INVESTORS' FORTUNE AND THE ROLE OF LIPPER IN DETERMINING UNIT TRUSTS PERFORMANCE DIFFERENTIAL

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ABSTRACT

This study examines the ability of Lipper ratings in differentiating and segregating unit trust funds from the lowest performer to the highest performer category. A sample of 68 Malaysian unit trusts from December 2000 to November 2010 were selected and analysed. Using the Jensen's alpha and Fama-French 3-factor model, this study provides evidence on performance differential between funds in each rating categories. The result shows that the highest rated funds, second to highest and third to highest significantly outperformed the lowest rated funds especially in a longer investment period. This result indicates that Lipper rating system is able and useful in identifying the lowest to highest performance funds.

Keywords: unit trusts,; fund ratings, performance

INTRODUCTION

Investors who are adequately informed made their selection criteria based on past, current, and expected future performance of unit trusts which in turn increased the need for performance evaluation. Furthermore, the growing popularity of unit trusts as an investment alternative to investors has put an additional weight on funds' performance evaluation. The situation motivates both academics and practitioners to continue in providing information to ease investors' decision making process.

Rating is a convenient source of information to the investors as their reference before committing their money into any funds. Gerrans (2004) found in his study that investors (Australian) use ratings to make their investment decisions. Beside, many investment management companies use ratings as promotional tools for their managed funds to attract potential investors by publishing their fund ratings in the prospectus. Fund management companies are also relying on fund ratings as one of benchmarks used to measure fund manager performance. They are likely to be replaced if the funds under their responsibility exhibit poor performance and receive unfavourable ratings (Barron & Ni, 2013). Despite the usefulness of ratings to the investors, its reliability is somewhat questioned as rating is primarily a measure of past performance where funds are ranked with no predictive of future performance (Del Guercio & Tkac, 2001).

Khorona & Nelling (1998) provide evidence from the US that funds with higher rating performed substantially better than lower rated funds. Moreover, highly rated funds also exhibit higher risk-adjusted performance as compared to the lower rated funds. This shows that fund rating system provided by independent research agencies has the ability to examine huge number of funds (in US market) and to identify quality funds among them.

In Malaysia, mutual fund industry is relatively small as compared with other developed countries such as the US and Europe. As at 30th June 2013, the total number of unit trusts in Malaysia is 599 funds which consist of 426 of conventional funds and 173 Islamic funds (Securities Commission Malaysia, 2013). On top of that, many studies have been conducted pertaining unit trust performance and the results showed that the historical performance of Malaysian unit trusts is unattractive. Previous studies (Shamsher & Annuar, 1995; Leong & Aw, 1997; Fauziah & Mansor,2007; and Low, 2007) converged into similar conclusion based on their results that showed Malaysian unit trusts on average is underperforming the market index and risk-free rate.

As a rating provider, Lipper should accurately supplying ratings information for investors by identifying and segregating higher rated funds from lower rated funds. Lipper is another source of information that is publicly available from independent research agencies that provide unit trust's ratings based on their own systematic methodology. Inaccurate information released to the market would affect the accumulation of wealth and the investors' fortune. For example, the Employees Provident Funds (EPF) members bear a considerable amount of RM600 million losses of investment in unit trusts in 2006. As a result, the Federation of Investment Managers Malaysia (FIMM) has been called to hold a dialogue with the EPF to clarify the losses (FIMM, 2006).

Therefore, the aims of this paper are to compare the performance between leader funds, four-rated, three-rated, two-rated, and one-rated funds, and to determine the ability of Lipper Leader ratings system in providing accurate information to investors. The outcome of this study could then be used to confirm the performance differences among fund categories. The remaining sections organized as follows: Section 2 discusses previous related literature. Section 3 explains the data selection and performance evaluation method used in the study. Section 4 reports the findings of the study. Section 5 concludes the paper.

LITERATURE REVIEW

As at August 2013, the net asset value (NAV) of unit trusts in Malaysia represents 20.42% of the Bursa Malaysia market capitalization with a total net asset value (NAV) of RM 326.401 billion (Securities Commission Malaysia, 2013). In January 2004, the total NAV is about RM 72.773 billion with the percentage of NAV to Bursa Malaysia market capitalization is 10.96%. The data shows that the NAV is growing about 4.5 times in nine years. Additionally, the industry is still expected to possess a strong growth potential in the future given the favourable economic condition of Malaysia. The growth and popularity of the industry thus motivate the investigation and performance analysis of unit trusts by academicians and independent research agencies in order to provide useful information by way of recommendations and ratings to investors, respectively.

There are many studies have been conducted to examine the information content, ability and usefulness of fund recommendations or ratings. However, none have been found covering the Malaysian unit trusts. Therefore, given the limited literature in Malaysia, this study will emphasized and discussed other studies originated outside of Malaysia. First, related literature on stock and fund recommendations will be discussed. This is followed by explanation on the usefulness of fund ratings and performance.

Many investors use recommendations made by professional research agencies or analysts in their investment decisions. Gerrans (2006) noted that "there are investors who make a living from recommendations to buy and sell securities". In fact, many studies have been done in examining the

usefulness of investment recommendations (Desai & Jain, 1995; Mathur & Waheed, 1995; Sant & Zaman, 1996; Ferreira & Smith, 1999; and Hirschey et al., 2000) or fund recommendations (Sawicki & Thomson, 2000) that are available through the internet, printed media, newsletters, and television. For example, in relation to stock recommendations, Mathur & Waheed (1995) examined the behaviour of stock prices of firms that were positively mentioned in the Business Week. This information is relatively seen to investors either as rumours or recommendations made by the analysts or brokerage houses that somewhat could contain useful information. Their results reveal that investors react positively as significant abnormal returns recorded immediately before and after the publication date. This shows that investors response positively to favourable information which in this case the stock recommendations that appeared in the magazine. This suggests that they make use of such recommendations to make investment decisions. This finding is consistent with the work of Stickel (1995), Womack (1996), Sant & Zaman (1996), Ferreira & Smith (1999), and Barber et al. (2001).

In terms of managed funds, there are a limited number of literatures on the information value of fund recommendations provided by independent research agencies. A study by Sawicki & Thomson (2000) in this area provides a different perspective of how investors should look and digest such information. They attempt to investigate the performance of approved funds that were believed to have superior quality and expected to perform well in the future made by leading research companies in Australia using six years data from 1989 to 1995. Their main objective was to seek if there was a significant difference between the performances of approved funds with disapproved funds. The results were different from the reported findings on stock recommendations where they found that there was no significant difference between the performances of approved with disapproved funds. They concluded that recommendations made by research companies would not provide much help to the Australian investors in selecting the best funds.

From the literature and evidences provided in the past studies, it could be seen that the broker or analyst recommendations on securities especially for stocks do influence the decision made by individual or institutional. Apparently, there is no evidence found in term of information value of fund recommendations. Instead, Sawicki & Thomson (2000) revealed that fund recommendations were not helping investors to find the best funds. However, this is only in the context of Australian fund industry. The results would probably be different if the study is being conducted in other countries, or if a different sample from other independent research agencies is utilized or different performance measures are used.

In recent years, there has been a growing body of literature concerning fund ratings (Khorana & Nelling, 1998; Loviscek & Jordan, 2000; Blake & Morey, 2000; Morey, 2002; Lashgari & Wahab, 2003; Gerrans, 2004; Morey, 2005; Gerrans, 2006; Kräussl & Sandelowsky, 2007; Del Guercio & Tkac, 2008; and Füss et al., 2010). Most of the literatures provide evidences from the US, Europe, and Australia but none in the Southeast Asean environment including Malaysia. Furthermore, most of the literature used Morningstar rather than Lipper. Although previous literatures only focus on Morningstar rating, it could somehow provide a basis of comparison with Lipper Rating System.

Fund ratings are somewhat similar to the fund recommendations discussed in the previous section. By looking into ratings, it can be interpreted as providing investors recommendation to buy highly rated funds and cautioning them on low rated funds. It is noted that ratings is considered as an important source of information to investors and financial planners in their selection criterion (Gerrans, 2004). It is also understandable that the fundamental motive of fund ratings is to provide a guide to quality and expected future performance of the rated funds (Gerrans, 2006). In order for ratings agencies to deliver quality fund ratings, the performance measures used to evaluate fund performance therefore must be superior and comprehensive to be able to differentiate and determine which funds are fitted or qualified for each rating categories.

One of the earlier studies on fund ratings is from the work of Khorana & Nelling (1998). They found that highly rated funds were associated with higher risk-adjusted performance, greater degree of diversification across asset classes, lower systematic risk, and longer tenures of fund managers.

Khorana & Nelling (1998) concluded that Morningstar ratings did provide useful information to investors and helped them in fund selection process. Additionally, other studies by Blake & Morey (2000), Lashgari & Wahab (2003), Gerrans (2006), and Kräussl & Sandelowsky (2007) also supported the results of Khorana & Nelling (1998).

Many of the studies are also documented that there were a little evidence to support a significant difference between the performances of highly rated funds with the next-to-highest rated funds. Rather, the results reported from several studies were mixed. Khorana & Nelling (1998) provided the findings that the performances of highly rated funds were substantially better than lower-rated funds in the period after receiving the ratings. These results also supported by Morey & Gottesman (2006). Morey & Gottesman (2006) found that there was a significant difference between fund performance even when he compared between two-star funds and one-star funds. Other studies by Blake & Morey (2000) and Morey (2005) reported contradicting results where they found that the performance of five-star funds was about the same with four-star and three-star funds in the US market. Furthermore, Füss et al. (2010) provided that there was no evidence found to support that Morningstar rating system could differentiate between higher-performing funds with medium-performing funds in the German fund market. This result is consistent to those reported by Gerrans (2006) in studying the Australian mutual funds.

In Malaysia context, there is limited or no study has yet to be conducted in examining the ability and usefulness of fund ratings to investors. Most of the literatures were concentrated on examining the general performance of unit trusts. One of the earlier studies is by Shamser & Annuar (1995). Shamser & Annuar (1995) examined the performance and characteristics of 54 unit trusts by using adjusted Sharpe index and Spearman rank correlation. Their study covered the period from January 1988 to December 1992. The results showed that unit trust returns were below the returns of risk free and market portfolio. This indicated that the degree of diversification of unit trust was below the expectation level and inconsistent across the studied period.

A latter study by Leong & Aw (1997) provided further evidence that Malaysian unit trusts continued to perform worse in the latter period of 1990 to 1999. A sample of 78 unit trusts was used in their evaluation. Their results showed that unit trust were not performing well relative to the market as proxied by the FTSE Bursa Malaysia KLCI and FTSE Bursa Malaysia EMAS index. They also revealed that unit trusts performed better when the FTSE Bursa Malaysia EMAS index was used as the benchmark. Consistent with the previous findings by Shamser and Annuar, Leong and Aw (1997) also found that unit trusts were not well diversified.

Fauziah & Mansor (2007) further examined the performance of unit trusts by covering a full economic cycle from 1990 to 2001. Their study used various portfolio performance measures namely the Jensen's alpha, adjusted Jensen's alpha, Sharpe index, adjusted Sharpe index, Treynor index, raw return, and market adjusted return. Based on their results, they concluded that the unit trusts had not performed well over the period of study. This indicated that on average the performance of unit trusts were below the market and risk free returns. Additionally, they also found that bond funds relatively outperformed other types of fund and the market return. This was true since the performance was measured using risk-adjusted basis where the bond funds exhibit much lower risk and stable returns as compared to the general equity funds even in the economy crisis period.

Another study by Low (2007) also provided evidence that was consistent with the previous studies. His objective was to examine the security selection skills and market timing ability of unit trusts. He used the Jensen' (1968; 1969) model, Merton (1981), and Henriksson & Merton (1981) to measure overall performance of unit trusts from 1996 to 2000. The results showed that the funds provided investors with inferior performance, largely driven by poor market timing ability and not by security selection skills. From the evidences, it could be concluded that unit trusts are not performing well relative to market portfolio and risk free rate in the Malaysian history. The inferior performance of funds thus rises to the issue of the ability and usefulness of fund ratings in assisting investors' decision-making.

From the literature discussed above, it is true that fund rating has played a significant role in assisting investors to make informed investment decisions. Empirical evidences provided by previous studies showed that rating was useful to investors as it provides information on superior (highly rated) and inferior (lowest rated) funds. However, no study has been conducted this far to examine the ability of unit trust ratings in segregating its performance in Malaysian market. Most of the Malaysian studies were focusing on performance evaluation of unit trusts. Hence, this study is implemented to fill the gap.

SAMPLE SELECTION AND METHOD

Sample Collection Method

The sample of unit trusts collected in this study was based on rating information provided by Lipper Leader's website. In order to examine the usefulness of Lipper rating system, this study only selected equity unit trusts that receive the same key rating in all the three performance measures. For example, unit trusts that receive 1-key rating for total return, consistent return, and preservation are considered the lowest performers. On the other hand, unit trusts with a rating of 5-key or the Lipper Leaders are normally the most superior performers. This selection process is taken to ensure a larger sample could be identified and included in this study. There were 68 unit trusts that passed the screening process and used as a sample in this study. The net asset value of the selected unit trusts was downloaded from Bloomberg Terminal.

The benchmark or market index data (FTSE KLCI index, EMAS index, MSCI Malaysia Value index, and MSCI Malaysia Growth index) and risk-free rate (Malaysian 3-month T-bill) were collected from DataStream. This study used monthly data that covers 10-year period for each unit trust from December 2000 to November 2010. This period of study is selected because it covers an economic cycle of 10 years. Furthermore, it is more appropriate because the market would have stabilized after the 1997 Asian financial crisis.

Lipper Rating System

Lipper is one of the unit trusts ratings supplier in Malaysia and recognized by the Federation of Investment Managers Malaysia (FIMM). Lipper is also popular among investors as well as fund management companies because it helps them to find information about total return, consistent return, and preservation performance of Malaysian unit trusts. This rating scores only focusing on return without considering the risk associated with the funds. Funds that received 5-key ratings (known as Lipper Leader) for Total Return scores are considered the highest performing funds in term of return generation as compared to their peers in the same fund classification (i.e. Equity fund). Lipper Leaders of this ratings score would reflect the persistency ability of such funds to perform in the future. Therefore, it is a great tool for investors in selecting quality funds.

Performance Measures

To measure fund performance, first, the return of unit trust is calculated using the standard procedure of calculating capital gain. The calculation of returns on unit trusts can be expressed as follows:

$$R_{it} = \frac{NAV_{it} - NAV_{it-1}}{NAV_{it-1}} + Div_{it}$$

(1)

Where R_{it} = return of fund i in period t; NAV_{it} = net asset value of fund i in period t; NAV_{it-1} = net asset value of fund i in period t − 1; and Div_{it} = dividend income of fund i in period t. In order to achieve the objective of the study, two performance measures are used to examine and compare the risk-adjusted performance of leader funds category with and the other rating categories.

The two performance measures utilized in this study were the Jensen's alpha (equation 2) and Fama-French three-factor model (equation 3). A formal regression analysis is needed to compute this measure using the following regression models:

$$R_{it} - RFR = \alpha_i + \beta_i (Rm_t - RFR) + e_i \qquad (2)$$

$$R_{it} - RFR = \alpha_i + \beta_{i1} (Rm_t - RFR) + \beta_{i2} SMB + \beta_{i3} HML + e_i \qquad (3)$$

Where Rit – RFR = excess return of portfolio i in period t; Rmt – RFR = excess return of market portfolio proxied by FTSE Bursa Malaysia EMAS index; SMB = difference of returns between small capitalization portfolio and large capitalization portfolio; HML= difference of returns between portfolio of high book-to-market and low book-to-market ratio; α i = alpha to measure portfolio performance; and β i = beta coefficient of portfolio i. The alpha value will indicate whether the performance of a portfolio or fund is superior or not.

The SMB factor was designed to capture the size risk while HML distinguished between value (high book-to-market ratio) and growth (low book-to-market ratio) stocks. In the work of Fama & French (1993), the SMB and HML factor were self-constructed. However, this study utilized market portfolios that are readily available in the market to represent the SMB and HML factor. Studies that have used this approach include the work of Gruber (1996) and Gerrans (2006) that used market indices as a proxy for those factors. For SMB factor, this study uses the return differential between FTSE BM Small Cap index (proxy for small capitalization portfolio) and FTSE BM KLCI index (proxy for large capitalization portfolio). Meanwhile, the HML factor constitute of the difference of returns between MSCI Malaysia Value index (proxy for high book-to-market ratio stocks) and MSCI Malaysia Growth index (proxy for portfolio of low book-to-market ratio stocks).

In order to analyse the difference of risk-adjusted performance between the highly rated and low rated funds, this study follows the work of Budiono & Martens (2009). They noted that the common approaches in the literature to find the performance differential is by regressing return differential of the top (highly rated) and bottom (low rated) deciles funds. This approach could also be adopted to find the difference between the funds in each rating category. Therefore, this paper utilized both of Jensen's Alpha and Fama-French three-factor model to perform this analysis. Hence, equation (4) and (5) could be adjusted into the following equations:

$$R_{5-1,t} - RFR = \alpha_i + \beta_1 (Rm_t - RFR) + e_i \qquad (4)$$

$$R_{5-1,t} - RFR = \alpha + \beta_1 (Rm_t - RFR) + \beta_2 SMB + \beta_3 HML + e_t$$
(5)

Where R 5 – 1,t = the return differential between fund with 5-key rating and 1-key rating. A similar approach as in Equation (7) and (8) is used to see whether there are significance differences among fund rating categories.

ANALYSIS OF RESULTS

Descriptive statistics of seven benchmark indices and five portfolios of unit trusts returns constructed based on assigned ratings from Lipper Leader are reported in Table 1. The data contain a monthly net asset value of 68 Malaysian unit trusts.

Overall, the average annualized returns (calculated by compounding the average monthly returns for 12 months) of unit trust is lower than the general equity indices but higher than the return of risk free rate and low risk investment vehicle which are proxy by the 3-month Malaysian Treasury bill. The MSCI Malaysia Value index provided the highest return with a value of 11.35%, which was followed by the FTSE Bursa Malaysia KLCI index of 8.76%. The lowest return was recorded by the MSCI Malaysia Growth index with 7.09%.

On the other hand, when a comparison was made among the rated funds, it shows that annualized returns of the highest rated funds (funds with 5-key rated or also known as Lipper Leader) outperform the lowest rated funds (funds with 1-key rating) with a difference of 10.19%. However, the results also show that the 4-key rated funds underperform the 3-key rated funds which contradict to the expectation of common investors. In a sense, the 4-key rated funds should outperform 3-key rated funds. This could probably due to the different investment objective of such funds where 4-key rated funds comprised of funds that generate returns without excessive exposure to risk such as investing in strong growth potential stocks (e.g. TA Growth Fund and TA Income Fund). As reported in Table 1, the standard deviation of 4-key rated funds (12.2%) is lower than 3-key rated funds (13.16%). Furthermore, the results also show that the annualized returns of 1- and 2-key rated funds are lower than the 3-month Malaysian Treasury bill rate and the Malaysian Government Security index for all maturities. A possible explanation that could be put forward is probably the nature of asset allocation strategy or perhaps the lack of stock picking ability of those fund managers. In term of volatility as measured by standard deviation, the results showed that the highest standard deviation of 25.46% was recorded by the FTSE Bursa Malaysia Small Cap index. This is probably true since the index comprises of small companies stock that were expected to exhibit higher risk as compared to the stock of large or blue-chip companies as proxied by the FTSE Bursa Malaysia KLCI index which has the lowest standard deviation of 17.3%.

Table 1 Summary statistics of benchmark indices and unit trust returns from December 2000 to November 2010

		Average annualized returns (%)	Standard deviation of returns (%)	Maximum (%)	Minimum (%)
FTSE BM EMAS Index		8.65	18.65	13.80	-19.20
FTSE BM KLCI Index		8.76	17.30	12.28	-17.77
FTSE BM Small Cap Index		8.31	25.46	25.91	-15.35
MSCI Malaysia Value Index		11.35	17.41	14.09	-12.89
MSCI Malaysia Growth Index		7.09	20.03	16.49	-24.34
3-Month Malaysian Treasury Bill		2.79	1.63	3.56	1.82
Fund Rating	1-Key	-4.67	10.65	7.02	-11.90
	2-Key	0.68	13.16	8.75	-11.47
	3-key	4.02	13.08	9.34	-10.91
	4-key	3.74	12.20	9.11	-9.28
	5-key (Lipper Leader)	5.52	12.71	8.87	-8.48

Table 2 Correlation coefficients of unit trust returns with benchmark indices

	Emas Index	KLCI Index	FTSE Small Cap	MSCI Value	MSCI Growth	T-bill	Fund Returns				
							1-key	2-key	3-key	4-key	5-key
FTSE BM EMAS Index	1.00										
FTSE BM KLCI Index	0.99**	1.00									
FTSE BM Small Cap Index	0.87**	0.82**	1.00								
MSCI Malaysia Value Index	0.97**	0.97**	0.82**	1.00							
MSCI Malaysia Growth Index	0.96**	0.97**	0.77**	0.91**	1.00						
3-Month Malaysian T-bill	-0.18	-0.19	-0.11	-0.17	-0.18	1.00					
1-Key	0.33**	0.31**	0.35**	0.34**	0.28**	-0.12	1.00				
2-Key	0.46**	0.45**	0.44**	0.45**	0.42**	-0.14	0.73**	1.00			
3-key	0.51**	0.51**	0.46**	0.49**	0.49**	-0.10	0.69**	0.91**	1.00		
4-key	0.46**	0.46**	0.43**	0.48**	0.43**	-0.15	0.73**	0.94**	0.92**	1.00	
5-key (Lipper Leader)	0.47**	0.47**	0.46**	0.47**	0.44**	-0.11	0.73**	0.91**	0.92**	0.93**	1.00

Note: **Correlation is significant at the 0.01 level (2-tailed)
*Correlation is significant at the 0.05 level (2-tailed)

Table 3 Risk-adjusted performance of unit trust based on Lipper Leader rating system for 10-year, 5-year, and 3-year investment periods from December 2000 to November 2010

Assigned ratings (year)	Number of funds	Average annualized returns (%)	Standard deviation (%)	Jensen's Alpha (%)	Rank	Fama-French 3-factor (%)	Rank
10-year period (December 2000 to November 2010)							
1-Key	6	-4.67	10.65	-0.483*	5	-0.525**	5
2-Key	9	0.68	13.16	-0.324	4	-0.357	4
3-key	3	4.02	13.08	-0.067	3	-0.046	2
4-key	7	3.74	12.20	-0.065	2	-0.127	3
5-key (Lipper leader)	7	5.52	12.71	0.068	1	0.049	1
FTSE BM KLCI Index		8.65	18.65				
3-month Malaysian T-bill		2.79	1.63				
5-year period (December 2005 to November 2010)							
1-Key	10	-1.03	7.79	-0.233	5	-0.246	5
2-Key	14	6.74	12.37	-0.036	4	-0.013	4
3-key	11	7.33	12.90	-0.021	3	-0.007	3
4-key	10	7.07	11.67	-0.005	2	0.015	2
5-key (Lipper leader)	16	9.41	12.22	0.206	1	0.200	1
FTSE BM KLCI Index		14.02	18.87				
3-month Malaysian T-bill		2.94	2.03				

Note: * Significant at $p < 0.10$; ** Significant at $p < 0.05$; *** Significant at $p < 0.01$

Assigned ratings (year)	Number of funds	Average annualized returns (%)	Standard deviation (%)	Jensen's Alpha (%)	Rank	Fama-French 3-factor (%)	Rank
3-year period (December 2007 to November 2010)							
1-Key	10	-5.04	8.42	-0.526	5	-0.693*	5
2-Key	15	-1.02	13.36	-0.387	3	-0.612	3
3-key	12	-1.18	13.62	-0.403	4	-0.630	4
4-key	11	0.37	12.44	-0.266	2	-0.442	2
5-key (Lipper leader)	20	1.41	12.07	-0.170	1	-0.364	1
FTSE BM KLCI Index		5.25	21.37				
3-month Malaysian T-bill		2.69	2.16				

Note: * Significant at $p < 0.10$; ** Significant at $p < 0.05$; *** Significant at $p < 0.01$

Pearson's correlation test was also used in this study to examine the relationship between unit trust returns and the benchmark indices from the period of December 2000 to November 2010. As reported in Table 2, the Lipper rated unit trust returns indicated significant correlations with the returns of FTSE Bursa Malaysia EMAS index, FTSE Bursa Malaysia KLCI index, FTSE Bursa Malaysia Small Cap index, MSCI Value index, and MSCI Growth index. Similarly, the results also showed that the market indices were highly related to each other with significant positive correlation coefficients ranging from 0.82 to 1.00. On the other hand, the returns of all unit trust portfolios and the equity market indices showed negative correlation with the 3-month Malaysian Treasury bill rate. These results also consistent with the reported findings by Lai & Lau (2010).

The results reported in Table 3 are specifically addressed to achieve the stated objectives of the study which are to examine the risk-adjusted performance of highly rated funds, to compare the performance among funds in different rating categories, and to identify the usefulness of Lipper rating system to Malaysian investors. As shown in Table 3, the highest average annualized returns for the 10-year investment period is recorded by fund with 5-key rating of 5.52%. Similarly, the lowest rated fund with 1-key rating is associated with the lowest average annualized return of -4.67%. The results are also consistent with the 5- and 3-year investment horizons where the fund with 5-key (1-key) rating generated average annualized return of 9.41% (-1.03%). However, the returns of 3-key and 4-key rated

funds for two investment horizons are rather unexpected where the return of 3-key rating is larger than 4-key rating by 0.28% (10-year period from December 2000 to November 2010) and 0.26% (5-year period from December 2005 to November 2010). As mentioned earlier, this could be due to the different characteristics or asset types between the 3-key and 4-key rated funds.

Overall, the results did show that the returns of leader (5-key rated) funds were much higher as compared to lowest rated (1-key rated) funds for the three investment horizons with a difference of 10.19% (10-year period), 10.44% (5-year period), and 6.45% (3-year period). Additionally, the 2-key rated funds also showed a considerably higher return than the 1-key rated funds across the three investment horizons with the difference of 5.35% (10-year period), 7.77% (5-year period), and 5.71% (3-year period). However, these results only looked at the raw returns of unit trusts without taking into consideration the associated risk. Therefore, an application of risk-adjusted performance measures was utilized to provide more meaningful results of unit trust performance.

In term of risk-adjusted performance measures, this study examined unit trusts performance using the Jensen's alpha and Fama and French performance measures. As reported in Table 3, the overall negative values of both performance measures across all investment horizons indicate the inferiority and inability of unit trusts to beat the market and the risk free rate. Moreover, the risk-adjusted performance of the lowest rated funds showed a significant inferior performance for 10-year investment horizon with a monthly return of -0.483% (about -5.796% annually) for Jensen's alpha and -0.523% (about 6.276% annually) for Fama-French 3-factor model. On the other hand, results also showed that only 5-key rated funds could outperform the market and risk free rate for 10- and 5-year investment horizons. However, it is found to be statistically insignificant. Despite an inferior overall performance of unit trusts, the Lipper's rating could still differentiate between bad and good funds. Results show that the alpha values of both performance measures of funds with 1-key rating exhibit a much lower value as compared to the fund with 3-, 4- or 5-key rating (see Table 3). In term of ranking, overall results showed that both the Jensen's alpha and Fama and French performance measure ranked funds in accordance to the rankings of Lipper in all three investment horizons. This shows that Lipper's rating system was able to identify the most inferior funds (1-key rated funds). All results discussed earlier suggested that the sample of unit trusts selected based on Lipper's rating category were not performing well relative to the market index and risk free rate thus supported the results from previous studies by Shamser & Annuar (1995), Leong & Aw (1997), Fauziah & Mansor (2007), and Low (2007). Moreover, results showed that only 5-key rated funds that able to outperformed the market benchmarks for 10- and 5-year investment horizons, but it is not statistically significant.

In order to achieve the objective of the study in examining performance differential between the ratings, further analysis is needed to be done. The result of performance differential between fund ratings is reported in Table 4. It is observed that the performance of 10-year investment horizon between 5- to 1-key, 4- to 1-key, and 3- to 1-key rated funds were significantly different at the 99%, 95%, and 95% confidence level, respectively, for both performance measures. Furthermore, a significant performance was also recorded between 5- to 2-key, 4- to 2-key, and 3- to 2-key rated funds with a confidence level ranging from 90% to 99% for 10-year investment horizon. In addition, it is also observed that both performance measures reported a significant performance difference between 5- to 1-key and 4- to 1-key rated funds at 95% confidence level for the 5-year investment horizon. Meanwhile, the results for 3-year investment horizon showed only the performance between 5- to 1-key rated funds is significant at 90% confidence level. The results reveal that not only the highest rated fund outperform the lowest rated fund but the next to highest (4-key) and second to highest (3-key) rated fund were also significantly outperforming the lowest rated fund for 10-year investment horizon. Additionally, only the highest and next to highest rated fund is reported to significantly outperforming the lowest rated fund in 5- and 3-year investment horizons. From the result, it reveals highly rated funds are significantly outperformed the lowest rated funds, hence supported the first hypothesis.

Table 4 Performance differential between fund ratings using the Jensen and Fama-French three-factor model

Performance differential (year)		Jensen's alpha		Fama-French 3-factor model	
		Alpha (%)	T-stat	Alpha (%)	T-stat
10-year period (December 2000 to November 2010)					
	5 to 1	0.552***	2.876	0.575***	2.926
	5 to 2	0.393***	2.662	0.405***	2.681
	5 to 3	0.136	1.008	0.096	0.713
	5 to 4	0.133	1.060	0.175	1.388
Ratings (key)	4 to 1	0.419**	2.261	0.399**	2.115
	4 to 2	0.260**	2.118	0.230*	1.848
	4 to 3	0.003	0.019	-0.079	-0.614
	3 to 1	0.416**	2.047	0.479**	2.345
	3 to 2	0.257*	1.704	0.309**	2.049
	2 to 1	0.159	0.817	0.169	0.849
5-year period (December 2005 to November 2010)					
	5 to 1	0.439**	2.296	0.446**	2.274
	5 to 2	0.241	1.239	0.213	1.099
	5 to 3	0.226	1.127	0.207	1.009
	5 to 4	0.210	1.171	0.185	1.034
Ratings (key)	4 to 1	0.228	1.609	0.261**	1.837
	4 to 2	0.031	0.287	0.028	0.249
	4 to 3	0.016	0.120	0.021	0.158
	3 to 1	0.212	1.148	0.239	1.263
	3 to 2	0.015	0.108	0.006	0.044
	2 to 1	0.197	1.288	0.233	1.525
3-year period (December 2007 to November 2010)					
	5 to 1	0.356*	1.873	0.322	1.606
	5 to 2	0.216	1.108	0.253	1.298
	5 to 3	0.233	1.124	0.268	1.231
	5 to 4	0.096	0.541	0.080	0.438
Ratings (key)	4 to 1	0.260	1.303	0.242	1.232
	4 to 2	0.120	0.807	0.173	1.115
	4 to 3	0.137	0.730	0.188	0.953
	3 to 1	0.123	0.509	0.054	0.217
	3 to 2	-0.016	-0.092	-0.015	-0.082
	2 to 1	0.139	0.641	0.069	0.338

This suggests that the Lipper's rating system could identify superior and inferior unit trusts. However, there is a weak evidence to show the difference between the performance of fund in highly rated group (between 5- to 4-key, 4- to 3-key, and 5- to 3-key) for the 10-year, 5-year, and 3-year investment horizons. This result is consistent with the work done by Blake & Morey (2000) and Morey (2005) in examining information content of Morningstar rating. It should be noted that using the Jensen's alpha and Fama and French 3-factor model would also reveal the management ability in term of stock selection skills. In this study, the findings indicate that the lowest rated funds have poor management ability in companion to the highly rated funds.

From the reported results, it can be concluded that the overall performance of unit trusts were below the market index and the risk free rate. Furthermore, only the highest rated funds that received 5-key ratings

from Lipper are outperforming the market benchmarks but it is not statistically significant. Nevertheless, the Lipper Rating System could identify between superior and inferior unit trusts. These results reveal that Lipper Rating System could somewhat provide useful information to the Malaysian unit trusts investors especially to avoid losses investing in lowest rated funds.

CONCLUSION

The findings of this study contribute towards a better understanding of how fund ratings could help investors in making informed investment decisions. In order to examine the risk-adjusted performance of unit trusts, two performance measures were utilized namely the Jensen's alpha, and Fama and French 3-factor model. Overall, the results reveal that the performance of unit trusts taken as a sample based on rating information is below the market index and risk free rate in 10-year, 5-year, and 3-year investment horizons. Additionally, only the highest rated funds exhibit superior performance against the market benchmarks used in the study. On the other hand, the rankings based on four performance measures generally correspond to Lipper's rating especially for the lowest rated (1-and 2-key) funds and leader (5-key) funds. Meanwhile, for 3- and 4-key rated funds, there was an inconsistency observed between Lipper's rating and the ranking of performance measures where the results show that 3-key rated funds outperformed 4-key rated funds. In addition, the test on differences in performance between funds in each rating categories shows that the highest rated funds, second to highest and third to highest are significantly outperforming the lowest rated funds in a longer investment horizon. The result indicates that Lipper's rating system could identify the lowest performing funds that should be avoided by investors. Likewise, the performance of 3-, 4-, and 5-key rated funds are not significantly different from each other. Therefore, investors could use these ratings to make informed investment decisions without going into time consuming analysis to identify between bad and good funds in the market. It may be concluded that investors could protect their wealth in unit trust investment by using rating information supplied by Lipper. The Lipper's Rating System is quite reliable in identifying the highest and lowest performing funds.

Future research should use self-constructed indexes rather than using existing indexes which might not even represent the factors concerned. Furthermore, the sample of the study should be included other fund classification such as mixed fund and bond fund. Moreover, future research also could utilize the sample from other rating suppliers such as Morningstar and compare them with Lipper's to see which one could provide superior information to investors. Since the rating provided by Lipper or Morningstar is subject to changes on a monthly basis, it is also recommended that future study would examine the effect of such changes on fund performance.

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