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A Multicriteria Approach to Mutual Fund Selection (pp. 1-20)

Wade D. Cook, Kevin J. Hebner

In practice, when investors select a mutual fund, they take into account a number of factors. However, the most popular approach for evaluating mutual funds employs only a single criterion, the funds' mean, risk-adjusted, rate of return (Jensen's alpha coefficient). In the present paper a multicriteria approach to mutual fund selection is presented. The multicriteria of the funds' alpha's, front and back-end load fees, the level of diversification, quality of service, and so on. It also recognizes that individual investors posses heterogeneous attributes and preferences, and hence, allows investors to formulate different ratings (and consequently rankings) of the set of competing mutual funds.

Active Timing Decisions of Equity Mutual Funds (pp. 21-39)

Robert Radcliffe, Robert Brooks, Haim Levy

In this paper we examine an aspect of professional investment management which has not been adequately documented and studied; the extent to which equity mutual fund managers actively adjust their portfolio's equity risk exposure over time. Estimates of a portfolio's quarter-end beta are developed using the actual stock holdings of the portfolio at the quarter-end. Changes in these beta estimates from one quarter to the next are shown to arise from both passive and active asset allocation. We find that active risk adjustment dominates passive rebalancing and that equity risk exposure is quite variable over time. Thus, individual investors who estimate the equity risk inherent in a portfolio based on a single time series return beta might seriously misestimate the portfolio's current equity risk. We also test whether active risk management is better characterized as anticipatory of future market events or reactive to past market events.

Long-Run Returns on Stock and Bond Portfolios: Implications for Retirement Planning (pp. 41-49)

Kirt C. Butler, Dale L. Domian

This paper presents asset returns over long holding periods in a form useful for retirement planning. Time diversification, heretofore analyzed for lump-sum investments, still serves to reduce the risk of stock investments when funds are accumulated month by month. We consider investments in five stock and bond asset classes as well as various asset allocation strategies. Probability distributions are computed for retirement wealth over a range of investment horizons.

Nobody Gains from Dollar Cost Averaging Analytical, Numerical and Empirical Results (pp. 51-61)

John R. Knight, Lewis Mandell

Dollar Cost Averaging is an investment system that is widely advocated by brokerage firms and mutual funds. In its best known form, an investor seeking to put a lump sum into risky assets is counseled to invest the money over a period of time in equal installments in order to avoid the devastating effect of a market fall immediately after a single, lump-sum investment. Using graphical analysis, historical stock market returns, and Monte Carlo simulations, this article demonstrates that no such benefit accrues to a Dollar Cost Averaging Strategy. Two alternative strategies, optimal rebalancing and buy and hold achieve better performance in all three analyses.

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An Index of Portfolio Diversification (pp. 73-85)

Walt Woerheide, Don Persson

A recurring question in the literature concerning diversification is what is the minimum number of securities required to achieve adequate diversification. The problem is that studies on this topic assume equally distributed holdings. In reality, portfolios are not evenly divided. The purpose of this paper is to evaluate the ability of five different measures of diversification to provide meaningful information about the degree of diversification of an unevenly distributed stock portfolio. The complement of the Herfindahl index was found to be the best of the five measures and its explanatory power was deemed to be adequate for general use.

The Individual Investor in the Market: Forming a Belief Regarding Market Efficiency (pp. 87-96)

Robert M. Peevey, Gene C. Uselton, John R. Moroney

Do the actions of investors drive the market toward efficiency or do investors utilize fads and other information unrelated to the true value of the security to drive the market away from efficiency? Investors have been forced to examine a multitude of challenges to the efficient markets hypothesis in recent years. One of the most formidable of the challenges is the "excessive market price volatility" argument. We examine this argument, as presented in the "variance bounds" literature, and conclude that, although markets may be inefficient, the "variance bounds" literature has not proved the case conclusively.

Performance and Risk Exposure of International Mutual Funds

(pp. 97-110)

Larry R. Lang, Robert M. Niendorf

This study examined whether internationally diversified mutual funds increased a U.S. investor's risk-adjusted return above that on a domestic benchmark mutual fund. Average returns on about one-half of the international funds exceeded the domestic benchmark fund's return. The risk-adjusted returns on the international mutual funds were not significantly different from that on the domestic benchmark fund. These results differ from earlier studies which generally found superior returns on international mutual funds. The benefits for the U.S. investor of holding an internationally diversified mutual fund appear to be limited for the period studied.

What Strategies Are Experienced Estate Planners Recommending? Evidence From Survey Data (pp. 111-130)

Chris J. Prestopino

Responses from 124 experienced estate planning attorneys in 33 states reveal the frequency with which their 1991 clients undertook over forty estate planning techniques commonly promoted in practitioner literature. Nearly 83 percent of their clients had a net worth of at least $600,000, implying the need for careful consideration of these strategies. Among the most popular techniques implemented include the durable power of attorney for property, durable power of attorney for health care, living will, credit shelter bypass plan, standard QTIP trust, revocable living trust, and nonsimple will. Among the least popular techniques include flower bonds, private annuity, grantor retained unitrust, large custodial gift, and grantor retained annuity trust.

The Risks of Pension Plans (pp. 131-156)

Robert W. McLeod, Sharon Moody, Aaron Phillips

This paper identifies and describes the risks to which the prospective pensioner is exposed. An understanding of the types of plans and the risks associated with each will assist the individual pensioner with making a proper analysis of the safety of his/her plan and acquaint the pensioner with the role of the Employee Retirement Income Security Act (ERISA) and the Pension Benefit Guaranty Corporation (PBCG) in safeguarding pension assets.