

## CHAPTER I

### INTRODUCTION

#### A. Background

Financial markets are generally designed to allow business to raise new funds by issuing securities and investors are people who allocate capital with the expectation of a future financial return or to gain more capital, financial market has mutual benefit both investors, corporations and government due to financial market runs two functions both economics and finance (Marzuki, 1997), on economics side financial market facilitating funds from investors to investees to build new businesses and gain more capitals when the business comes bigger it will encourage of creating job and the impact to the government is increasing of GDP and prosperity of the people.

Financial market are traditionally segmented into money markets and capital markets. Money market instruments include short-term, marketable, liquid, low-risk debt securities. Money market instruments sometimes are called cash equivalents, or just cash for short. The money market is a subsector of the fixed-income market. It consists of very short-term debt securities that usually are highly marketable. Many of these securities trade in large denominations and so are out of the reach of individual investors. Capital market in contrast, include longer-term and riskier securities.

Securities in the capital market are much more diverse than those found within the money market.

An investor generally prefers for bank deposit which offers a fixed rate of income, but actually the action of an investor does not really save the value of money, because a bank deposit does not provide a hedge against inflation and it does not give a specific and efficient return to the investor itself. Saving and investing are two kinds of different things, but they have the same purpose, is to protect the value of an asset, we also have heard about “saving is good but investing is smart”, so to protect the asset the investor needs to change its type of product of investment.

The term of investing could be activities that hold consumption and put some funds to the sector both financial and real sector with a high return, generally an investor invests their money is based on their expectation to enhance their future consumption possibilities by increasing their wealth, and nowadays financial markets are more efficient and significant to fight against inflation. Based on the form, investment activity is divided into two sectors of investments the first is real sector and financial sector, Real sector investment is the investment activities conducted by investing and working in the real sector, real investments generally involved some kind of tangible asset such as property, lands, factories, physical gold, etc, and Financial sector investments are investments made indirectly, by financial instruments or securities purchasing such as stocks, bonds, deposits, mutual funds, and so on.

Before constructing investment portfolio, an investor should start by defining its purpose. The purpose of investing is to transfer purchasing power from the present to the future. A portfolio is a store of value designed to meet investors reasons for postponing the consumption of goods and services from the present to the future . several reasons for saving and investing may include: (1) the capacity to meet financial emergencies, (2) the financing of specific future purchases, such as the down payment for a home and other future needs, (3) the provision for income at retirement, (4) the ability to leave a sizable estate to heirs or to charity, (5) the ability to speculate or receive enjoyment from accumulating and managing wealth.

Indonesian economics has been growing rapidly and now Indonesia is the 16th largest economic growth in the world and 4th in Asia with the level of GDP reach USD 888,538,201,025.3 (*source: WorldBank*) the case of the slowdown of global economics and economics crisis in Europe in 2012 make the economy in several countries such as The United States, Malaysia, and Turkey facing negative development. Though so, Indonesia is able to survive and show positive growth. The reason may come from the robustness of Indonesian economics performance. There is factor that make the Indonesian economy is strong. First, the size of the population of Indonesia. Indonesia classified as fourth largest population in the world makes the domestic Indonesian market is very potential to drive economic growth, especially in terms of consumption, with a population of over 240 million people make the domestic market so value added. The high population in Indonesia became

the reason why the pressure of crisis abroad is not so affect to the economic growth of Indonesia.

This is becoming a reason of investment potential in indonesia, there are many choices that investors can be choosen both direct investment and portfolio investment, but the the depelovment of Indonesian economics make portfolio invesment becomes a choice for investor. But in choosing a product of investment is not easy because it will impacts wealth, nowadays financial market offers high potential return and becoming best choice for invetors.

Financial market is a market in which people or corporations can trade financial securities and other financial products currencies and derivatives, and financial market has been exist for years and can be easily found in every contries both depeloved or depeloving countries, for example PT. Bursa Efek Indonesia (Indonesia Stock Exchange – IDX) in indonesia.

Capital market is a part of financial market it is a market where securities such as shares, bonds, mutual funds are issued to rise medum to long-term financing and where the securities are traded. The securities can be shares bonds or mutual funds are issued by corporations in which the comapnies goal is to rise money or capitals from investors. Firstly when companies issued the securities, they will be traded in primary market, primary market can be known as a first time when companies issued securities and sell them to the investors, in this type of market investors impact companies and there is kind of exchange between investors and comapany where company place securities to investors and investors place their money to the company, when

this type of market has completely done, the market will turn to secondary market where the transaction of securities will not impact company, this type of market is the place of investors to sell the securities between investors, and the trading of the securities is opened up to all the investors in a particular market.

Protecting asset or rising of an asset value is the goal of investment, sometime characteristics of investors on risk appetite are different, Financial market offers high return to investors but the correlation between risk and return are positive, where an investment product offers high return it will also offers high risk, that is what happening on financial market, the only way to get high return with low risk, investors need some classic strategies to fight against risk, it has to be done a powerful strategy a diversification, diversification is a risk management technique that mixes a wide variety of investment within a portfolio. diversification comes up with problems to the particular investors, due to investors who have small amount of money will not be possible to do diversification, so this type of investors need a product in which offers high diversification.

Some other choices for investors who have limited fund for diversification portfolio investment, stock market is generally divided into two types of investment segment (Satrio, 2012), first is Direct portfolio Investment and indirect portfolio investment, direct portfolio investment can be buying securities directly from the market, and indirect portfolio investment is investment where transaction of securities are handled by investment

companies, the development of indirect portfolio investment brings some advantages to the investors, firstly indirect portfolio investment is an investment product with a wide diversification product, and the second, the fund will be managed professionally by professional investment managers. For particular investors Indirect portfolio investment is an appropriate investment choice however it won't maximize profit.

The same with mutual fund, share market is a place where shares are traded, share market as a part of financial market become popularized among investors because of it provides highest return in the market, shares are Certificate representing one unit of ownership in a corporation its performance also has been growing rapidly than other, investing in shares is one of the best choice to create financial security, independence, and generational wealth, Investors are generally seeking for investment product that provide high return. The development of economics will be reflected by stock market performance figure 1 shows return on The IDX Composite or Jakarta Composite Index (JSX) is an index of all stocks that are traded on the Indonesia Stock Exchange (IDX). In Indonesian the index is called the Indeks Harga Saham Gabungan, abbreviated IHSG. This benchmark stock index is divided in nine sectoral indices, JSX recorded growth of 1617 percent for the past 12 years, according to the data IDX shows better performance with great growth up to 2014, American crisis impact indonesia on 2008 and stock market in every countries were provide poor performance this can be shown on table that Composite index were at level 1.111 The high population in

Indonesia became the reason why the pressure of crisis of America is not long so affect to the economic growth of Indonesia on the next years.



Figure 1. IDX Performance (source. PT. Bursa Efek Indonesia)



In Indonesia stock exchange there are about 512 public company shares have been listed, as individual index was divided into a company listed in many type classifications, it is industrial classification and trading industry, shares can be classified equity classification benchmark market can be seen on figure 2.

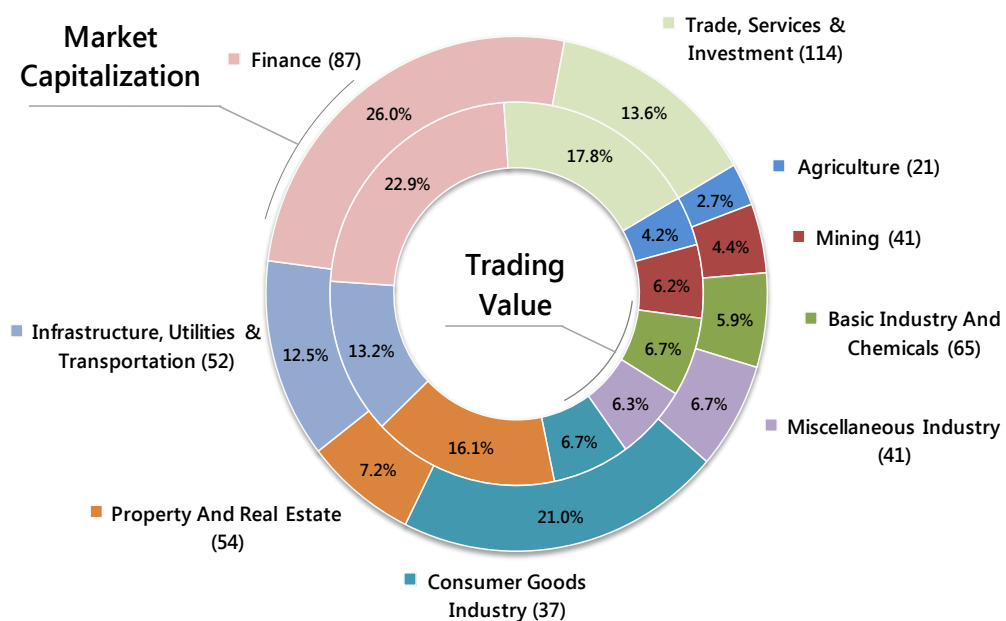


Figure 2. (Market Capitalization and Trading Value) Source. PT. Bursa Efek Indonesia

On the figure 2 shows the IDX Composite or Jakarta Composite Index (JSX) market capitalization and trading value by industry, in IDX shares are classified into 9 sectors as follows, Agriculture, Mining, Basic Industry and Chemicals, Miscellaneous Industry, Consumer Goods Industry, Property and Real Estate, Infrastructure, Utilities and Transportation, Finance and Trade Services and Investments. Financial sector leads the share market with 26% market capitalization in Indonesia Stock Exchange and 22.9% total trading

value, the second position there is Consumer and goods with 21% market capitalization and its trading value with 6.7% , the third, Trade Service and Invesments with 13.6% market capitalization and its trading value on the second position with 17.8%, the fourth is Infrastructure, Utilities and Transportation which its 12.5% market capitalization with its trading value in number 13.2%, the fifth is Property and Real Estate with its market capitalization as 7.2% and its trading value is on third position on number 16.1%, the sixth is Miscellaneous Industry with its market capitalization on number 6.7% and its trading value is on number six as much as 6.3%, the seventh is Basic Industry and Chemicals with 5.9% market capitalization and its trading value as big as consmer and goods, the eighth is mining industry with its market capitalization as big as 4.4% with its trading value on the seventh position as much as 6.2%, and the last one is Agricultur Industry with its smalest market capitalization and trading value as follow 2.7% and 4.2% .

From all company stocks listed in Indonesia stock exchange, the stocks are chategorized as follow: blue chip stocks, income stocks, cyclical stocks, defensive stocks, growth stocks, speculative stocks, Penny stocks.

*Blue chip stock*, is the best known of all the categories of stocks presented above. These stocks represent the best-known firms among the investment community. But it is difficult to define exactly this category of stock, because in most cases blue chip stocks are presented using the examples of the firms. One common definition of Blue Chip Company is that this company has long continuous history of divided payments.

*Income stocks*, are the stocks, the earnings of which are mainly in the form of dividend income, as opposed to capital gains. It is considered a conservative, dependable investment, suitable to supplement other income. Well-established corporations with a consistent record of paying dividends are usually considered income stock. In addition, income stocks usually are those that historically have paid a larger-than-average percentage of their net income after taxes as dividends to their shareholders and the payout ratio for these companies are high.

*Cyclical stocks*, are the securities that go up and down in value with the trend of business and economy, rising faster in the periods of rapidly improving business conditions and sliding very noticeably when business conditions deteriorate. During a recession they do poorly. The term cyclical does not imply that these stocks are more predictable than other categories. They are cyclical because they follow business cycle.

*Defensive stocks*, are those which are opposite to cyclical stocks. These stocks shift little in price movements and are very rarely of interest to speculators. The defensive stocks have low Betas and thus are assigned to the stocks with lower risk. Held by long-term investors seeking stability, these stocks frequently withstand selling pressure in a falling market.

*Growth stocks*, are stocks of corporations whose existing and projected earnings are sufficiently positive to indicate an appreciable and constant increase in the stock's market value over the extended time period. The rate of increase in market value for these stocks is larger than those of most

corporate stock. Income stocks pay out a relatively high percentage of their earnings as dividends, but growth stocks do not. Instead, the company reinvests its earnings into profitable investment opportunities that are expected to increase the value of the firm, and therefore, the value of the firm's stock. Many firms have never paid a dividend and publicly state they have no plans to do so. By default it seems these should be a growth stocks, because a stock that pays no dividend and does not increase in value would not be a very attractive investment. Though the analysts and the experienced investors themselves spend the time trying to discover little-known growth stocks.

*Speculative stocks*, are the stocks issued by relatively new firms of unproven financial status and by firms with less than average financial strength. Speculation, by definition, involves a short time horizon, and the speculative stocks are those that have a potential to make their owners a lot of money quickly. At the same time, though, they carry an unusually high degree of risk.

*Penny stocks*, are low-priced issues, often highly speculative, selling at very small price a share. Thus, such stocks could be affordable even for the investors with small amounts of money. The categories of the stocks presented above are not really mutually exclusive. As an examples show, some blue chip stocks at the same time can be an income stock. Similarly, both cyclical and defensive stocks can be income stocks.

Indonesia stock exchange currently trades 512 company stocks and has 22 index-constituents in total on today, for the information that Indonesia stock exchange has launched a new index called IDX30 on April 23rd 2012, which represents the 30 leading stocks in the market, the IDX30 consists of stock with the biggest market capitalization included in the LQ45 which covers the IDXs most liquid stocks, actually the IDX30 is expected to be reference for investors who wants to invest in a company shares with high liquidity and big capitalization, and this index can be used as stock-based investment and a reference for investors to invest in best stocks in Indonesia, because factors to be considered for selecting the IDX30 constituents are transaction activities, including transaction value, frequency, transaction days, and market capitalization. And they will be reviewed periodically once in six months in February and August every year.

With Indonesia's economy and capital market getting better, foreign capital entering Indonesia is believed to continue growing. It will be seen on the leading shares of Indonesia Stock Exchange (BEI) recorded growth of 1617 percent for the past 12 years, Under these conditions, no wonder if the investment in shares listed on the Stock Exchange is in great demand by foreign investors, especially in the long-term instruments, can be seen on table below:

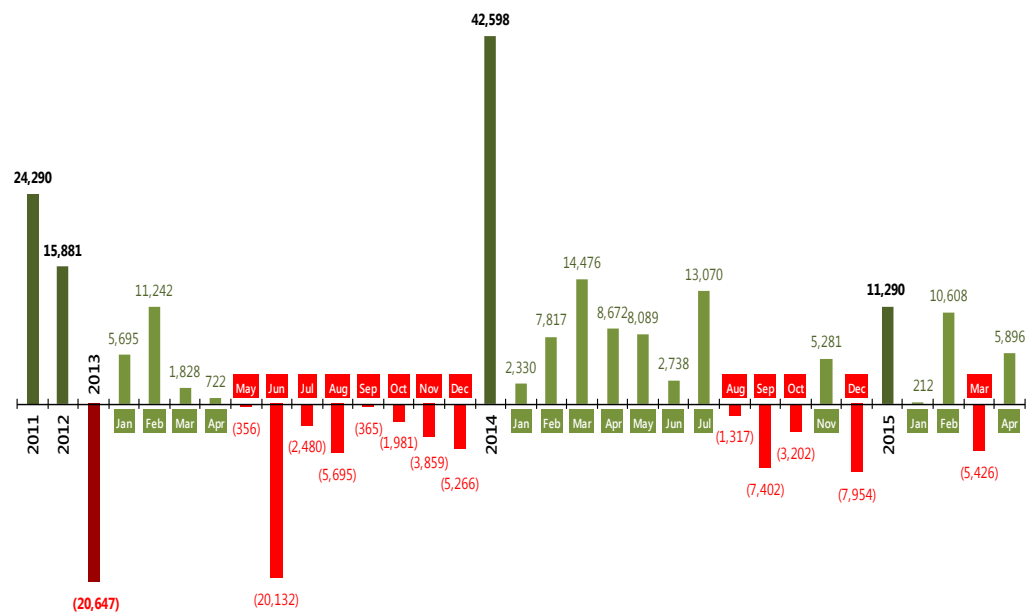


Figure 3. volume trasaction Foreign and Local Investors. Sources PT. Bursa Efek Indonesia

On the table above can be seen net buying and selling by foreign investors from 2011 up to April 2015 that Indonesia Stock Exchange is dominated by foreign investors and their transaction is getting bigger and bigger, somehow the number of local investors still small, from 240 milions of people less than 1 percent of the people of indonesia invest their money on stock market, most of them are prefer for bank deposits, on the table 3 we can see the distribution of tradble stock in transaction between Foreign and local Investors:

Table 1. Investors Summary (source: PT. Bursa Efek Indonesia)

Investors' Nationality	March-15		2014		2013		2012	
	(IDR Billion)	%	(IDR Billion)	%	(IDR Billion)	%	(IDR Billion)	%
<b>Local Investor</b>	<b>1,077,807</b>	<b>34.78%</b>	<b>1,026,760</b>	<b>35.51%</b>	<b>868,718</b>	<b>37.06%</b>	<b>1,040,619</b>	<b>41.21%</b>
Individual	182,116	16.90%	170,208	16.58%	157,417	18.12%	140,026	13.46%
Institution	891,854	82.75%	854,035	83.18%	709,834	81.71%	899,339	86.42%
Others	3,837	0.36%	2,516	0.25%	1,466	0.17%	1,254	0.12%
<b>Foreign Investor</b>	<b>2,021,224</b>	<b>65.22%</b>	<b>1,864,980</b>	<b>64.49%</b>	<b>1,475,457</b>	<b>62.94%</b>	<b>1,484,385</b>	<b>58.79%</b>
Individual	14,459	0.72%	14,361	0.77%	25,687	1.74%	31,145	2.10%
Institution	1,374,759	68.02%	1,274,049	68.31%	975,049	66.08%	1,025,196	69.07%
Others	632,007	31.27%	576,570	30.92%	474,720	32.17%	428,044	28.84%
<b>TOTAL</b>	<b>3,099,032</b>		<b>2,891,739</b>		<b>2,344,174</b>		<b>2,525,005</b>	

Hence most of long term investment portfolio are designed to meet a specific financial needs and to reach in investor goals by rising money on investments, but the evidence seems to indicate that a predominance of risk aversion in the market and as long as investors correctly perceive riskiness of various asset this implies that risky assets must on average yield higher return than less risky asset (Michael,1967). Hence in evaluating the performance of share or equity portfolio can be used by the performance of the market return itself and it can be based on market indices performance, for the example is 9 clasified leader market indices in indonesian market as follow: Agriculture, Mining, Basic Industry and Chemicals, Miscellaneous Industry, Consumer Goods Industry, Property and Real Estate, Infrastructure, Utilities and Transportation, Finance and Trade Services and Investments, and also Jakarta Stock Exchange (JSX) or in the other word is Index Harga Saham Gabungan (IHSG).

In the indonesia stock exchange there are indices that are often used as the basis for the establishment of a portfolio it is IHSG in the other side Indonesia stock exchange new index called IDX30 which represents the 30 leading shares that consists of stock with the biggest market capitalization which covers the IDXs most liquid stocks to be reference for investors with high liquidity and big capitalization shares company in the market, accoarding to its existance as stock based invesment does it have better performance for investors as a reference in best shares.

Stock market investing provides opportunities at the cost of risk. For investors, the ultimate investing goal is to make as much money as possible by acting in such a way that the highest possible profit is realized at minimal risk, and today Indonesia Stock Exchange provides market needs in action by creating a bechmark invesment as a base investment for investor, Research in performance of IDX30 is relatively new, there are thousands of company shares availble for purchase, choosing a share for one invesment



is a fraught with uncertainty and it is very important to be disclose weather the IDX30 deserves to be a reference for investor as a benchmark invesment on share market.

The measurement and valuation of portfolio performance on IDX30 stocks need to be valuated because of it is as a bechmark and stock-based investment in indonesia and need to be valued and evaluated. Jensen, Shrape, and Treynor measurmens is used for investment decision making in constructing a portfolio by measuring the market return at the same time. These measurements is based on its analysist on fast return in forecasting of predicting the returns and risks in the future time. These measurments also have different characteristics in difining market performance where Jensen uses Alpha, Sharpe uses Standard deviation and Treynor states that the volatility of the market affects the return.

## **B. Research Questions**

Accoording to Status quo right now, Invesment decisions are made by investors theirselves, in deciding appropriate invesment products investors are usualy confused to decide which product of investments are best for them, generally the investors with high or low risk appetite expect best return for their invesment. In Share Market offers best return, somehow the return of the equity will be depend on invesment alocation on equity, the lates research states that Mutual Fund Performance is better than stock performance if the managemnt could manage the fund profesinally (Brahmabhatt , 2012), but in the other side stock performance could be good or bad, because market are ultimately driven by investors and stock prices are what individuals make them out to be (Satrio, 2012).

The test of risk adjusted performance is very important to investors theirselves, remembering that investor need a best product of investment related to how good the

investment manager may allocate and construct the funds. The result of the consistency of risk-adjusted Performance will provide information to investors regarding the measurement tool is able to deliver the same or consistent information to investors regarding performance of a portfolio, so that investment decisions can be made appropriately.

There are some reseraches on the risk adjusted performance in measruing the portfolio performance in several countries and local reserachers with various results, accoarding to Yamin and Lawrence in uhud (2010) the corelation between three measurments showed a high degree, which meant that there are corelation and differences among them. The consistence of these three measurments was found by wahyudi (2003) in purwanti (2008) stated that there were not different performance in three measurments related to risk and return that was measured by jensen, trynor and sharp, whether to an insurancelinked shares or mutualfund and also stocks.

Those explanations have refered to the basic question related to this study: “is there any sygnificant differences between portfolio performance with Risk Adjusted Performance and IDX30 represents 30 leading stocks that covers the IDX’s most liquid stocks and consists of stocks with the bigger market capitalization in indonesia, are they deserve to be an inveseement benchmark and investors reference in appropriate asset alocation?”

### **C. Research Purposes**

The main objective of the study was to find out the different of the portfolio performance with Jensen, sharpe and Treynor measurements and to find out whether IDX30 index the best stocks as a reference for long-term investment in Financial Market in Indonesia.

The objective of the study is briefly discussed below:

1. To Analyst the different of Sharp expected return with Sharp Index Performance
2. To Analyst the different of Treynor expected return with Treynor Index Performance
3. To Analyst the different of Jensen expected return with Jensen Index Performance
4. To Analyst the different of Sharp expected return, Treynor expected return, Jensen expected return with Risk Adjusted Performance
5. To Analyst the influence of Risk Adjusted Performance with Net Profit
6. To analyst the different among Risk Adjusted performance models (Shrap, Treynor and Jensen).

#### **D. Research Benefits**

1. This study will help in gaining a better understanding of what an investor look for in investment options on capital market.
2. This study could benefits academics to implement of finance study or theory on real field.
3. This study also could be used by investment managers in designing or constructing better portfolio to suit the need of the investors.