THE PERFORMANCE AND MARKET-TIMING SKILLS OF CONSUMER DISCRETIONARY FUND MANAGERS

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ABSTRACT

This study evaluates the selectivity skill and market-timing ability of fund managers who invest in consumer discretionary stocks over the 2010-2023 period. The nature of the consumer discretionary sector is unique. Since firms involved in this business segment offer non-essential goods and services, this sector is crowded by healthy and fierce competition. Therefore, it becomes essential to analyze fund managers to see whether they have the skills to select the right mix and generate superior returns. The study further examines the selectivity and market-timing skills at two sub-periods (2013-2020 and 2021-2023). This study uses the single-factor CAPM and 4-factor Carhart models to examine the selectivity skill of fund managers. Both the single-factor CAPM and the 4-factor Carhart models are expanded to the Treynor-Muzay (1966) model to estimate the market-timing skill and its implication on the alpha of sample funds. The findings of the study show insignificant positive to negative stock-picking skills and positive and significant market-timing skills of fund managers.

***Keywords**: Mutual Funds; Selectivity Skill, Market Timing*

1. INTRODUCTION

Actively managed funds are important investment vehicles for both retail and institutional investors. According to the Investment Company Institute (ICI hereafter) Factbook 2023, mutual funds managed $60.1 trillion (AUM) worldwide, whereas it was $28.6 trillion in the United States alone by the end of FY 2022. The same report documents that nearly 71.7 million households in the US had some funds invested in these investment vehicles, whereas a staggering 120.5 million individuals in the US had invested in mutual funds by the end of FY 2022. There are numerous reasons why investors pour their money into mutual funds. Institutional investors such as pension funds, foundations, and endowments, for example, may be required by their constitutions to invest a part of their funds into mutual funds. The reasons for retail investors could be diversification and professional management at a relatively lower cost. The sheer size of assets under management shows both the demand and economic impact these funds generate for the U.S. economy. Given the considerable impact actively managed funds have on investors and the firms they invest in, a thorough study of these funds is warranted.

One interesting aspect of the US economy is that most of its growth is fueled not by capital expenditure but by consumer spending. According to multiple reports, consumer spending contributes to two-thirds of the US economy. Despite the impact of consumer spending on the economy, not many studies have specifically evaluated sector funds focused on consumer spending. This study attempts to evaluate the performance and market-timing skills of fund managers who invest in firms that belong to the consumer discretionary sector. Selectivity skills refer to the ability of a fund manager to pick stocks that are undervalued, have strong fundamentals, and are poised to beat passive benchmarks. These stocks belong to firms that have strong cash flows and strong balance sheets and are still undervalued by the market participants. Market timing refers to the ability of fund managers to predict the direction of the market and accordingly allocate between stocks and cash, increasing or decreasing the beta of the portfolio.

I choose consumer discretionary because, unlike the consumer staples sector, which includes essentials like clothing, household products, food, and items that consumers need to purchase, the consumer discretionary sector has items that consumers can live without. In other words, the demand for consumer discretionary products is highly elastic and can drastically change under varying economic conditions. For