable since they were not highly dispersed for each response. This was also shown by measures of skewness and kurtosis which shows the dispersion in most cases skewed to the left.

4.4.0 Behavioral patterns and fund performance

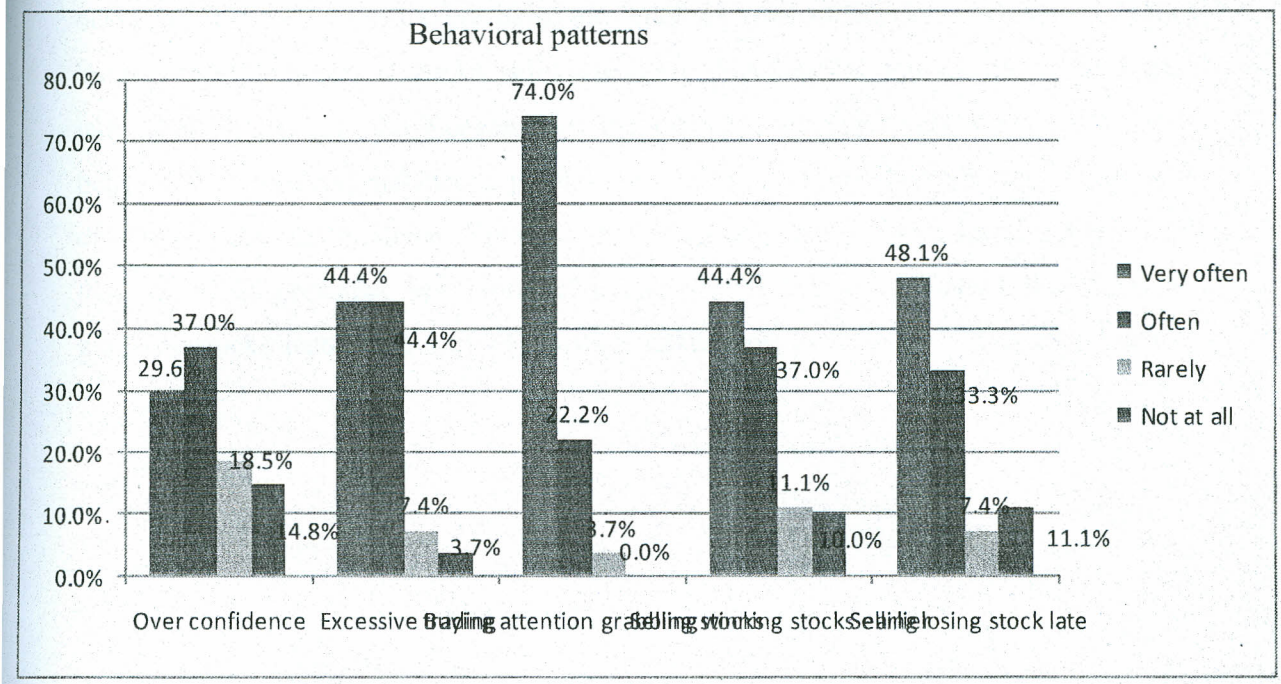
Information on the behavioral patterns displayed by investors in Kenya was also investigated. The various behaviors studied in the study:

1. Overconfidence
2. Excessive trading
3. Buying Attention Grabbing stocks
4. Selling winning stock earlier
5. Selling losing stock late

Table 4.3.0 Behavioral patterns displayed by investors

Behavior	Very often	Often	Rarely	Not at all
Over confidence	8 (29.6%)	10 (37%)	5 (18.5%)	4 (14.8%)
Excessive trading	12 (44.4%)	12 (44.4%)	2 (7.4%)	1 (3.7%)
Buying attention grabbing stocks	20 (74%)	6 (22.2%)	1 (3.7%)	0 (0%)
Selling winning stocks earlier	12 (44.4)	10 (37%)	3 (11.1%)	2 (10%)
Selling losing stock late	13 (48.1%)	9 (33.3%)	2 (7.4%)	3 (11.1%)

Figure 4.4.1 behavioral pattern displayed by investors (the curve shown below)



Behavioral patterns

Behavioral pattern have been found to affect the fund performance. The researcher found out that most investors display behaviors such as overconfidence, excessive trading, buying attention grabbing stocks, selling winning stocks earlier and selling losing stocks late. This implies that the Kenyan fund market has been negatively affected by these behavioral pattern and inability to predict the market. Most investors end up losing most of their investments in Kenya due to these behavioral aspects. The researcher found out that the most prevalent behavioral characteristic in Kenya is buying the attention grabbing stocks accounting for 99.6% which makes most investors lose their investments.

4.4.0 Behavioral patterns and fund performance

	overconfidence	Excessive trading	Buying attention blabbing stocks	Selling wining stocks earlier	Judicial systems	Expenses	Load fees
Mean	3.2667	2.8095	3.1524	3.4857	3.2000	3.4428	2.4356
Median	3.0000	3.0000	3.0000	4.0000	3.0000	3.0000	3.0000
Mode	**4.00**	2.00	2.00	4.00	4.00	4.00	3.00
Std. Deviation	**1.12609**	1.23577	1.26342	1.12345	1.77689	1.28965	1.4532
Variance	1.20232	1.87654	1.30862	1.54320	1.37543	1.67891	1.4321
Skewness	-1.820	.308	.000	-.584	-.081	-.091	-.405
Std. Error of Skewness	.226	.246	.246	.246	.246	.234	.342
Kurtosis	2.938	-.922	-1.356	-.438	-.944	.867	.865
Std. Error of Kurtosis	.330	.330	.330	.330	.330	.330	.330

From the above table, its clear that, most investors display negative behavioral characteristics. This characteristics negatively affect the fund performance; a likert was used to determine the frequency with which such behaviors are shown by investors. The mean from the responses was found to be within the range of 2.8 and 3.48, this can be interpreted to mean that most investors oftenly practice this behavioral patterns. The practice of this behavior negatively affects the fund performance.The level of dispersion was found as measured by standard deviation and variance was found to range between 11.2% and 17.7%, this means that the level of responses were within reliable range and hence the findings were reliable. This is further shown by measures of skewness and kurtosis.

4.5.0 Managerial capabilities and fund performance

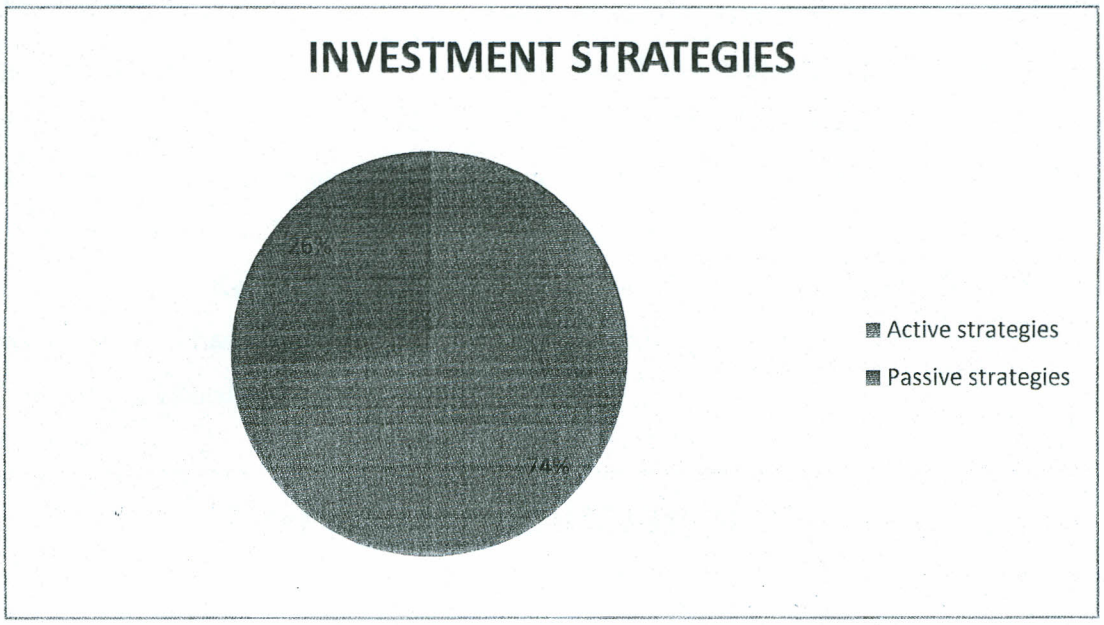
The researcher investigated the managerial capabilities displayed by fund managers. In particular the researcher investigated the following:

1. Investment strategies employed by fund managers
2. Market timing and stock picking abilities
3. Education skills
4. Experience

4.5.1 Investment strategies employed by fund managers

The researcher found out that, 20 (74%) respondents employ active strategies in investing the funds while 7 (26%) use passive strategies in investing the funds. Active strategies have been found to negatively affect the fund market whereby most investors undertake to carry out their market research before investing in any stock. This is as opposed to passive strategies involving limited ongoing buying and selling actions. Passive investors will purchase investments with the intention of long-term appreciation and limited maintenance .With this fund market is likely to be negatively affected by these active strategies of investment.

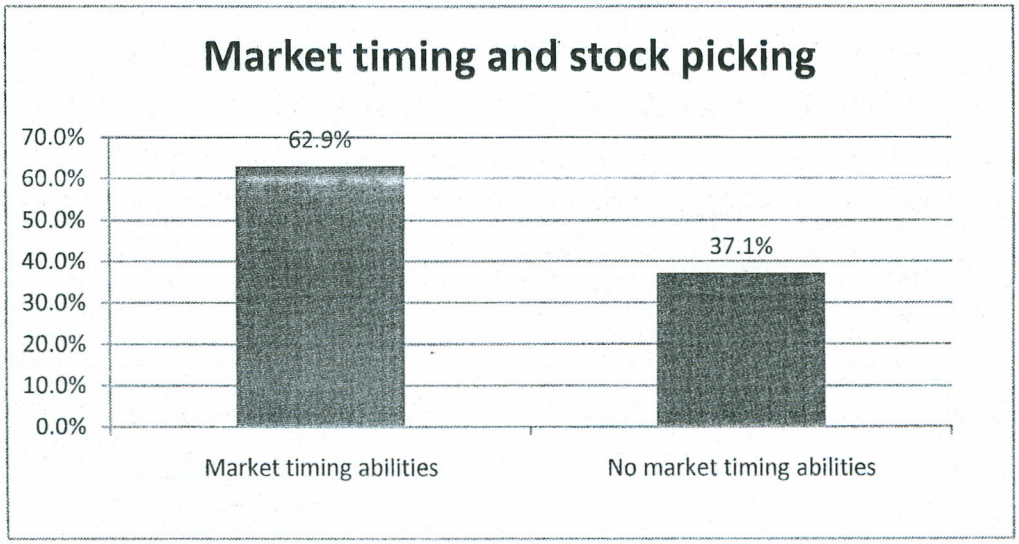
Figure 4.5.0 strategies employed by fund managers



4.5.2 Market timing and stock picking abilities

The researcher investigated the market timing and stock picking abilities of fund managers. The researcher found out that, 17 (62.9%) respondents possess market timing and stock picking abilities, while 10 (37.1%) do not possess the abilities. This implies that; the Kenyan fund market is likely to perform very well since the market and stock picking abilities has been positively associated with good fund performance.

Figure 4.5.1 market timing and stock picking abilities

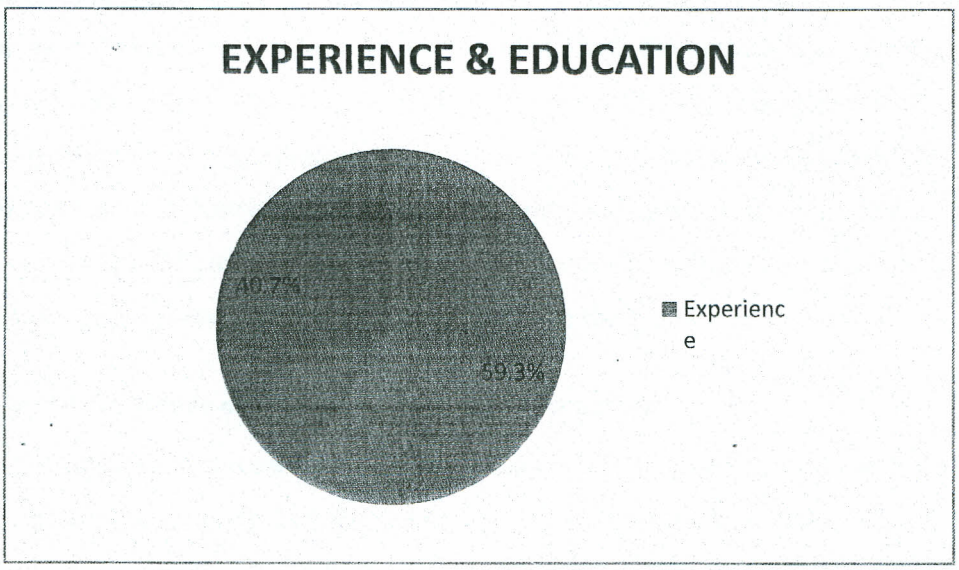


Market timing and stock picking

4.5.3 Education skills and experience

The researcher sought to determine whether education skills matters in determining the performance of the fund. The researcher found out that, 16 (59.3%) respondents considers experience as the key determinant while 11(40.7%) considers education as the key determinant in assessing the performance of the fund. experience and education level has been found to be key determinants in fund performance. Due to the young nature of fund market in Kenya, experience largely lacks amongst several fund managers but education level has played a positive role in fund industry.

Figure 4.5.2 education and experience



4.5.0 Analysis of Managerial Capabilities

	Investment strategies	Market timing and picking abilities	Education skills	Experience
Mean	2.6000	2.3333	3.0667	1.4332
Median	3.0000	3.0000	3.0000	2.0000
Mode	4.00	4.00	4.00	2.00
Std. Deviation	1.12318	1.12375	1.21106	1.20081
Variance	1.26154	1.26282	1.46667	1.44194
Skewness	-.898	-.278	-.097	.486
Std. Error of	.236	.236	.236	.236

Skewness				
Kurtosis	.007	-1.020	-1.281	-.697
Std. Error of Kurtosis	.467	.467	.467	.467

From the above table, most fund managers were found to practice active strategies when investing; this is shown by a mean, median and mode of 2.6, 3.0 and 4.0. Most fund managers were found to possess market timing and stock picking abilities as shown by mean of 2.33, median of 3.0 and mode of 4.0. This highly favors the performance of fund market. Level of education was also found to affect the performance of fund market positively as shown by a mean of 3.066. However, the experience of most fund managers was found to be inadequate as shown by a mean of 1.4, this negatively affects the fund performance in Kenyan market. The measures of dispersion from the mean was found to lie between 11% and 12%, this can be interpreted to mean that the responses from the fund managers were found to be reliable hence the credibility of data collected.

4.6.0 Persistence of returns and fund performance

The researcher investigated the persistence of returns and how they affect fund performance. In particular the researcher investigated the following:

1. The trends in performance of the fund.
2. Reasons for such trends.
3. Relevance of past information.
4. Ability to predict the market.

4.6.1 The trends in performance

Information regarding the trends in performance was sought and the following table summarizes the findings

Table 4.6.0 Trends in performance

Trend	Frequency	Percentage	Cumulative percentage
Constantly increasing	16	59.3%	59.3%
Constantly decreasing	0	0%	59.3%

Same returns	1	3.7%	63%
Varying from time to time	10	37%	100%

In determining the persistency of performance, the researcher found out that most funds' performance has been constantly increasing returns, funds with such consistency have been found to outperform the market as opposed to funds with drifting returns. This makes it suitable, the Kenyan fund market.

4.6.2 The use of past performance

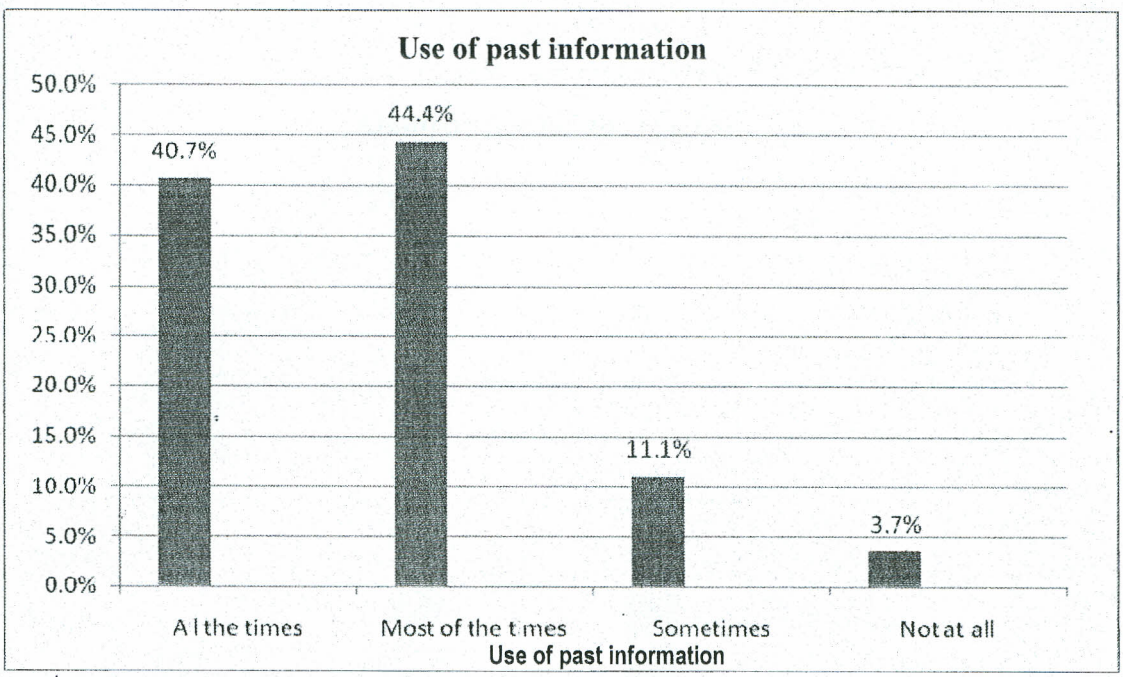
Information regarding the extent of use of past information to predict the future was sought and the following table summarizes the findings

Table 4.6.1 Trends in performance

Trend	**Frequency**	**Percentage**	**Cumulative percentage**
All the times	11	40.7%	40.7%
Most of the times	12	44.4%	85.1%
Sometimes	3	11.1%	96.3%
Not at all	1	3.7%	100%

Source; fund managers questionnaire

Figure 4.6.2 use of past information



The use of past information to predict the market has been found to positively affect fund performance and especially when combined with the current information and future information. Since most people were found to use pat information, the Kenyan fund market stands a better chance of performing well and especially when this information is used alongside the current market information.

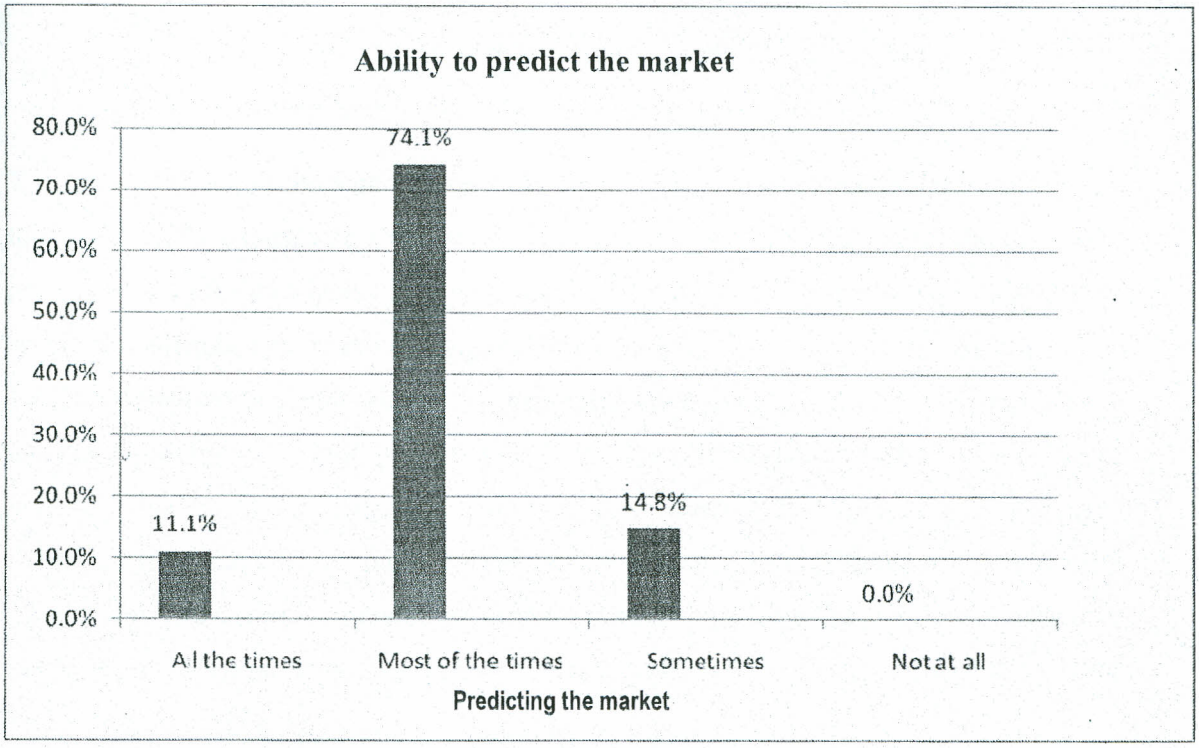
4.6.4 Ability to predict the future

Information regarding the ability to predict the future was sought and the following table summarizes the findings

Table 4.6.2 Ability to predict the future

Trend	Frequency	Percentage	Cumulative percentage
All the times	3	11.1%	11.1%
Most of the times	20	74.1%	85.2%
Sometimes	4	14.8%	100%
Not at all	0	0%	

Figure 4.6.3 ability to predict the market



Most of the fund managers were found to possess the ability to predict the market. This is a key factor in determining the fund performance. With this, the Kenya fund market with most managers with ability to predict the market stands a better chance of performance

Table 4.6.3Analysis of Persistence of returns

	Trends in performance	Reasons for such trends	Relevance of past information	Ability to predict the market
Mean	1.6667	1.3222	2.5564	1.3354
Median	3.0000	2.0000	3.0000	2.0000
Mode	3.00	3.00	2.00	2.00
Std. Deviation	1.6532	1.5437	1.1342	1.8745
Variance	1.3427	1.4537	1.6342	1.346
Skewness	-.798	-.278	-.134	.342
Std. Error of Skewness	.246	.234	.243	.236

Kurtosis	.007	-1.020	-1.281	-.697
Std. Error of Kurtosis	.467	.467	.467	.467

The researcher found out that the trends in fund performance as consistently increasing, this is shown by a means of 1.667 and median and mode of 3.0. This gives the managers predictive abilities and hence improved fund performance. The reasons for such trends have been attributed to market timing and stock picking abilities as shown by a mean of 1.332 and median of 2.000. since fund managers were found to have this skills, there is increased possibility of fund performance Use of past information was also found to be prevalent among fund managers as shown by the means of 2.556, this highly increases the fund performance since managers are capable of using past information to predict the future. The measure of dispersion as shown by deviations from the mean were found to range from 11% and 18%, this makes the responses more reliable since they are not highly dispersed from the mean.

4.7.0 Regression analysis

Regression analysis was used to estimate the effect of independent variables (factors affecting fund performance) and dependent variable (fund performance). Karl Pearson moment correlation was used to determine such relationship. The model is represented by:

MFP= f (A+IS+FC+FCBP+PR+MS)

where; Where MFP= Mutual fund performance, A= constant, F= function, IS= Investment Style, FCBP= Fund characteristics and behavioral pattern, PR= Persistency of returns, MS= Managerial skills

Table 4.6.0 regression coefficients

	Unstandardized coefficients		Standardized Coefficients	t	Sig.
Model	B	Std error	beta		
Constant	.227	.114		3.985	.000
Investment styles	.643	.298	.350	1.386	.005

Fund characteristics	.571	.213	.214	1.452	.032
Behavioral patterns	-.543	.080	-.381	-1.033	.013
Managerial capabilities	.809	.343	.363	1.462	.033
Persistence of returns	.436	.211	.253	1.564	.028

Using the values of the coefficients from the regression table above, the established regression equations takes the form of:

Fund performance= 0.227+0.643*investment style+0.571*fund characteristics-0.543*behavioral patterns+0.809*managerial capabilities+0.436 persistence of returns

This can be interpreted to mean, in absence of the various fundamentals of fund performance, the fund performance will change by a magnitude of 0.227. The results further indicate that there is a positive correlation between fund performance and investment style adopted; a unit change in investment style will result in 64.3% change in fund performance. Similarly, the research establishes a positive correlation between fund performance and fund characteristic, managerial capabilities and persistence of returns. This means that a unit change in fund characteristic, managerial capabilities and persistence of returns will result in 57.1%, 80.9% and 43.6% change in fund performance. The research further established that there is a negative correlation between the fund performance and behavioral characteristics meaning, a unit increase in behavioral characteristic will lead to a reduced fund performance by 43.6%. The results also show that all the variables are significant as the p-values are less than 0.05 ($p \leq 0.05$)

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter provides summary, conclusion and recommendations and suggested further studies.

5.2 Summary of Findings

5.2.1 Investment styles and fund performance

The study established that the performance of mutual fund highly depends on the investment style employed by fund managers. This is shown by positive Pearson coefficient of correlation of 0.643. Most fund managers invest in blend of funds. The average value of fund was found to be 50 million and above and most investors often dispose off their investments. In assessing the performance of the funds, most fund managers combine benchmarking and industry performance to determine the performance of their fund. In investing the investors' wealth, the fund managers purchase and sell a diversified portfolio as shown by a high percentage of 66.7% of fund managers who invest in diversified portfolio. The investors frequently purchase and sell their securities. A high number of fund managers, 62.9% were found to use brokers in purchasing and selling securities.

5.2.2 Fund characteristics and fund performance

The study found out that fund characteristics are positively correlated to fund performance. This is shown by a positive correlation of 0.571. Most respondents accounting to 85% felt that fund industry is not well regulated. The average value of funds was found to be 6-10 years while the average net assets were found to be between 10 and 50 million accounting for 59.2%. Most fund managers serve a combination of individual and corporate accounting for 55.6%. Most fund managers felt the Kenyan judicial system is good accounting for 45%. The fund managers were also found to incur high expenses in administration and advertising the funds. This is shown by a high percentage of 59.3, who concur that they incur very high expenses.

5.2.3Behavioral Patterns and fund performance

The researcher found out there is correlation between behavioral patterns displayed by investors and fund performance. This is shown by a negative correlation between behavioral patterns and fund performance of -0.543. The study also established that the investors often portray overconfidence, excessive trading, buying attention grabbing stocks, selling winning stocks earlier and sell losing stock, all this affects the fund performance negatively

5.2.4 Managerial capabilities and fund performance

The researcher established that there is correlation between managerial capabilities and fund performance. This is shown by positive correlation of 0.809. 74% were found to employ active strategies in fund investment while most fund managers were found to have market timing and stock picking abilities as shown by a high of 62.9%. Most fund managers consider education as opposed to experience a key determinant of fund performance.

5.2.5 Persistence of returns and fund performance.

The researcher found out there is a positive correlation of 0.436 between the persistence of returns and fund performance. The trend in performance has been constantly increasing as shown by high frequency of 59.3%. Most fund managers relate this performance to superior managerial capabilities as opposed to luck; this is shown by high frequency rate of 81.5%. Most fund managers were found to use past information to predict the future as shown by frequency rate of 44.4%. Most fund managers were found to have the ability to predict the market accounting for 74.1% of the managers.

5.3.0 CONCLUSION

From the foregoing research, it can be concluded that, the performance of fund will be greatly determined by the fundamentals of fund performance in the following ways:

5.3.1 Investment styles

In relation to the findings of this research, it can be concluded that there is high positive correlation between fund performance and investment style adopted. It can also be concluded that the investment styles adopted by fund managers in Kenya is perfect for fund performance. Most of the investment style characteristics favor fund performance.

The type of funds invested in Kenya was found to be blend of growth and value fund, this favors the fund market. Other investment style found to favor fund market included the average value of the fund, frequency of investments, methods of assessing fund performance, securities invested in and frequency of buying and selling investments. All this characteristics makes Kenyan fund market favorable.

5.3.2 Fund characteristics

Fund characteristics were found to have a positive correlation with fund performance. Most of the fund characteristics were found to be favorable for fund performance. This includes clientele type, average net assets, judicial system, advertising expenses and commissions charging. However, the regulation and the age of the fund in Kenya were found to be unfavorable. To a large extent, characteristics of Kenyan fund market were found favorable for fund performance

5.3.3 Behavioral patterns

The study established that there is negative correlation between behavioral pattern and fund performance. The research further established that, there are negative behavioral patterns portrayed by investors in Kenyan fund market. Behavior patterns such as overconfidence, excessive trading, buying attention grabbing stocks, selling winning stocks earlier and selling losing stocks late were found to be prevalent in Kenyan market. This has negatively affected the fund market in Kenya as investors lose their investments due to these behavioral characteristics.

5.3.4 Managerial capabilities

The researcher found out that, there is a positive correlation between managerial capabilities and fund performance. Market timing and stock picking capabilities were found to be prevalent in Kenyan market. Educational skills were also found to be prevalent in Kenyan market. This highly favors the fund market in Kenya and as such the fund market has greater chances of better performance. However, the fund managers experience was found to be highly inadequate owing to average age of the funds in Kenya

5.3.5 Persistency of returns

The research established that, the fund performance of fund market in Kenya has been persistently increasing. This positively impacts the Kenyan fund market since it enables

the fund managers to be able to predict the market and hence increasing the performance. The research further established that there is positive correlation between fund performance and persistency of returns. The persistency in returns which was found to be constantly increasing enables the fund managers to predict the market and hence high fund performance.

5.4.0 Recommendation

In the light of the research findings, the study established a positive relationship between investment style and fund performance. The study recommends that, the Kenyan fund managers be trained on the best investment styles including, the size of fund to hold, type of funds to invest in, frequency of change of investment style, methods of assessing performance among other investment style characteristics.

The study also established a positive relationship between fund characteristics and fund performance. Most characteristics in Kenyan were found to favor fund performance. However, regulation of fund industry was found to be greatly lacking as one of the fund characteristic. It is recommended that the various regulators of fund industry come up with the necessary regulations to control the fund market and hence fund improving performance.

The behavioral characteristics were found to have negative relationship with fund performance. This factor has been found to be prevalent in Kenya. Behaviors such as overconfidence, buying attention grabbing stocks, selling winning stocks earlier and losing stock late were found to be prevalent. The research therefore recommends that fund investors and managers be trained on the best practices to avoid such negative behaviors.

Persistency of returns and managerial capabilities were found to have a positive relationship with fund performance. in this regard, the researcher recommends time to time training of fund managers to enhance this vital skills and hence removing the element of luck when investing.

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APPENDIX 1: QUESTIONNAIRE

Please tick the most appropriate answers

PART A: BACKGROUND INFORMATION

1. Sex

(a) Male ☐ (b) Female ☐

2. Age bracket

(a)18-30 ☐ (b) 31-40 years ☐

(c) 41-49years ☐ (d.) 50 years and above ☐

3. Highest education level

(a) Doctorate ☐ (b) Masters ☐

(c) Bachelors ☐ (d) Diploma ☐

4. For how many years have you been in fund management profession?

Below 1 year ☐ 1- 5 years ☐

6-10 years ☐ over 10 Years ☐

Section B: Investment styles

5. What type of fund do you invest the funds

☐ Growth ☐ value ☐ combination

6. Estimate the average value of funds you manage.

☐ Ksh.. 1- 10,000,000 ☐ Ksh.10,000,001- 100,000,000

☐ Ksh.100,000,001 and above

7. How often do you change your investment style?

☐ Very often ☐ Often ☐ rarely ☐ not at all

8. In assessing the performance of the fund, which criteria do you use?

☐ Past performance ☐ Industry performance ☐ benchmarking

☐ combination of the methods (diversification)

9. When investing, what kind of instruments do you prefer?

☐ Government securities ☐ Corporate debt securities ☐ Equity securities ☐ combination

10. How often do fund investors dispose their holdings in the fund you are managing?

☐ Very often ☐ Often ☐ rarely ☐ not at all

11. How do you buy and sell your securities?

☐ Through a broker ☐ direct buying

PART B: FUND CHARACTERISTICS AND BEHAVIORAL PATTERNS

Fund characteristics

12. In your opinion, is the fund industry well regulated?

☐ Yes ☐ No

13. What is the average age of the funds that you are managing?

☐ 1 month- 5 years ☐ 6 - 10 years ☐ 11 years- 15 years ☐ above 15 years

14. What kind of clientele do you serve?

☐ Corporate ☐ individuals ☐ both

15. Estimate the average net assets of the funds that you manage.

☐ Ksh. 1-1,000,000 ☐ Ksh. 1,000,001- 10,000,000

☐ Ksh.10,000,001 – Kshs. 50,000,000 ☐ Kshs. 50,000,001 and above

16. How do you rate the judicial system in terms of competence and equity?

☐ Excellent ☐ very good ☐ Good ☐ poor ☐ very poor

17. How do you rate your advertising expenses?

☐ very high ☐ high ☐ low ☐ very low

18. What is your main objectives when investing the funds?

☐ High monthly/ Annual returns to investors ☐ growth of investors wealth ☐ Both

19. When do you charge your commission charges?

☐ when investing in the fund (Front end load) ☐ when selling their investments (Back end load)

20. In administration of the fund, how would you rate the expenses incurred (Management fees)?

☐ very high ☐ high ☐ low ☐ very low

21. In your opinion does the mutual fund industry have necessary and supportive regulations in Kenya?

☐ yes ☐ No

if the answer s no in 15 above. Please indicate the area which in your opinion should be improved?

.....

.....

22.Certain factors may make investors irrational when investing and disposing off their investments. From the following list, indicate how often this factors are displayed by investors in the fund you are managing (tick as appropriate).

	Very Often	Often	Rarely	Not at all
Overconfidence	☐	☐	☐	☐
Excessive trading	☐	☐	☐	☐
Buying Attention				
Grabbing stocks	☐	☐	☐	☐
Selling winning stock earlier	☐	☐	☐	☐
Selling losing stock late	☐	☐	☐	☐

23. How would you describe the investor's investment strategies?

☐ Passive (advice from experts) ☐ Active (trying on your own while Carrying out analysis)

24. In your daily activities, you buy and sell securities, in your opinion which is your most prevalent activity, that is, in terms of time and costs?

☐ Buying ☐ selling

25. some funds outperform others in the market; others do not do very well, in your opinion how you would explain this?

☐ Managerial capabilities ☐ net assets amount ☐ Luck ☐ combination

Differences of the fund of the three

PART C:PERSISTENCE OF RETURNS AND MANAGERIAL CAPABILITIES

26. How would you describe the performance of your fund over the period in operation?

☐ constantly increasing ☐ constantly decreasing ☐ constant (same returns) ☐ varyng from time to time

27. If the answer in number 17 above is constantly increasing, how would you explain it:

☐ Superior managerial capabilities ☐ Experience ☐ Luck And skills

28. In trying to outperform market, how frequent do you use past performance information of the fund to predict performance of stocks?

☐ All the times ☐ sometimes ☐ rarely ☐ not at all

29. How would you describe your investment strategies as the fund manager?

☐ Passive (use of a selected benchmark) ☐ Active (make attempt to get best securities)

30. How often do you succeed in market timing and picking the right stock for Investment?

☐ all the times ☐ Most of the time ☐ 50% success And 50% failure ☐ Never

31. In assessing managerial capabilities, educational skills and experience matters, in your opinion, which of the two matters most?

☐ Education ☐ Experience

32. In your opinion which area in fund management requires improvement?

.....

.....

APPENDIX 2

Registered Fund Managers in Kenya– 2012

1) African Alliance Kenya Investment Bank Limited
2) Amana Capital Limited
3) Apollo Asset Management Company Limited
4) British-American Asset Managers Limited
5) CO-OP Trust Investment Services Limited
6) Dry Associates Limited
7) Genesis Kenya Investment Management Limited
8) ICEA Asset Management Limited
9) Jubilee Financial Services Limited
10) Kenindia Asset Management Company Limited
11) Madison Asset Management Services Limited
12) Old Mutual Asset Managers (Kenya) Limited
13) Pinebridge Investment East Africa Company Limited
14) Sanlam Investment Management Kenya Limited
15) Stanbic Investment Management Services (EA) Limited
16) Zimele Asset Management Company Limited

Source: Retirement Benefits Authority, 2012