

Research Article

Inferring the behaviour in choice of unit trust fund

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ABSTRACT: Unit trust fund investment is popular among the retail investors as it provides professional management with low cost and the needed diversification. It is used as investment not as speculation. The choice of fund is ultimately important. The choice of fund picked by the investor should be in line with the financial objective of the investor. The current study thus proposed how investors select their fund and whether behaviour of investor has a role to play in it.

Introduction

Investing in the unit trust fund is normal for small investors in our country because it is a simple, fast, passive and economical way to invest. Malaysia has 42 unit trust management companies and 56202 unit trust consultants, 431 conventional funds and 181 Islamic based funds. There are 14,454,436 conventional accounts and 2,223,965 Islamic base accounts ("Federation of Investment Managers Malaysia," 2014).

Unit Trust Fund is a structured shared investment with investors that have the same objectives pool their funds to invest in a portfolio of securities or assets (Gan, 2008). It is managed by professional fund managers and invests in a portfolio of fund that may include cash, bonds and deposit, shares, properties and commodities. The right to the fund in Malaysia is according to the units own as the fund is breakdown into units (Gan, 2008). Investors do not own the whole portfolio of shares directly but they own a number of units they invest according to the price of the day.

2. Motivation of this study

The most crucial challenge faced by investors in investing unit trust fund is the investment choice of fund. When an investor makes a profit or incurs a loss, it attributed mainly to his decision-making abilities in his choice of fund. The financial anomalies manifest that something is fundamentally missing in the traditional model of market behaviour, even the most prominent and well-educated investors have failed.

Bogel (1993) discovered that in investment, nobody has problem with investment instead there are always issues with people and this happens because the people are the ones who created the funds and it is the people who invest in it. He continued to highlight the most uncomfortable truth in unit trust fund industry in United States of America where around 7% of unit trust fund "died" each year between 2001 and 2002, while in the 1960s, only 1% fails. Although funds are dying at a rapid rate, they are born at even quicker pace (Nofsinger, 2001). How investors choose their fund? Gerd G.

(2011) offered three major answers to it. The mind applies logic, statistic, and heuristics. According to Gerd G. (2011), the very truth was that people often rely on heuristic, but they lose in accuracy

As said by Nofsinger (2005), memory is about the perception of physical and emotional experience and not as much as a factual recording of events. How it affects depend on how these events unfold on us. Brain records the events through a process and store different features of the experience. These store features are the basis for the subsequent recall. Our memory deals with two areas. The happy or sad event is the first event. The same truth is applicable to investments as well. According to Nofsinger (2005), people feel better about experiences with a higher satisfaction. Consider a scenario in which the two stocks increased in price. Over 12 months Stock A increased to \$125. While stock B rose to \$120 in a month. It is this memory that Wright (2000) said that resulted in the investor to feel better about the stock B, even its performance was not on par with Stock A.

3. Considering the Past

Nofsinger, (2005) had found out that investors select their fund by considering the past. Using past outcome as a factor in the current uncertainty are commonly used by many investors is known as considering the past according to Nofsinger (2005) In a simple experiment carried out Thaler (1990) on 95 undergraduates' economics students to take a series of two phases gambles using real money. The three questions included in the study and the numbers in brackets are the percentages of subjects who chose the selected answer.

Problem 1: You have just won \$30. Now choose between:

- a) A 50% chance to gain \$9 and a 50% chance to lose \$9. (70%)
- b) No further gain or loss. (30%)

Problem 2: You have just lost \$30. Now Choose between:

- a) A 50% chance to gain \$9 and a 50% chance to lose \$9. (40%)
- b) No further gain or loss. (60%)

Problem 3: You have just lost \$30. Now you choose:

- a) A 33% chance to gain 430 and a 67% chance to gain nothing. (60%)
- b) A sure \$10. (40%)

Problem 1 illustrates the house money effect while problem 2 and 3 illustrate the complex preferences in play when people consider themselves behind in some mental accounting. In problem 2, a loss of \$30 does not generate risk seeking when there is no chance to break even but when given that chance, in problem 3, majority of the subjects opt for gamble. House money effect is the phenomenon that prior gains may increase people's willingness to accept risky gambles (Thaler, 1990). It is due to past success. During the initial phase, money was not involved in the gamble and in the second phase students were asked whether they like to gamble. Their findings suggested the following effects: a) Snake Bite Effect b) Past Success.

3.1 Snake Bite Effect (Past Investment Loss Experience)

According to Nofsinger (2005), following a financial loss, investors become averse to risk and this is known as snake bite effect. After losing money and faced with a gamble, investors will choose to decline to take risk generally. Snake seldom bites people, but when it bites the victims become more mindful. They may rest for awhile and look around for sure opportunity before entering the market again.

Wright (2000) said the saying "fool me once shame on you, fool me twice shame on me" is a good account of this behaviour pattern. Investors investing in blue chip stock, due to unexpected happening that beyond control, he realises a big loss. This investor will be risk averse, very cautious with his next investment so that the mistake will not be repeated. It is because investors had experienced what caused them to be extra cautious than normally would. By doing so, they may be adding losses in their future endeavour (Wright, 2000). After feeling hurt, the feeling of unlucky is always there, they will avoid risky adventure; therefore, they herd.

Hao (2012) suggested that herding behaviour represents an observable fund characteristic that enhances the predictive power of past returns and captures a distinct dimension of fund skill, thus helping investors distinguish good funds from bad ones. He continued examined actively managed US mutual funds over the period 1990-2009 and discovered that there is a correlation between higher herding inclination and lower performance. The inferior performance of herding funds was persistent, not driven by the price impact of aggregate institutional trades, and more pronounced during and after periods of greater investment opportunities in the mutual fund industry. This result suggests that fund herding behaviour provides valuable information for inferring the

cross-sectional distribution of skill in the mutual fund industry. The association between the herding behaviour of mutual funds and their future performance, Hao (2012) suggested that herding behaviour reveals skill: herding funds may be less skilled than their anti-herding and therefore exhibit subsequent underperformance.

Merli and Roger (2011) discovered that bad past performance will lead to herd but Bikhchandani and Sharma (2000); (Chen, 2012) did not agree that investors herd if their investment did not perform well. What they found that 77% of these mutual funds investors were momentum investors, investing in past winners; but did not methodically sell past losers. The evidence of trend herding into past winners was stronger than herding into past losers. Therefore, it will be very interesting to see whether those investors with bad performance in the past will herd as research shows strong evidence of herding into past winners. Pertaining to these findings, it is proposed that:

Proposition 1a: There is a significant relationship between snake bite effects in investment choice of unit trust fund.

3.2 Past Success

As said by Nofsinger (2005), past success is where investor has experienced a gain or profit in the past and Mallouk (2014) concurred with it as in any given year, there are winners. While the majority of mutual funds tend to lose to the index, some beat it. As said by Mallouk (2014), the issue is that they tend not outperform again, and there was absolutely no indication that the performance persists. We know that over a period, performance usually gives way to underperformance. Investors will always try to reduce the impact of their poor return, will always highlight the good return, and by taking this step, will end up overrating both their past return and their potential future performance of their account (Wright, 2000). Overestimating their investment return is a common occurrence.

The ability and skill of investors are always a big question. Nofsinger (2005) agreed that overconfident is learned through past success. He stressed that if a decision turns out to be good, it is attributed to their skill and ability. Bad luck is to blame if it turns out bad even when much luck is involved. It is here where investment decision choice is to decide in a matter of minutes and seconds. It depends on the financial literacy of the investors to process the information available.

In evaluating risky decision today, people are using past outcome as a yardstick. Investors were more willing to take risk after making a gain and risk averse after making a loss. The money earned from the successful investment is not recognised as theirs said Nofsinger (2005) Are you willing to take more risk with your opponent's money or your own money? Nofsinger (2005) found that 77% of economics student will place a bet after winning \$15.00 discovered it. After losing \$15.00, only 41% chose to gamble.

The reason for it was segregation. The profit did not belong to them. They act as if they are betting with his opponent's

money. The house- money effect predicts that investors are more likely to invest risky stock after a series of successful investment. The evidence of how individual reacts, affected by prior gain and loss is illustrated by Thaler (1990). After a prior gain, people become more open to assume the risk and this observed behaviour is referred to as the house money effect.

Mallouk (2014) discovered that the vast set of a mutual fund, the overwhelming majority underperform, and there is no evidence the winners will continue to win. A trader past performance in any given market has little or no bearing on their expected future performance said Mallouk (2014). Under normal circumstances, the key to understanding why a manager has outperformed over a period is to look at the field. There is a small minority of investment managers who beat the S&P over 10 years, which cannot be a strong argument to hiring those managers, but a strong example of a field full of carnage, where an intelligent investor should avoid hiring them in the first place. Therefore, it is proposed that:

1b: There is a significant relationship between past successes in investment choice of unit trust fund.

4. Financial Knowledge

Knowledge is acquired through many sources, all at varying levels of quality and reliability. These include formal education from college courses, seminars and, even training classes. The informal sources come from parents and relatives, co-investors and friend (Keller, 1987; Lee, 1999). In addition to that, many investors learned through bad experience and sweet memories. It is a general belief that people learn best from experience (Hoch, 1986), while most research also suggests that learning from experience is difficult (Brehmer, 1980; Einhorn, 1978; Hogarth, 2002).

4.1 Advice

Investors invest base on information or advice they received and this is observed in PT where the reaction of an investor is base on a subjective reference point. Forbes (2009) clearly stated that one of the reasons why investors tend to agree is because of the nature of the advice they received from stockbrokers and market commentators.

Welch (2000) studied over 50,000 recommendations issued by 226 brokerage houses by using US Zacks' database from 1989 to 1994. There was strong evidence that investors followed recommendations towards the current consensus regardless of the underlying distribution of advice given. This is a well-known phenomenon known as "white coat effect" according to Desteno (2015) where ones believe that the person who gives advice is an expert or person with authority. Importantly he found that the strength of herding towards consensus was never affected by whether the consensus' recommendation was good predictor of future stock price performance or not. Welch (2000) discovered that the tendency to herd was stronger during the bulls market rather than the bear market. Kramer M. (2007) compared the portfolio of advised and self-directed investors in over 52 months. He used a large dataset

with over 600,000 return observations of 16,053 Dutch investors. He found that the portfolio of advice and self-directed investors differs remarkably, but he did not find any evidence of significant outperformance or underperformance of advised investors.

What was discovered by Karabulut (2010) was that the usage of financial advisors lowered portfolio returns and increased portfolio risks compared to when individuals managed their investment on their own. Still, the usage of financial advisor improved diversification and moderate home bias. It managed to lower trading frequencies, account turnovers, and failed in market timing in asset allocations. This research used 10,434 randomly selected customers from a large German Commercial Bank from January 2003 until October 2005 and statistical method is use in this study.

The involvement of financial advisors may prevent behavioural biases such as overconfidence and loss aversion that may give rise to excessive trading and risky share inertia, according to Shapira (2001). Kramer M. (2009) agreed that advisors can help their clients to defeat the barrier to stock holding both by providing information and eliminating the misperceptions to the stock market.

Studies on comparing professionals in finance with ordinary investors depend on context. Bradley (1981) found out that generally people who obtained good general knowledge usually have very unrealistic higher expectation to answer the questions correctly. Torngren (2004) who studied overconfidence in stock market found that professionals and non-professionals overestimate their abilities and that the professionals overrated their abilities by a greater margin.

4.2 Information

Information and profit is highly correlated (Suleyman Ic., 2013). In unit trust investments, information is slow coming as it all depends on the underlying assets of the portfolio. It is undeniable that unit trust investors need to know the underlying asset changes. However, most investors will treat it as a passive investment.

Information based on herding theory explains herd behaviour over informational effects. This is what Suleyman Ic. (2013) said when thinking about this concept. He agrees that the modern communication facilities had helped the financial system and makes this theory as the most important. When investors follow other investors' footsteps, and do not use their own information, according to the initial finding of Banerjee (1992) this is characterised as a herding behaviour.

It was argue that information cascades by observing the decision of their predecessors for information. The previous actions of other investors are internalised based of each investor and it becomes a yardstick for decisions and the domination of previous actions of others over their own opinions. According to Alevy (2003), information cascade takes place when previous trade opinions have been agreed with the personal opinions and not when everybody follows the previous decisions and the information commencing this

cascade is perceived to be optimal information. This concept is social learning or observation based learning.

S. Bikhchandani and Sharma (2000), S. Bikhchandani, D. Hirshleifer & I. Welch (1998) and Peterson (2012) were in the same boat when they stated that price movement of securities reflect the direction of the market. The investors take this as a signal of the market movement to choose their security and reflect the decisions and actions of the good informed investors and it resulted in information cascades.

In information cascade, the very first transaction is the most important one because it shows whether you are in the right track or not. The opinion of Suleyman Ic (2013) about the financial market today is speed and it is an important performance indicator. It has the potential of converting correct decisions into cascades when considering that failure of decision-making has a severe alternative cost. It is proposed that:

Proposition2a: Advice and information received has significant influence to the investment choice of unit the trust funds

4.3 Illusion of Knowledge

Varying levels of actual knowledge versus perceived knowledge, combined with unrealistic expectation, according to Suzanne (2012) is creating sizable barriers to healthy decision making. To Nofsinger (2005), illusion of knowledge referred to the inclination for people to believe that the precision of their forecasts increases with more information; with more information increases one's knowledge thus improves one's decision. Partially, overconfidence is result of illusion of knowledge (Nofsinger, 2005).

Slovic (1973) studied the impact of giving extra information to individuals handicapping a horse race. First, he gave each individual 5 important pieces of information and asked for their predictions. Then he gave them additional 35 pieces of information. This time when he asked for their predictions, the handicappers were less accurate but twice as confident. As said by Mallouk (2014), by gathering more information, we feel better about the investment and trade more. Those who trade more are those who underperform more. Mallouk (2014) agreed that the investor make a big mistake because to them collecting more information means they are adding more intelligence that will enable them to trade to their advantage. Nevertheless, the more information we gathered the more problems we faced and was proven right (Wright, 2000).

Illusion of knowledge provides confident and this is why investors react. It provides a point where investors believe in it and as agreed by PT. Heuristic does play a role as formal and informal source of advice and information is ready available. The menace to understanding is not so much ignorance as the illusion of knowledge. Several research reveal that people are not always accurate judges of their knowledge (Dunning, 2011). It was asked by Stav Atir (2015) whether people can differentiate between what they know and what they do not know. The answer is people overestimate their knowledge

(Stav, 2015). Therefore, it is proposed that:

2b. *Illusion of knowledge has significant relationship in investment choice of unit trust funds.*

5. Miscalibration

Fischhoff, Slovic, and Lichtenstein (1977) showed that investors made overconfident decisions by using past events to resemble the future events with greater certainty than justified. They were only right 80% of the time.

Hilton, Regner, Cabantous, Charalambides, and Vautier (2011) showed that the core finding that supports the reality of judgmental overconfidence is that people is miscalibrated. They overestimate the probability of their judgment to be correct. Miscalibration depends on the way it is measured. In particular, higher confidence is observed in the interval production task where participants were asked to state an interval such that they were XX% (e.g., 50%) sure that the correct response to the questions fell in that interval.

5.1 Judgment

Shiller (1997) said that overconfidence is associated with investors' judgment, underestimating the margin of error that likely to be committed. Graham (2009) argued that people were more willing to bet on their own judgments when they feel skilful or knowledgeable. Lambert, Bessière, and N'Goala (2012), showed that there were negative dissimilarities between bankers and students in the level of overconfidence in judgment. However, overconfidence seems to determine decision-making in a dissimilar way across the two groups. Students were more overconfident in general tasks such as global knowledge of assets but not in investing. They were rather risk averse. Bankers were overconfident. It mainly affects the specific task (investment choice and valuation) and risk aversion had no effect on them in investment decision.

Glaser, Langer, and Weber (2010) analyze the judgment bias between investment bankers who work in international banks and ordinary people. Based on the reply of 123 professionals, they found that professional judgment was biased. In most tasks, their amount of overconfidence was significantly higher than the respective scores of an ordinary people. It is proposed that:

Proposition 3: There is a significant relationship between investors' judgment in the investment choice of unit trust funds

6. Conclusion

Based on previous research by Nurasyikin (2012), experience fund manager, fund rating and size of fund was found not to be influential factor on choice of fund. It was also discovered that the type of fund was not an important criteria. Past performance of fund was highly taking into consideration in choice of fund (Nurasyikin (2012) although past performance did reflect the future performance. However, what can influence to their choice of fund can be their own behaviour.

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