Briefly Noted

52-Week Highs Perform Better Than Record Highs

One alternative form of momentum investing is to buy stocks trading near their 52-week highs. Another form is to buy stocks trading near their historical (record) highs. The former strategy—buying stocks trading at 52-week highs—has performed better than the latter. Notably, both strategies work better when stocks priced below $5 and January returns are excluded. The improvement is more pronounced for stocks trading near their historical highs.

California State University professor Ajay Bhootra looked at exchange-listed stocks traded between 1963 and 2015. He analyzed returns with no filters (all stocks and all months) as well as with the $5 and January filters applied.

A portfolio composed of stocks ranking in the top 30% in terms of their relative closeness to their respective 52-week highs resulted in monthly outperformance of 0.35% relative to a portfolio of stocks ranking in the bottom 30%. A portfolio composed of stocks ranking in the top 30% in terms of their relative closeness to their historical ("record") highs *underperformed* a portfolio of stocks ranking in the bottom 30% by 0.18%.

When stocks under $5 are excluded, the 52-week high-minus-low portfolio (top 30% minus bottom 30%) realized a monthly return of 0.73%. Among stocks trading near their historical highs, the monthly returns for the top 30% stocks (high) were 0.36% better than the bottom 30% stocks (low). Excluding returns for the month of January increased the high-minus-low monthly return for the 52-week high portfolio to 1.08%. The historical high ratio portfolio returned 0.60% on a high-minus-low basis.

When stocks priced below $5 and returns from the month of January are excluded, the 52-week high ratio portfolio realized a monthly return of 1.07% on a high-minus-low basis. The historical high ratio portfolio's high-minus-low monthly return improved to 0.74%.

A reason why the 52-week high ratio portfolios outperform the historical high portfolios is due to investor reaction. Bhootra's analysis backs a 2011 study by Jun Li and Jianfeng Yu ("Investor Attention, Psychological Anchors, and Stock Return Predictability") showing investors underreacting to the good news associated with 52-week highs. Conversely, investors view the distance from a 52-week high as a proxy for how much negative news is priced in.

"Another Look at Anchoring and Stock Return Predictability," Ajay Bhootra; Finance Research Letters, 2017.

For Mutual Funds, Competition Doesn't Mean Lower Fees

Competition is usually associated with lower prices. The exact opposite pattern is occurring within the mutual fund industry. Expense ratios for U.S. domestic equity funds operating in more competitive market segments "charge significantly higher annual expense ratios than funds operating in less competitive market segments."

Among the better-known measures of cost is the expense ratio. The expense ratio is the management fee that fund providers charge to operate each fund. This fee rises with the competition, the opposite trend of what one would expect.

The study's authors found that expense ratios tend to be inelastic. In competitive segments, performance-sensitive investors pull out of or avoid underperforming funds, leaving only investors who are generally insensitive to performance as shareholders of such funds. This allows funds to increase their management fees with little concern of incurring outflows. In other words, the performance-insensitive investors don't shift their dollars elsewhere in the face of higher fees.

At the same time, higher fees do not attract more competition. An analysis of untabulated results found high-fee segments experience no faster growth in the number of funds within them than low-fee segments do. This may suggest the existence of barriers to entry. At the same time, when new funds enter a segment, competition within the segment does not necessarily increase.

The analysis found other notable trends in fund fees. Lower fees tended to be found most frequently among younger funds and larger funds. Funds with more volatile returns and higher levels of turnover have higher fees. Fund fees tend to be sticky, meaning they don't change much. The study's authors attribute this either to the existence of long-term strategies used for setting fees or to the potential costs of changing the fee structure.

This analysis was done on a sample of domestic equity funds over the period of 2000 through 2015. Funds were grouped by the Lipper Classifications. Competition was measured by using the inverse of the Herfindhal-Hirschman index. This index is typically used to measure concentration within an industry; the inverse of the ratio indicates less concentration and thereby competition.

Source: "Price Competition in the Mutual Fund Industry," Sitikantha Parida and Zhenyang Tang; Economic Modelling, 2017.

Proxy Adviser's Gender and Shareholder Meetings Guidelines

Each year, Glass Lewis reviews internal corporate governance guidelines annually. It is one of the two most prominent firms of its type and advises more than 1,200 institutional investors. Glass Lewis guidelines determine whether or not the firm recommends that its clients vote in favor of or against corporate board members and proxy proposals.

Glass Lewis is making noteworthy revisions to their policies for 2018. Among the policy guideline changes are:

Greater Clarity of Board Gender Diversity: The firm will consider the gender makeup of companies' board of directors when evaluating their oversight structure. In 2019, Glass Lewis will "generally recommend voting against the nominating committee chair of a board that has no female members."

Dual-Class Share Structures: Glass Lewis "believes dual-class voting structures are typically not in the best interests of common shareholders." As such, it is now considering the presence of such structures when evaluating corporate governance following an initial public offering (IPO) or corporate spin-off.

Board Responsiveness: The firm says that corporate boards have an "imperative to respond" to shareholder dissents representing more than 20% of votes cast to a proposal at an annual meeting. Furthermore, Glass Lewis says companies with dual-class share structures should be responsive when a majority of unaffiliated shareholders support a shareholder proposal or oppose a management proposal.

Virtual Shareholder Meetings: Glass Lewis holds a nuanced view of meetings held over the internet instead of in person. The firm thinks virtual meetings can "complement" traditional, in-person shareholder meetings but also "have the potential to curb" meaningful communication between shareholders and a company's management. Starting in 2019, the firm will "generally recommend voting against" governance committee board members of companies not providing disclosure about holding virtual-only shareholder meetings.

Director Commitments: Glass Lewis will evaluate the specific duties and responsibilities of directors who serve in executive roles other than CEO (such as an executive chair) as part of its decision about whether to apply a limit of two total board memberships for public executives.

CEO Pay: The firm will begin displaying the ratio of CEO pay to the median compensation of their company's employees in its proxy reports, but says the ratio will not be "a determinative factor in our voting recommendations."

Source: "2018 Proxy Paper Guidelines," Glass Lewis, December 2017.

Executives Misconstrue Employees' Investment Preferences

An option for a default allocation exists in many workplace retirement plans. Employees participating in such plans who do not specifically choose funds are placed in a default option (e.g., target date funds in the U.S.). Though there are advantages to having these defaults, the decision as to what the default strategy should be is often made without a clear understanding of employee preferences.

A study of Australian retirement plans demonstrated this disconnect. The country's Superannuation Guarantee legislation mandates minimum employer contributions to individual retirement accounts. Under this system, workers have the option of choosing investment strategies. If they don't, their contributions are allocated to a default option chosen by the plan's trustee. Redesigned default investment ("MySuper") products began appearing in 2013 and forced a "sector-wide review of default investment strategies." These factors gave researchers the opportunity to compare employers' perceptions and employees' preferences.

Researchers interviewed 28 plan executives who manage about 45% of total (default) savings overseen by large institutional investors. They then surveyed over 1,000 adults. Australians can either choose a non-default plan (e.g., a self-managed super fund) and/or a non-default strategy (e.g., a specific fund offered by the plan provider). Approximately 26% were placed into the default plan while 9% are in the default option "because they prefer it."

In designing their plans' default investment strategy, the executives took into account participants' demographics but admitted to not knowing participants' risk preferences or background wealth. The risk tolerance of plan participants was not a guiding factor in choosing default investment strategies. Executives also viewed workers who opted for the default investment or strategy as being disinterested.

Individuals who accepted the default investment strategy viewed the default strategy as being suitable and the plan as being trustworthy and accountable. They expressed a significantly lower tolerance for risk than for all surveyed participants. They also were more concerned with ensuring a basic amount of retirement wealth than with the fund's performance.

Source: "One Size Fits All? Tailoring Retirement Plan Defaults," Adam Butt, M. Scott Donald, F. Douglas Foster, Susan Thorp and Geoffrey J. Warren; Journal of Economic Behavior & Organization accepted manuscript.