CHAPTER I

INTRODUCTION

1.1 Research Background

Capital market has an important role in the economy of a country, and it is also an indicator of a country's economic progress. The presence of capital market is very important for companies and investors, because it can be an alternative source of financing for companies' operation through the issuing shares or bonds by companies that need funding.

Capital market is defined as the market for various instruments or longterm securities that can be traded. The purposes of capital market in Indonesia are to direct funds from the community to be channeled in productive sectors and to realize the equal distribution of opinion through shares ownership of company (Suad and Pudjiastuti, 1993).

The development of capital market in addition to increasing the source of funding outside the banking community is also a potential funding for companies that need funds over the medium and long-term, while for the community the precense of capital market as an additional alternative for investing. Capital market in Indonesia run two function simultaneously, namely the economic function and finance function. Performing economic function with allocated the fund efficiently from parties who have excess funds (investors) to the company listed in the capital market (issuer). Whereas the finance function of capital market is presented by the possibility and opportunity of getting returns for investors in accordance with the character of investments that will be selected.

As one of the instruments of the economy, the stock market always affected by several events on its environment, such as events that occur due to macroeconomic policy, monetary policy, fiscal policy, and government regulation both in real and financial sector. The Indonesian Stock Exchange (IDX) witnessed solid growth over the past five years, both in terms of the number of issuers and their combined market capitalization, but it remains highly dependent on global sentiment. Its future performance will hinge on global risk appetite, but also on economic adjustments and fiscal policies at home. According to Global Business Guide Indonesia (2015), IDX listed 459 companies with a total capitalization of $414 billion (4,126.99 trillion IDR) at the end of 2012, up from 396 listings valued at $108 billion (1,076.49 trillion IDR) four years earlier. The investment grade ratings bestowed on Indonesian sovereign debt by rating agencies Fitch and Moody’s in late 2011 and early 2012 supported market sentiment. Reflecting overall healthy earnings and strong economic growth, IDX’s key gauge, the Jakarta Composite Index (JCI), more than tripled in the years 2009 through 2012 and continued to rally in early 2013.

There are two types of instrument that tend to be interested by investors in Indonesia stock market or known as Indonesia Stock Exchange (IDX) are investment in stock and mutual fund. Rapid economic development, low public debt and a young population provide Indonesia with perfect ingredients for a thriving mutual fund industry. Despite quickly-rising personal incomes, however, only relatively few Indonesians are active investors, while the vast majority prefer to stash their savings in a bank account, if not in their homes. The experience of the Asian financial crisis in 1997, which sparked the collapse of numerous Indonesian banks and eventually of the Suharto regime as well, goes some way to explain savers' misgivings about investing in rupiah assets. Hence Indonesia's funds industry is relatively small. Over the past years, however, an extended period of financial stability under the stewardship of Bank Indonesia and the Finance Ministry has begun to restore confidence in Indonesia's capital markets.

Global investment companies, therefore, are reassessing opportunities to manage Indonesians' growing wealth. While unfavourable regulations have been cited as one of the reasons for the cautious approach foreign fund operators have been taking on the Indonesian market so far, the long-term potential appears to be immense amid rising demand from individual and institutional investors.

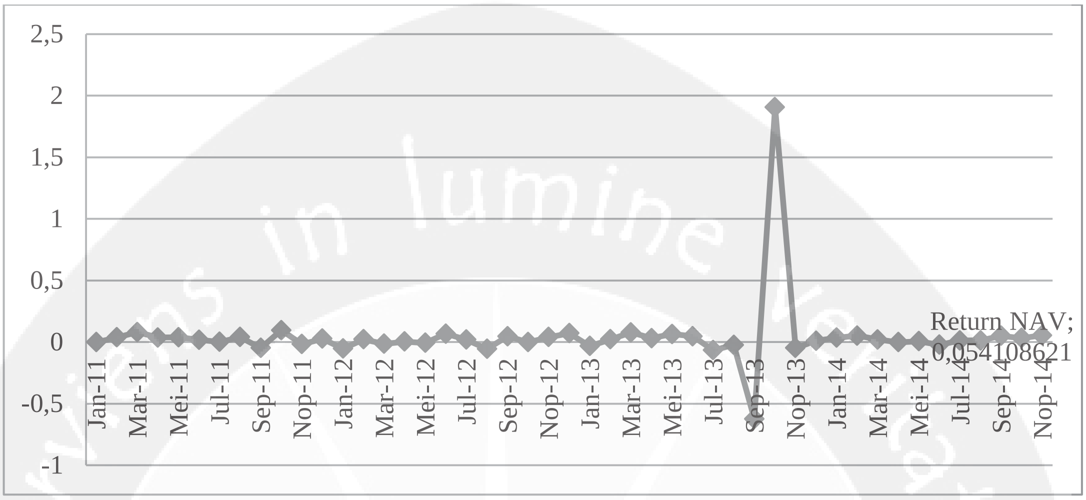
One type of mutual fund is a equity mutual fund. Equity funds are mutual funds that at least 80% of the portfolio is managed in stock (usually stock companies). Equity funds generally provide the potential for higher returns in the form of capital gains (the difference between buying and selling price) through the growth of stock prices and dividends. Equity funds typically usually have considerable potential for big returns can be up to 20% a year and has a large potential risks.

Demand for equity mutual fund investment in Indonesia can be expected to grow both on the retail and institutional side for a number of reasons (Global Business Guide Indonesia, 2015): (1) Strong economic growth, low public debt and rising disposable incomes in Southeast Asia's largest economy allow for increased savings, (2) A young and growing population creates the need to build financial reserves for children's education, retirement and unforseen events, (3) Growing awareness about the benefits of investing should generate demand among well educated Indonesians, many of whom worry about inflation eating away at their savings amid unattractive bank interest, (4) Assets of insurance companies and pension funds are rising, as more Indonesians seek to secure their standard of living. Insurance market penetration is low but rising, suggesting a growing pool of assets that needs to be managed.

Investor sentiment can be defined as a belief about future cash flows and investment risks that is not warranted by fundamentals (Beer and Zouaoui, 2013). In recent years, the usefulness of investor sentiment measures to predict stock market returns has been the subject of frequent inquiries. A considerable number of empirical investigation utilizing different measures of investment sentiment have been conducted. While theoretical models have early incorporated the existence of noise traders into equilibrium asset pricing (e.g., Black, 1986 and De Long et al., 1990), the empirical evidence for a correct proxy to quantify sentiment has not provided clear findings.

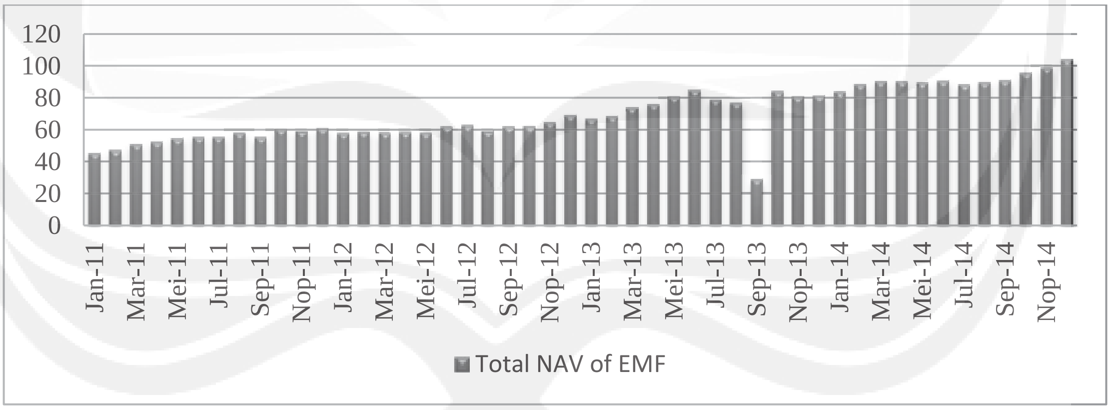
Data are easily available on how mutual fund investors allocate across fund categories. Brown et al. (2002) propose an overall market sentiment measure based on how fund investors are moving into and out of, for example, “safe” government bond funds and “risky” growth stock funds. Mutual fund investors are well-known to chase investments with high recent returns (for example, Warther, 1995), so whether the causality also goes the other direction—whether their allocation decisions actually lead to mispricing—is a tricky question. Frazzini and Lamont (2008) find some affirmative evidence by using fund flows to proxy for sentiment for individual investor sentiment in the stock market for 137 stocks. They find that when funds holding a particular stock experience strong inflows, the subsequent performance of that stock is relatively poor.

The eagernesses of investor to get high return or high income become one of the reasons the investors tend to use equity mutual fund as alternative investments. Investor who do not have much time understanding of the financial markets can be catered to provide with an opportunity to hold the diversified portfolios thus maximizing the overall risk of their investments. The choices are not only based on single decision but from all the informations they could get. The fluctuation of stock market also influence the performance of mutual fund. In general the movement of the Jakarta Composite Index (JCI) and equity mutual funds are in the same direction, so if the stock in JCI rises, stock mutual funds will also rise. The difference is simply the percentage of increasing stock prices. Meanwhile, because of the number of stocks are many, sometimes there is a stock's movement is contrary to the direction of the movement of the JCI.



Source: Otoritas Jasa Keuangan, 2015

Figure 1.1. Monthly Return of Equity Mutual Fund Period January 2011-2014



Source: Otoritas Jasa Keuangan, 2015

Figure 1.2. Monthly NAV of Equity Mutual Fund Period January 2011-2014 (in million)

The development of equity funds in Indonesia from 2011 to 2014 continues to increase, despite a decline in 2013 amounted to 62.31% in September and increased by almost 2-fold in the next month making equity funds are still believed to be one of promising alternative investments.

Growth of equity mutual funds from 2011 through 2014 could surpass the performance of JCI, where throughout the period, equity funds were able to grow by 25.39% compared to JCI which only grew by 12.50%. The development of mutual funds are still influenced by the strengthening of the stock price index conditions, volatility of global economic conditions, and the presidential election that occurred in 2014.

At the year of 2011, there was arguably full-year turbulence in stock investments. Ranging from the price of oil in the Middle East, the U.S. rating up to economic development and European debt became a major factor of uncertainty. As a result a surge or decline in the share price of 3-4% in a day seems to be the usual views. Stock investors ' reaction also varies, there is a fixed buy and hold, there is also a cut loss while looking at the situation. This condition causes some investors are using stock mutual funds as a tool for seeking short-term profits. That means even though mutual funds are designed as a long-term instrument, but when the market goes down many investors will make an investment and then sell it when the market rises despite not too long ago purchased. This lesson makes investors assume when there is a downturn; it is the right time to make a purchase. It can implicate that investors still has beliefs with Indonesia condition that occur in increasing of mutual fund can affect to the development of Indonesia Capital Market.

1.2 Problem Statement

This research will investigate:

Is there an impact of investor sentiment-based equity mutual fund on excess return and volatility in Indonesia Stock Exchange (IDX) from period January 2011 to December 2014.

1.3 Scope of the Research

In order to limit the discussion on the issues and acquire clearer direction for researcher, some boundaries are made on the following issues:

a. The equity mutual fund selected for this research is active equity mutual funds listed in Bapepam period 2011 – 2014.

b. This research excludes equity mutual funds denominated in foreign currency and sharia equity mutual fund.

c. The stock market used for this research is Jakarta Composite Index (JCI) period 2011 – 2014.

d. Excess return in this reseach is measured by Capital Asset Pricing Model (CAPM) where SBI will be the proxy of risk-free rate interest rate collected from period 2011 – 2014.

1.4 Benefit of the Research

a. The Author

This research is important to make a better understanding about the impact of investor sentiment-based equity mutual fund on excess returns and volatility in Indonesia Stock Exchange.

b. The Investor

This research will give some information to investor and also help them in making consideration and decision, so they can get capital gain and excess returns in their investment action.

c. The Readers

The research hopefully can contribute to broaden knowledge and deepen concept surrounding the topic to the readers and become one of references in conducting investment as well as helping them to have understanding about the impact of investor sentiment-based equity mutual fund on excess returns.

d. Other Researcher

This research will be a reference in order to support another researcher, especially to the topics that related to the impact of investor sentiment-based equity mutual fund and its impact on excess returns and volatility.

1.5 The Objective of the Research

The objective of this research is to analyze the impact of investor sentiment-based equity mutual fund on excess returns and volatility in Indonesia Stock Exchange (IDX) from January 2011 to December 2014.

1.6 The Originality of Writing

This research is carried out based on the previous researchers that have been done before. Basically, this research is a replication research based on the previous research with the title "Investor Sentiment, Mutual Fund Flows and its Impact on Returns and Volatility" (Beamont el al., 2008). Some research related to this topic is also used to broaden the sources and to deepen knowledge of the empirical result related to the impact of investor sentiment-based equity mutual fund on excess returns and volatility.

1.7 Writing Structure

Chapter 1. Introduction

This chapter describes the research background, problem statement, scope of the research, objective of the research, benefit of the research, and the originality of writing.

Chapter 2. Theoretical Background

This chapter describes the theoretical background relevant to this research and it consists of review of the literature, review on related study, and hypothesis.

Chapter 3. Research and Methodology

This chapter describes the research design and it consist of type of methodology, sampling, research data, data gathering and data source, research variable, and method of analysis.

Chapter 4. Data Analysis

This chapter describe the analysis of the research result and explain the impact of investor sentiment-based equity mutual fund is significant or not affecting the excess return.

Chapter 5. Conclusion and Suggestion

This chapter describes the conclusion, managerial impact, limitation of the research, and suggestion for further research.