

## MASTER'S THESIS

### Benefits from market timing strategies: a comparison between Hong Kong and U.S.

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*Date of Award:*  
2008

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**Benefits from Market Timing Strategies:  
A Comparison between Hong Kong and U.S.**

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**A thesis submitted in partial fulfillment of the requirements**

**for the degree of**

**Master of Philosophy**

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**January 2008**

# ABSTRACT

Market timing strategies have been widely examined by both academicians and financial practitioners in the last few decades. However, the studies were mainly implemented among industrialized economic entities. As one of the world's largest financial centers, Hong Kong has long been ignored by this kind of study. There is no clear suggestion on the feasibility of market timing strategies in Hong Kong, or whether institutional investors as well as individual investors should or could successfully apply such strategies to benefit. With a new definition of bullish and bearish market situations, this thesis has updated the simplified binary method introduced by Sharpe (1975) to provide some insights about the benefits from market timing strategies. To facilitate a comparison, both Hong Kong and U.S. would be tested over a two-decade time from 1987 to 2006. Moreover, to confirm the rising of sector effects, property and utility indices of the Hong Kong stock market are selected to test the potential gains from market timing between stock sectors.

The thesis examines both cases of perfect market timing and imperfect market timing. We contribute to the literature by (i) decomposing the effect of transaction cost level's shifting on portfolios returns into different parts to have a better understanding of the whole impacts; (ii) investigating the minimum requirements for market timing portfolios to outperform the corresponding benchmarks and the return advantages employing a new series of benchmarks with full risk adjustment; (iii) examining results

from different bullish and bearish prediction skills and test empirically whether the bullish forecasting is as important as suggested by previous studies; (iv) analyzing the minimum summation of bullish and bearish prediction powers required to beat the benchmarks.

The results of the thesis show that perfect market timing is not as “perfect” as described in the former research works. Based on the full risk-adjusted comparisons, market benchmark portfolios sometimes offer better rewards. When the transaction cost level is lowered, the cost reduction itself would cause the greatest effect on the portfolios’ return. Effects of more transactions and market condition shifting can only be complementary. For imperfect market timing, the results indicate that market timing strategies are hard to apply in the U.S. market, but in the Hong Kong market, especially between the two stock sectors, market timing is easier and applicable. Individual investors should revise their portfolios less frequently because of their unsatisfactory prediction skills. However, for institutional investors who possess outstanding forecasting accuracies, frequently revising the portfolios could help them fully explore their power to gain from market timing. If heterogeneous forecasting abilities for bullish and bearish markets are assumed, bullish market prediction seems to be more critical than the bearish one, confirming previous findings. Furthermore, a 130% sum of bullish and bearish prediction abilities is generally the minimum requirement to benefit from market timing strategies according to the empirical results.

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