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Equity Fund Size and Growth: Implications for Performance and Selection (pp. 1-12)

Conrad S. Ciccotello, C. Terry Grant

Should individuals choose the largest or smallest equity funds for investment? This study explores the relationship of equity fund size to performance. Historical returns of large funds are found to be superior to their smaller peers. Yesterday's best performing funds tend to become today's largest funds as individuals invest heavily in response to the communications about the fund's past success. But the findings suggest that, once large, equity funds do not outperform their peers. Especially for funds in aggressive growth objectives, the advantages of being small appear to outweigh the disadvantages. For individual investors with aggressive growth objectives, a strategy of investing in smaller funds may thus be wealth maximizing.

Professional Stock Analysts' Recommendations: Implications for Individual Investors (pp. 13-29)

M. Mark Walker, Gay B. Hatfield

Conclusions regarding analyst performance often depend on the evaluation technique employed. Using a wide variety of techniques, we find that although there is some evidence that analysts do have the ability to identify undervalued and overvalued securities, individual investors generally experience inferior portfolio performance by analyst recommendations published in the "Market Highlights" section of USA Today (even before transaction costs are included). As a result, individual investors should view studies that purport to show superior performance with skepticism. This statement is particularly true when the assertions are based on stock index comparisons.

Computing Yields on Enhanced CDs (pp. 31-42)

Robert Brooks

In this paper, we seek to provide a framework for comparing certificates of deposit (CD) products that vary in their features. There are now fixed-rate Cds with no early withdrawal penalties as well as floating-rate Cds with guaranteed floors. With the model developed here, we examine the required change in the effective annual rate required in basis points to make CD products with embedded derivatives (called enhanced Cds) comparable with the standard CD products (ones with large early withdrawal penalties). This framework is beneficial for both retail customers seeking to make rational comparisons and bank executives seeking to provide optimal liability products and seeking to manage the resulting interest rate risk.

Churning: Excessive Trading in Retail Securities Accounts (pp. 43-56)

Stewart L. Brown

Churning involves excessive trading by stockbrokers in order to generate commissions. Current practice uses the turnover ratio to detect excessive trading. The turnover ratio is a flawed indicator of the actual harm of excessive trading which is commissions. This paper examines the intersection of law and financial analysis in the retail securities arena. A unique set of data from 23 actual churning cases is used to argue that the turnover ratio should be replaced by a more direct measure of the trading costs: the commission to equity ratio. An appropriate benchmark related to the return on common stocks is suggested to gauge excessive trading in a commission context.

Ratios and Benchmarks for Measuring the Financial Well-being of Families and Individuals (pp. 57-70)

Sue A. Greninger, Vickie L. Hampton, Karrol A. Kitt Joseph A. Achacoso

Financial planners and educators comprised a panel of 156 experts in the Delphi study designed to identify and refine ratios and benchmarks for measuring financial well-being. Consensus between the two groups existed for benchmarks on 20 of 22 ratios in the areas of liquidity, savings, asset allocation, inflation protection, tax burden, housing expenses, and insolvency/credit. Consensus regarding the usefulness of specific ratios was observed for liquidity and tax burden but not for inflation protection and insolvency/credit. The preferred ratios were generally less complex and more easily measured than many of the ratios used in previous work. From the findings, a profile of financial well-being for the typical family/individual was proposed.

An Emerging Partnership: AFS and the CFP© Board (pp. 71-81)

Dede Pahl

The past 20 years have witnessed growth in personal financial planning-as a profession and as a separate body of knowledge worthy of attention by the academic community. The Certified Financial Planner Board of Standards is a private, nonprofit, regulatory organization that has emerged as the group bringing these new practitioners and the personal finance academics together in the quest towards an independent body of knowledge developed exclusively for personal financial planning. The CFP© Board has funded its own research, through job analyses and market surveys and academic research through grants and monetary awards for seminal articles and research papers.

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Risk Aversion Measures: Comparing Attitudes and Asset Allocation (pp. 87-99)

Diane K. Schooley, Debra Drecnik Worden

Households reported willingness to take financial risk is compared to the riskiness of their portfolios, measured as risky assets to wealth. Overall, their portfolio allocations are reliable indicators of attitudes toward risk, demonstrating an understanding of their relative level of risk taking. Multivariate regression analysis using multiply imputed data from the 1989 Survey of Consumer Finances indicates that households generally exhibit decreasing relative risk aversion. Further, investment in risky assets is significantly related to socioeconomic factors, attitude toward risk taking, desire to leave an estate, and expectations about the adequacy of Social Security and pension income.

A Simulation Approach to the Choice Between Fixed and Adjustable Rate Mortgages (pp. 101-117)

William K. Templeton, Robert S. Main, J.B. Orris

Mortgage borrowers appear to have a difficult time evaluating the costs and risks associated with the choice between a fixed rate mortgage and an adjustable rate mortgage (ARM). This study uses a simulation approach to model the choice. We represent the risk of the ARM with distributions of present value cost differentials for a variety of mortgage life periods. We provide insight on the financial planning aspect by modeling the impact of mortgage rate changes on the size of payments for ARMs. Simulation can yield non-intuitive results that may lead to better decision making by borrowers.

Personal Finance: An Alternative Approach to Teaching Undergraduate Finance (pp. 119-131)

Jill Lynn Vihtelic

Effective teaching invites students into the discipline and helps them to see and make connections between the discipline's content and their lives. This paper identifies an alternative approach to effective teaching of undergraduate finance. Personal finance, as opposed to managerial finance, provides a more appropriate foundation on which to center the undergraduate finance curriculum. It better matches students' interests, personal experiences, and cognitive structures. This paper takes the position that personal finance should precede managerial finance as the introduction and start to the finance major in the undergraduate business curriculum.

The Effects of Mutual Fund Managers' Characteristics on Their Portfolio Performance, Risk and Fees (pp. 133-148)

Joseph H. Golec

The purpose of this study is to test whether a mutual fund managers' characteristics helps to explain fund performance, risk and fees. The statistical tests consider performance, risk and fees simultaneously to avoid biased results produced by earlier studies that ignore simultaneity. Results show that a fund's performance, risk and fees are significantly impacted by its manager's characteristics. All else equal, investors can expect better risk-adjusted performance from younger managers with MBA degrees who have longer tenure at their funds. Also, funds with low fees and more diversified portfolios perform better. The most significant predictor of performance is the length of time a manager has managed his or her fund (tenure). Funds that keep administrative expenses low also perform relatively well but large management fees do not necessarily imply poorer performance. Apparently, a large management fee signals superior investment skill which leads to better performance.