ABSTRACT

In 1980, Bowman proposed the Bowman paradox, a negative relationship between the risk and return in 85 U.S. industries, a contradiction with the high risk-high return doctrine. Examining the open-end equity mutual funds in Thailand, this study documents the negative relationship that can occasionally be seen between risk and return in the industry during 2003-2012. The study further examines the factors that will affect the probability that a fund will deliver an outstanding low-risk, high-return performance using unbalanced panel logistic regression on a binary dependent variable. The results showed that funds with high non-systematic risk, also called idiosyncratic risk, and/or older funds, were more likely to deliver a low-risk, high-return performance, and the funds that were managed by the company that managed a high number of funds were less likely to deliver such performance. This study also proposes a new performance evaluation tool called the “risk-return matrix.” This matrix suggested the funds with outstanding low-risk, high-return past performance.

This study applied the results to three new investment strategies, which demonstrated satisfactory outcomes. First was to invest, at time t, in funds that were classified as low risk at time t-1. This yielded an average return higher than investing in high-risk funds. Second was to invest in funds that exhibited the best performance according to the risk-return matrix. This delivered an aggregated three-year return higher than the industry average. Third was to invest in funds with a higher level of idiosyncratic risk than the industry average, were older than the industry average, and were managed by a company that had fewer funds under management compared to
the industry average. This investment also delivered a return better than the industry’s average return.

This empirical study hopes to contribute to both academic and practical applications. It should call attention to whether the high-risk, high-expected return notion can be applied to the mutual fund industry. Additionally, its application to new investment strategies could serve as alternatives for investors to gain higher return while being exposed to lower risk.