

Table 8. Three-factor-model alphas for portfolios that are formed based on prior three-year three-factor-model alphas, net and gross of total annual expenses.

The test portfolios correspond respectively to all first years following portfolio formation, all second years following formation and all third years following formation. Regressions use monthly data. T-statistics are in parentheses.

PR3YA DECILE	AVG PR3YA	Ann. Exp.	Net of Total Annual Expenses						Gross of Total Annual Expenses					
			Number of Years after Portfolio Formation						Number of Years after Portfolio Formation					
			1		2		3		1		2		3	
Test Period			1981-95		1982-96		1983-97		1981-95		1982-96		1983-97	
High	0.52	1.36	0.03	(0.45)	-0.03	(-0.54)	-0.10	(-1.83)	0.14	(2.19)	0.08	(1.37)	0.02	(0.34)
2	0.16	1.27	0.02	(0.29)	-0.05	(-0.95)	-0.10	(-1.73)	0.12	(2.17)	0.05	(1.02)	0.01	(0.12)
3	0.02	1.26	-0.05	(-0.87)	-0.08	(-1.64)	-0.08	(-1.51)	0.06	(0.99)	0.02	(0.40)	0.03	(0.51)
4	-0.08	1.29	-0.07	(-1.40)	-0.03	(-0.59)	-0.07	(-1.40)	0.03	(0.64)	0.08	(1.47)	0.04	(0.75)
5	-0.15	1.28	-0.05	(-1.11)	-0.10	(-2.00)	-0.10	(-2.08)	0.05	(1.04)	0.00	(0.09)	0.01	(0.12)
6	-0.23	1.31	-0.04	(-0.77)	-0.05	(-0.95)	-0.08	(-1.69)	0.07	(1.36)	0.06	(1.26)	0.03	(0.62)
7	-0.31	1.31	-0.08	(-1.41)	-0.10	(-1.85)	-0.04	(-0.65)	0.03	(0.51)	0.01	(0.18)	0.07	(1.19)
8	-0.42	1.33	-0.12	(-2.20)	-0.06	(-1.06)	-0.07	(-1.33)	-0.01	(-0.17)	0.05	(0.93)	0.04	(0.80)
9	-0.56	1.44	-0.16	(-2.39)	-0.13	(-1.85)	-0.06	(-0.93)	-0.04	(-0.58)	-0.01	(-0.09)	0.06	(0.90)
Low	-0.96	1.49	-0.26	(-3.74)	-0.11	(-1.60)	-0.08	(-1.18)	-0.14	(-1.95)	0.02	(0.25)	0.05	(0.73)
Average	-0.20	1.33	-0.08		-0.07		-0.08		0.03		0.04		0.03	
rank r		-0.53	0.94**		0.72*		-0.12		0.92**		0.62		-0.76*	
1-10 alpha			0.29	(3.40)	0.08	(0.85)	-0.02	(-0.24)	0.28	(3.27)	0.06	(0.73)	-0.03	(-0.39)
1-All alpha			0.08	(1.53)	0.02	(0.31)	-0.04	(-0.89)	0.08	(1.54)	0.02	(0.32)	-0.04	(-0.87)

Each year we rank all unit trusts based on their three-factor alphas over the prior three-year period. If a unit trust starts within the three-year period, we include it if has at least thirty months of returns. Based on these rankings, we form ten portfolios with the same number of unit trusts in each portfolio. The ten portfolios are held for one year and then reformed each year. If a unit trust ends during a year, it is included until the last month it reports a return. A monthly total return series is estimated for each portfolio by calculating each month the average post-tax return of the live and dead unit trusts and adding the difference between the average pre-tax return and the average post-tax return of the live unit trusts. Annual expenses are estimated for each portfolio by calculating the average TER of those unit trusts for which a TER is available. Returns gross of total annual expenses are calculated by adding one twelfth of the annual expenses to the net-of-expenses returns.

We then examine this time series in three parts. First, we examine the set of years where each year is the first year following portfolio formation. We then examine the set of years where each year is the second year following portfolio formation, and then the set where each year is year three following portfolio formation. For example, for alphas based on 1978-80, year 1 return is 1981, year 2 is 1982, etc.

PR3YA is the average prior three-year three-factor alpha of the UT's in each decile. Rank r is the spearman rank correlation coefficient between the pre-formation deciles and the post-formation alphas. The 1-10 alpha is the three-factor model alpha of the series produced by subtracting the monthly return of the top PR3YA decile portfolio from that of the bottom PR3YA decile portfolio. The 1-All alpha is the three factor model alpha of the series produced by subtracting the monthly return of the top PR3YA decile portfolio from that of the portfolio of all Unit Trusts.

** Denotes significance at one percent level for a two-sided test

* Denotes significance at five percent level for a two-sided test