



The Impact of Investment Manager Expertise on Mutual Fund Performance in Indonesian Dynamic Market Conditions

Alfi Syahri^{a,*} , and Irene Rini Demi Pangestuti^b 

a. Faculty of Economics and Business, Diponegoro University, Semarang, Indonesia.

* Corresponding author.

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Abstract

This study investigates the performance of 29 equity mutual funds in Indonesia, focusing on the influence of investment-manager expertise and market conditions. Using primary data sourced from Infovesta, we uncover a significant relationship between market conditions and fund performance. Our analysis reveals a statistically significant probability of changes in market conditions, with a calculated probability of 0.000, indicating a rare occurrence, less than 5% of the time. The coefficient value of 1.563714 further strengthens this relationship, indicating a substantial impact of market conditions on fund performance and supporting the acceptance of our third hypothesis. We find that bullish and bearish market conditions, representing rising and declining stock markets respectively, have a profound effect on equity mutual fund performance. Specifically, during bullish phases, fund performance improves, while in bearish market conditions, it declines. These results highlight the complex interplay between market dynamics and fund performance, underscoring the importance of skilled management in navigating market fluctuations effectively. Our findings contribute to the refinement of investment strategies, offering insights for achieving enhanced performance in dynamic market environments and advancing the discourse on effective portfolio management strategies.

Keywords: market sentiment, market timing skill, mutual fund, mutual fund performance, stock selection.

JEL Classification: G1, G11, G20, G23.

Introduction

Besides stocks, which remain the most frequently traded instrument, mutual funds have also become a popular investment alternative among many investors. According to Cagnazzo (2022), mutual funds are a suitable vehicle for investors who prefer not to be directly involved in constructing their investment portfolios. In addition, Lucas et al. (2019) note that many investors favor mutual funds as an

alternative investment instrument when comparing their returns with those of bank deposits over long periods. Mutual funds are also preferred by investors who lack the time to monitor their portfolios and by those less able to assess investment risks and returns (Gusni et al., 2018).

Official data published by the Financial Services Authority (Otoritas Jasa Keuangan; OJK) show that the total net asset value (NAV) of mutual funds at the end of December 2013 amounted to IDR 193 trillion. This figure exhibited an increase by the end of December 2022, reaching IDR 508 trillion. The information reveals a growth rate of 38 percent in the mutual fund industry. Focusing on equity mutual funds in Indonesia, Table 1 below presents data on the NAV, the number of million units, NAV per unit, and the return of equity mutual funds during the period of 2017-2022.

Table 1. Total Net Asset Value (NAV) of Indonesian Stock Mutual Funds 2017-2022

Year	NAV of Equity Mutual Funds (Millions of rupiah)		Participation Units (Millions)	NAV/PU	Return
2017	Rp	137.638.725	72.878.000.000	Rp 1888,614	-4.7%
2018	Rp	165.232.978	91.366.000.000	Rp 1808,466	-4.2%
2019	Rp	139.157.327	98.546.000.000	Rp 1412,096	-21.9%
2020	Rp	127.792.839	94.282.000.000	Rp 1355,421	-4.0%
2021	Rp	134.597.442	92.338.000.000	Rp 1457,65	7.5%
2022	Rp	111.444.116	77.489.000.000	Rp 1438,185	-1.3%

Source: OJK, Infovesta data processed.

As shown in Table 1, equity mutual funds have experienced fluctuations in NAV over the past five years. At the end of 2017, the total NAV of equity mutual funds reached IDR 137 trillion. This figure rose to IDR 165 trillion in 2018 but fell to its lowest level of IDR 111 trillion by the end of 2022. Average return data also shows that stock mutual funds, judging from their performance, have fluctuating movements.

Fluctuations in the performance of equity mutual funds are influenced by various factors, one of which is fund-manager expertise (Ling and Abdul-Rahim, 2021). Fund managers need stock-selection and market-timing skills to execute buy and sell transactions within the managed portfolio (Jiang et al., 2021). According to

Gusni et al. (2018), the ability in stock selection and market timing are two aspects that can elucidate the fund manager's advantage in managing portfolios with the aim of achieving optimal investment results. The proficiency of fund managers is considered crucial to meet investor expectations regarding mutual fund performance and to provide attractive investment returns (Lucas et al., 2019).

Drawing upon insights from Infovesta concerning stock selection skill, market timing skill, and the Sharpe ratio of mutual fund managers throughout the period spanning from 2017 to 2022, it is discernible that the respective averages therein are of substantive interest and warrant scrutiny as a focal point for scholarly investigation. The mean values of stock selection and market timing skills, alongside the Sharpe ratio, are meticulously delineated in Table 2.

Table 2. Average Number of Stock Selection Skill, Market Timing Skill, and Sharpe Ratio

Year	Average Stock Selection Skill	Average Market Timing Skill	Average Sharpe Ratio
2017	-0.0046	-1.1530	2.4079
2018	-0.0015	0.1693	-2.7376
2019	-0.0047	-2.0127	-2.3919
2020	0.0013	0.1744	-1.6547
2021	-0.0062	-2.4552	-2.1762
2022	0.0086	-13.1082	-1.0333

Source: Infovesta, data processed.

Table 2 shows discernible fluctuations in the mean values of stock-selection and market-timing skills relative to the Sharpe ratio over the research period 2017–2022. The average Sharpe ratio over this period is negative. A negative Sharpe ratio signifies that the mutual fund portfolio yields returns lower than those of risk-free assets (Rodionova et al., 2022). Prior research by Rodionova et al. (2022) indicates that a negative Sharpe ratio may be attributable to market pressures arising from crises or geopolitical upheavals.

The Sharpe ratio, as posited by Agarwal and Pradhan (2019), is encompassed within the framework of mutual fund performance evaluation methods that necessitate a constant sensitivity to the fund's risk concerning the market, commonly referred to as beta. Examples of performance measurement methods for mutual funds include those proposed by Jensen (1968), Litner (1965), Mossin (1966), and Sharpe (1966). This condition leads to a potential bias in the estimation

of the fund manager's abilities, namely stock selection and market timing. The alpha values derived from an assessment with fixed risk cannot conclusively demonstrate the skill of fund managers in stock selection and do not constitute a superior performance metric (Agarwal and Pradhan, 2019). To address this issue, Agarwal and Pradhan (2019) advocate for adjustments to economic risk factors to ascertain a more accurate measure of the genuine performance or capabilities of mutual fund managers.

Research on the expertise of mutual fund managers and the performance of equity mutual funds is extensively conducted in Indonesia, as evident in studies by Adhi Sakti and Ryandono (2022), Andriani and Mawardi (2018), Gusni et al. (2018), Rachmawati et al. (2020), and Sanjaya et al. (2020). However, these studies typically examine the influence of fund manager abilities with a presumed stability of market conditions or economic changes. Similar to the adjustments proposed by Agarwal and Pradhan (2019), this research seeks to introduce the variable of changes in the Indonesian stock market conditions, which will serve as a moderation variable, as a means of adapting to the risk factors associated with changes in stock market conditions.

Additionally, this study will incorporate control variables, namely the age of the mutual fund (fund age), and the tenure of the fund manager (management tenure). Previous research by Y. Chen et al. (2021) and Jitmaneroj (2023) indicates a correlation between investment manager capabilities and mutual fund characteristics. Jitmaneroj (2023) argues that funds managed by experienced managers tend to exhibit superior performance. Therefore, management tenure is employed as a control variable. Chen et al. (2021) also utilize Fund age as a control variable, positing that mutual funds operating for an extended duration may experience suboptimal performance due to decreased liquidity, while newer funds may achieve better performance.

This research is conducted to examine the influence of fund manager expertise on the performance of mutual funds under changing market conditions (bullish and bearish). The expectation is that this study will contribute to enhancing the understanding of investors and prospective investors regarding the performance of mutual funds, particularly those in Indonesia. The outcomes of this research aim to serve as a guide or reference source for investors making decisions regarding the allocation of their investment funds in Indonesian mutual funds.

Literature Review

Stock-selection skill refers to fund managers' proficiency in identifying undervalued stocks—those whose prices are not commensurate with their intrinsic value—with the aim of generating capital gains and outperforming benchmark indices (Agarwal and Pradhan, 2018; Nawaz Khan et al., 2020; Neto et al., 2017; Suvarna, 2022; Thobejane et al., 2017). Consistent with this notion, Markowitz (1952) introduced modern portfolio theory, which outlines how to minimize risk through portfolio formation by selecting assets on the basis of expected return and risk (Agarwal and Pradhan, 2019).

In addition to stock selection, market-timing ability is also crucial for anticipating changes in market movements (Agarwal and Pradhan, 2019; Andreu et al., 2018). Such anticipation aims to capture return momentum by interpreting market signals and adjusting the portfolio accordingly (Badhani and Kumar, 2020; El Ammari et al., 2023). According to Fama (1970), an ideal stock market is one in which prices provide accurate signals for resource allocation, enabling investors to make sound decisions on the assumption that current prices reflect widely available information. When prices consistently reflect available information, the market is said to be efficient (Fama, 1970). This concept is closely related to the market-timing ability exercised by fund managers.

In addition to fund-manager expertise, other variables may influence mutual fund performance; this study focuses on changes in market conditions. Fluctuating stock-market movements may prompt investors to adopt contrarian strategies or otherwise deviate from prevailing market sentiment. This tendency arises from behavioral biases—such as overreaction, risk aversion, and overconfidence—that contravene established investment principles (Chen et al., 2018).

The influence of changes in market conditions is supported by Agarwal and Pradhan's (2019) research, which asserts that many measurement methods presuppose a constant sensitivity of mutual fund risk to the market, assuming that market and economic conditions remain unchanged. This assumption leads to potential bias in estimating the capabilities of fund managers, specifically stock selection and market timing. Examples of such performance measurement methods include those proposed by Jensen (1968), Litner (1965), Mossin (1966), and Sharpe (1966). In line with the studies by Agarwal and Pradhan (2019) and Dong and Doukas (2020), this research introduces changes in stock market conditions as a moderation variable in the form of a dummy variable to examine how alterations in stock market conditions impact the performance of equity mutual funds. According to Apau et al. (2023), Fletcher (2000), and Jun et al. (2014), the stock

market condition variable takes on a value of 1 if the market return in the previous year is greater than 0, $RM(t-1) > 0$, indicating a bullish condition, and a value of 0 if the market return in the previous year ($t-1$) is less than or equal to zero, $RM(t-1) \leq 0$, indicating a bearish condition.

Previous research on the influence of fund manager skills, such as stock selection and market timing abilities, on mutual fund performance has been extensive. However, the obtained research findings tend to vary, leading to inconsistency in research outcomes. For instance, a study by Y. Chen et al. (2021) in China evaluating stock selection skills showed a positive impact on mutual fund performance. A similar study by Zouaoui (2019) in Saudi Arabia also indicated a positive influence of stock selection skills on mutual fund performance. In Indonesia, Andriani and Mawardi (2018), Azis et al. (2022), Sanjaya et al. (2020), and Setiawan et al. (2019) likewise find that stock-selection skill positively affects equity mutual fund performance. By contrast, Chauhan (2019) in India and Adhi Sakti and Ryandono (2022) report a negative effect of stock-selection skill on mutual fund performance.

With respect to market-timing skill, Chen et al. (2021) in China and Veeravel and Balakrishnan (2022) in India find a positive effect on equity mutual fund performance. Similar results are reported for Indonesia by Adhi Sakti and Ryandono (2022), Azis et al. (2022), Merti and Nur (2022), and Rachmawati et al. (2020). However, research conducted by Andreu et al. (2018) in Spain and by Dewi and Nurwulandari (2022), Gusni et al. (2018), Sanjaya et al. (2020), and Setiawan et al. (2019) in Indonesia indicated that market timing skills do not significantly affect mutual fund performance. Consequently, there exists a research gap that warrants further exploration in subsequent studies.

Methodology

The primary data utilized in this study include the monthly net asset values of each research sample, Bank Indonesia (BI) interest rate data, and monthly returns from the Composite Stock Price Index (IHSG), sourced from Infovesta. The research encompasses 29 equity mutual funds as the sample, meeting specific criteria, namely, having been established 1 to 2 years before 2017, not being suspended by the Financial Services Authority (OJK), and consistently reporting financial statements throughout the study period.

This research is focused on examining the impact of investment manager expertise, specifically stock selection skill and market timing skill, on the performance of equity mutual funds, considering market conditions as a

moderating variable. Additionally, it takes into account control variables such as fund age and management tenure. The dependent variable in this study is the performance of equity mutual funds, measured using the Sharpe ratio. This ratio is selected due to its widespread utilization, particularly in Indonesia (Rachmawati et al., 2020). The formula for calculating the Sharpe ratio was proposed by Sharpe (1966) as follows:

$$Sp = \frac{(R_p - R_f)}{\sigma_x}$$

where R_p represents the average return of the mutual fund, R_f denotes the Bank Indonesia interest rate (Risk Free) and σ_x is the standard deviation of the mutual fund. The measurement of the average return of the mutual fund is defined as:

$$R_p = \frac{NAV/PU_t - NAV/PU_{t-1}}{NAV/PU_{t-1}}$$

It stated that R_p represents the return of the mutual fund in year t , NAV/PU_t is the net asset value per unit of the mutual fund in year t , NAV/PU_{t-1} is the net asset value per unit of the mutual fund in year $t-1$.

Furthermore, the measurement of the mutual fund manager's expertise utilizes the metric proposed by Treynor and Mazuy (1966), as follows:

$$R_i - R_f = \alpha_1 + \beta_1(R_m - R_f) + \beta_2(R_m - R_f)^2 + e_p$$

It defines as R_i represents the return of a mutual fund portfolio, R_f is the risk-free return. Then, R_m is the return of the market portfolio, α is the intercept, β_1 is the regression coefficient of market excess return or slope during bearish market conditions, α indicates the stock selection skill of the mutual fund manager, β_2 is the regression coefficient indicating market timing skill of the mutual fund manager, and ϵ represents the standard error.

This study also introduces a dummy variable for changes in market conditions as a moderating variable. According to Apau et al. (2023), Fletcher (2000), and Jun et al. (2014), the stock market condition variable takes on a value of 1 if the market return in the previous year is greater than 0, $RM(t-1) > 0$, signifying a bullish condition. It takes on a value of 0 if the market return in the previous year ($t-1$) is less than or equal to zero, $RM(t-1) \leq 0$, indicating a bearish condition.

This study employs the panel data regression measurement method as the dataset implemented in this research is panel data. Several equations of panel regression measurement models in this study are delineated in the following formulas:

Model 1: $Performance_{it} = \alpha + \beta_1 Tenure_{it} + \beta_2 Age_{it} + \varepsilon$

Model 2: $Performance_{it} = \alpha_1 + \beta_1 SSS_{it} + \beta_2 MTS_{it} + \beta_3 MKTCON_{it} + (\beta_4 SSS_{it} * MKTCON) + (\beta_5 MTS_{it} * MKTCON) + \varepsilon$

Model 3: $Performance_{it} = \alpha_1 + \beta_1 SSS_{it} + \beta_2 MTS_{it} + \beta_3 MKTCON_{it} + (\beta_4 SSS_{it} * MKTCON) + (\beta_5 MTS_{it} * MKTCON) + \beta_6 Age_{it} + \beta_7 Tenure_{it} + \varepsilon$

Findings

Given that the classical assumption tests have been satisfied, regression analysis can be conducted for each model. In Model 2, panel regression was estimated with market conditions as a moderating variable; the results are presented in Table 3.

Table 3. Hasil Uji Regresi Moderasi

Variables	Coefficient	t-Statistics	Probability
Stock Selection Skill (SSS)	89.17277	4.613965	0.0000
Market Timing Skill (MTS)	0.066886	1.445232	0.1503
Market Condition (MKTCON)	1.563714	5.784374	0.0000
SSS*MKTCON	27.67826	1.202941	0.2307
MTS*MKTCON	-0.008769	-0.184985	0.8535

Source: Research finding, using EViews.

The results of the moderation panel regression in Table 3 indicate that stock selection skill, with a probability value of 0.000 smaller than 0.05 and a coefficient of 89.17277, exerts a positive and significant influence on the performance of mutual funds. The first hypothesis of this research is thus accepted. This demonstrates that the ability of fund managers to select stocks plays a crucial role in enhancing the performance of managed equity mutual funds. Conversely, if fund managers fail to make effective stock selections, it may result in a decline or underperformance in the managed mutual fund's performance. These findings align with the studies of Azis et al. (2022), Ling and Abdul-Rahim (2021), Merti and Nur (2022), Rachmawati et al. (2020), and Sanjaya et al. (2020), which also affirm the positive impact of stock selection skill on the performance of equity mutual funds.

The market timing skill has a probability value of 0.1503, which is greater than 5%, indicating that market timing skill does not significantly influence the performance of equity mutual funds. Consequently, the second hypothesis of the research is rejected. These findings are not in line with the results of studies by

Andreu et al. (2018), Ferson and Mo (2016), Gao et al. (2020), and He et al. (2015). However, this research aligns with Nawaz Khan et al. (2020), whose study showed that market timing skill does not significantly impact mutual fund performance. The outcomes of this research are also supported by Das and Uma Rao (2015), who found that only 8 out of 238 samples significantly affected the performance of equity mutual funds, while the remaining samples were not significant or had no impact. Furthermore, the results of this research are consistent with studies conducted in Indonesia by Sanjaya et al. (2020), which also indicate that market timing skill is not significant in influencing the performance of equity mutual funds.

The probability of changes in market conditions in this research is 0.000, smaller than 5%, with a coefficient value of 1.563714. These results indicate that market conditions have a positive and significant impact on the performance of equity mutual funds. The third hypothesis of this research is accepted. Market conditions in this study are indicated by two states: bullish, representing a rising stock market, and bearish, representing a declining stock market. When the market is bullish, the performance of equity mutual funds also improves. Conversely, in a bearish market condition, the performance of equity mutual funds declines. These findings align with research results produced by Dong and Doukas (2018), Huang and Fang (2021), and Wu (2011), which demonstrate that market conditions have a positive influence on the performance of equity mutual funds.

Furthermore, in the moderation model in this study, it is depicted by introducing an interaction variable between the market condition variable and both stock selection skill and market timing skill. The interaction variable between market conditions and stock selection skill shows a probability value of 0.2307, meaning that the interaction between market conditions and stock selection skill cannot influence the performance of mutual funds. The fourth hypothesis of this research is rejected. This indicates that market conditions cannot enhance or weaken the stock selection skill of fund managers. The results of this research contradict the findings of Apau et al. (2023), Dong and Doukas (2018), Wu (2011), and Agarwal and Pradhan (2019), which demonstrate a positive impact of the interaction between market conditions and stock selection skill on the performance of equity mutual funds.

Next, the interaction variable between market conditions and market timing skill shows a probability value of 0.8535, greater than 5%. This result indicates that the interaction between market conditions and market timing skill does not have an effect on the performance of equity mutual funds. However, interestingly,

when control variables are included, the interaction between market conditions and stock selection skill shows a probability value of 0.0157, smaller than 5%, so it can be said that the interaction between market conditions and stock selection skill has a positive and significant impact on the performance of equity mutual funds. This can be observed in Table 4. Thus, it can be concluded that the fifth hypothesis of this research is accepted.

The research findings indicate that the stock selection skill exercised by mutual fund managers has a positive impact on the performance of equity mutual funds during bullish market conditions. Conversely, the stock selection skill applied by fund managers has a negative and significant effect on the performance of equity mutual funds during bearish market conditions. These results align with previous studies conducted by Agarwal and Pradhan (2019), Apau et al. (2021; 2023), Dong and Doukas (2018), and Wu (2011), which assert that market conditions can influence the performance of equity mutual funds. Additionally, the research by Schuitemaker (2018), which incorporates both bullish and bearish market sentiments as moderation variables, is consistent with these findings.

Moderation Regression Analysis Using Control Variables

Table 5. Results of Moderation Regression with Control Variables

Variables	Coefficient	t-Statistics	Probability
Stock Selection Skill (SSS)	81.17037	6.332367	0.0000
Market Timing Skill (MTS)	0.013208	0.427703	0.6694
Kondisi pasar (MKTCON)	1.446769	8.284302	0.0000
SSS*MKTCON	36.75184	2.440329	0.0157
MTS*MKTCON	0.041229	1.305461	0.1935
Tenure	-1.375806	-8.410598	0.0000
Age	0.031108	1.839291	0.0067

Source: Research finding, using EViews.

Conclusion

This study examines the effects of fund-manager expertise and market conditions on the performance of equity mutual funds in Indonesia. Hypotheses were tested to assess the significance of these effects. Stock-selection skill has a significant positive effect on equity mutual fund performance, indicating that effective stock selection—reflected in a positive alpha—enhances fund performance.

Market-timing skill, by contrast, does not significantly affect equity mutual fund performance over 2017–2022. Highly volatile market conditions over this period—driven by global economic turbulence and, in particular, the COVID-19 pandemic in Indonesia—likely hindered fund managers’ ability to anticipate market movements, rendering market-timing effects insignificant.

Changes in market conditions also have a significant positive effect on equity mutual fund performance: performance improves in bullish markets and declines in bearish markets. The fourth hypothesis is that stock selection skill has a positive and significant effect on the performance of equity mutual funds with market conditions as a moderating variable. This result indicates that during a bullish stock market from 2017 to 2022, fund managers were able to make effective stock selections, thereby improving the performance of equity mutual funds. Conversely, during a bearish market condition in those years, fund managers were unable to make optimal stock selections, resulting in a decline in the performance of equity mutual funds. However, market conditions cannot moderate the impact of market timing skill on the performance of equity mutual funds. This implies that when market conditions change, whether bullish or bearish, fund managers cannot accurately time the market.

The findings of this research contribute to various stakeholders with interests in mutual funds, including investors, prospective investors in equity mutual funds, fund managers, and regulatory bodies such as the Financial Services Authority (Otoritas Jasa Keuangan) and the Indonesia Stock Exchange (Bursa Efek Indonesia). The results can be utilized by investors and prospective investors in making informed decisions regarding the selection of mutual funds, considering aspects such as the competence of fund managers in stock selection. Additionally, investors should take into account the prevailing market conditions, whether bullish or bearish, when deciding to invest in equity mutual funds. For fund managers, this research serves as a valuable insight into making sound stock selections amid fluctuating market conditions. Moreover, regulatory bodies, specifically OJK and BEI, as overseers, are encouraged to exercise careful consideration when granting approvals to investment managers for the issuance of their mutual fund products.

Statements and Declarations

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- Conflict of interest: The authors declare that there is no conflict of interest.

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