

UK market efficiency and the Myners review: a univariate analysis of strategic asset allocation by industrial sectors.

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Abstract

The Treasury's report "Institutional Investment in the United Kingdom: A Review" (the Myners Review) suggests that various sectors of the UK equity market may be suitable for active investment management, tacitly assuming efficient whilst others are not. The validity of this assumption is tested against 29 industrial sector indices with index. Sector efficiency is, taken to be that index values reflect information correctly (strong efficient) or to the extent that benefits do not exceed costs (weakly efficient). Existence of a sector index following a random walk is used to test efficiency with the subsequent conclusion that passive management would be appropriate. Where the time series forecasting gains less than the management costs of active trading indicate weak efficiency with the corollary that active management is still applicable. Industrial sectors where the index can be forecast with gains in excess of costs are appropriate for active management. The indices are tested for stationarity: none are stationary in levels but all are stationary in their first difference, the logarithmic return. Tests for randomness are applied to random walks and random walks with drift and/or trend. Non-random time series are examined for maintained regression using MA and ARMA. Where appropriate, ARCH is applied to the variance, utilising GARCH, Threshold GARCH, GJR-GARCH, Exponential GARCH and Component GARCH. Additionally there is a test for cointegration. All potential data series are tested for independent identical distributions using the BDS test. If the maintained regression is rejected (see Appendix III) then that series is assumed to be explained. The results show that four indices are strong efficient and nine sectors that should be managed passively. Only one sector is found where there is scope for active management to generate an abnormal gain in excess of costs. Nineteen of the indices had GARCH, which indicated a possible lack of efficiency in active management style. One index was unexplained. Thus the Myners review's suggestion of active management was valid, but limited solely to the Personal Care & Household Products sector.

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