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Comparison of Dog's of the Dow Strategy

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Abstract Investors always try to find the ways to beat the market. In recent years, one popular strategy among International investors involves a portfolio comprising of the ten highest yielding stocks selected from among the KSE all share index stocks in the Karachi Stock Exchange-KSE, (one of the most popular stock indices of the Pakistan). Such portfolio based on the Dow Dividend Strategy (DDS) came to be known as the 'Dogs of the Dow.' Portfolio of 'Dogs of the Dow' has been found to outperform the Dow on numerous occasions. The proposed study will extend the well documented Dogs of the Dow (Dow Dogs) strategy to Pakistan stock market. Purpose of this research is to compare the impact of DoD(KSE) portfolio performance with other developed and underdeveloped countries. The result shows that Pakistani Stock market faces the same external conditions like other developed and under developed countries. In conclusion, the Dogs of the Dow strategy can be a successful investment strategy in the Pakistani market but with some limitations.

Keywords Dogs of the Dow, Stock Market, Investment Strategy

1. Introduction

Investors participating in markets, whether it is trading commodities, fixed financial gain instruments, real holding, or fairness securities, all share the similar goal of achieving the highest rate of return for their tegument while accumulation themselves to the last-place even of essay. To reduce or choose the level of risk capitalist expose themselves to and better finance returns, over indication investors have Devi a variety of different form and methods to help improve or manipulate their investment returns. An example of these models is an investment strategy that has been used for trading justness securities in the United Express known as the "Fella of the Dow" investment strategy.

The DoD is an investing strategy which was introduced in 1991 by O'Higgins in his book, Beating the Dow. This is a strategy in which top ten yielding stock is purchased for the period of one year. (Chinmoy &Sahu, 2001).

One theory, which purports to beat the market, is the "Dow Dog" theory. This theory states that an investor should pick a day, a birthday, some anniversary or the end of the calendar year, and purchase a portfolio consisting of the top ten yielding stocks which is listed in the DJIA. One year later, portfolio would be restructured by selling the stocks that are no longer in the high yield group and replace them with stocks that are.To draw factual conclusion the following two hypotheses is tested:

H_1: DoD strategy is as beneficial for KSE/Pakistani investors as for other developed markets.

2. Literature Review

In United States of America USA the popular newsletter Beating the Dow and Barrons's" began following the system on a regular basis popularizing the term "Dogs of the Dow(O'Higgins et al 1999).

Table 1. Dogs of the Dow – US Evidence 1961- 1998

	Ten Highest Dividend Yield Stocks	Dow Jones Industrial Average
Period	1961-1998	1961-1998
Average Annual Return% p.a	15.1%	12.5%
Geomatric Return, % p.a	14.0%	11.4%
Annual Volatility	15.6%	15.4%
Return/Risk	0.90	0.74
Beta	0.91	1.00
Jensen's Alpha	3.6%	0.0%
% Positive Years	87%	79%
% of 10 years periods with outperformance	90%	10%
Minimum Annual return	-15.9%	-22.3%
Largest Drawdow	-15.9%	-32.2%

Source: Michael Clemens, "Dividend investing strategy for long term outperformance", 2012.

Will Roger (an American investment expert) said that people should be more concerned with the returns of their principal than the return on their principal. That observation sums up today's out of control attitude towards the stock market. Consider the following: In July 1996, a federal commission on the long-term future of social security, driven by a need for higher returns to meet projected deficits, and to bolster warning public confidence in our nations principal retirement system, issued recommendations (Mc Carry et al 1999).

In the Korean market the relationship between dividend yields and stock returns was examined. Korean market provided some implications and institutional features that differ from United States and other countries.(Jinwoo et al, 2008)

In Finland, DoDstrategy was examined by ICE-CAPITAL Securities Ltd in 2010. The empirical findings suggests that this investment strategy is profitable in Finnish market.(Eemli Rinne, 2011).

This strategy was also applied to the markets in Canada. This was in the form of high-dividend–yield strategy to the Toronto 35 Index. Their results showed that the strategy produced higher risk-adjusted returns than the Toronto 35 index. (Sue Visscher et al, 2003)

If we look around the world and put a glance on USA which is the birth place of this strategy. It'll be worth full to discuss the work of Michael chemens(2012). He examined the dividend investing strategy for long term outperformance in USA famous indexes and in all over the world. By providing very significant charts, he concluded that dividend strategies looked some for time period with losses, which added a significant utility to investor experience. The outperformance of high dividend yields stocks has been strong over 1928-2011 time frame. Since the basic returns for this outperformance are more behavioral in nature than institutional. He also said that chance says history will repeat itself.

Like other different countries of the world China our neighbor country also tried this strategy on their stock market. Caral Wang et al(2011) investigated that why DoD strategy barks loudly in China. They analyzed the cross-sectional variations in the magnitude of the predictive power of Dow Dogs strategy in Chinese stock. They concluded that behavioral factors drive superior predictive power of Dow Dogs Strategy. Market inefficiency comes from investors irrationality and herding behaviors which in supported by behavioral hypothesis.

It can be proved through evidences of research from Polland. Janusz Brzeszynski (2007) analyzed the profitability of an investment strategy focused on high dividend yield stocks from the polish market according to Dog's of the Dow theory concept author have constructed a portfolio of Top ten highest dividend yielding companies. By using T-Statistics and dividend yield it was concluded that the portfolio containing 10 best and highest dividend yield stocks were been able to beat the Polish market but not consistently.

Dale L. Domian et al. (1998) discovered the rise and fall of the " Dogs of the dow strategy. They analyzed the data of American index during 1973-1992. The main objective of the study was to demonstrate the behavior of stocks consistent with market overreaction. It was concluded by them that dow dividend strategy is no longer selecting the true dogs.

3. Research Methodology

In this paper, we propose applying the "Dogs of the Dow"investment strategy to the KSE, which is the principal stock exchange in the country and compare its performance with other three stock markets of developed and developing countries. As of 31 December 2012, the KSE had about 600 listed securities.The most popular market index for the Pakistan stock market is the KSE-100 Index, which is calculated from the prices of allcommon stocks (including unit trusts of property funds) on the main board of the KSE, except for stocks that have beensuspended for more than one year. The index is a marketcapitalization-weighted price index, which compares thecurrent market value of all listed common shares with itsvalue on the base date. Here we apply the "Dogs of the Dow" strategy to the KSE-100 index, which is "calculated from the stock prices of the top 100 listed companies on KSE in terms of large marketcapitalization, high liquidity and compliance withrequirements regarding the distribution of shares to minor shareholders". Two equations are used for calculating dividend yield and total return of stock market and top ten companies for each year. This calculation is practiced for all other three indexes as well.

$$R = (Pt - Pt\text{-}1)/Pt\text{-}1 \quad (1)$$

$$Dy = D0/Pt\text{-}1 \quad (2)$$

Where;
R= return
Pt= Current price
Pt-1= Previous market price
Dy= Dividend yield
D0= Current paid dividend

Above metioned two equations are used for calculating total stock return and dividend yield. Log is used for calculating market return of all indexes.

4. Data Analysis

The data of three other foreign indexes, which are standard and Poor's (S&P)500 index of US , Dow Jones Industrial Average (DJIA) of US , andStock Exchange of Thailand (SET)50 index of Thailand is analyzed.

During the period of 2002-2005 DoD underperformed S&P500 and outperformed DJIA with slight difference.Likewise during the same time period of 2002-2005 DoD underperformed KSE100 index.

During the period of 2009-2011 DoD of Thai stock market outperformed Thai SET50 in two years(2009 and 2011).While in the same period of 2009-2011 DoD of Pakistani stock market also outperformed KSE100 index for two years(2009 and 2011).

It can be concluded that Pakistani Stock market face the same external conditions like other developed and under developed countries.

Table 2. Return comparison DoD versus DJIA , S&P500 and KSE100

Return comparisonDoD versus DJIA & SP500 2002-2005 & KSE100								
YEAR	SP500	DJIA	DOD	DOD-SP500	DOD-DJIA	KSE-100	DOD	DOD-KSE
2002	-22.1	-15.01	-10.75	11.35	4.26	112.2	100.5	-11.7
2003	28.69	28.29	33.26	4.57	4.97	65.53	64.3	-1.23
2004	10.88	5.31	4.5	-6.38	-0.81	39.06	45.28	6.22
2005	4.91	1.72	-4.95	-9.86	-6.67	53.68	20.36	-33.32
Total Return	22.38	20.31	22.06	-0.32	1.75	270.47	230.44	-40.03
Average	5.595	5.0775	5.515	-0.08	0.4375	67.6175	57.61	-10.0075
Standard Devia	21.04	17.82	19.53	9.79	5.39	31.63	33.78	17.19
Mean	5.59	5.07	5.51	-0.08	0.43	67.61	57.61	-10

Table 3. Return comparison DoD versus Thai SET50 and KSE100

Return comaparison DoD versus Thai SET 50 & KSE100						
YEAR	DOD	SET50	DoD-SET50	DOD	KSE 100	DoD-KSE100
2009	80.03	64.54	15.49	95.38	60.05	35.33
2010	33.02	38.31	-5.29	9.62	28.08	-18.46
2011	5.2	-0.25	5.45	16.01	-5.61	21.62
Total Return	118.3	102.6	15.65	121	82.52	38.49
Average	39.42	34.2	5.2166667	40.34	27.507	12.83
Standard Deviation	37.82	32.58	10.39	47.77	27.5	27.95
Mean	39.41	34.2	5.21	40.33	27.5	12.83

5. Findings and Conclusions

The results of the study indicates, that on the basis of mean returns DoD portfolio outperformed KSE-100 index during 2002-2012.The portfolio of 'Dogs' appeared to outperform the KSE only when there had been a phenomenal rise in the activities. It can be concluded that financial and economic crisis and other worse market conditions have their bad impacts all over the world. Consequently impact of stock trade movement of these three indexes(SET50, S&P500 and DJIA) is as like KSE100 index during period of 2002-2005 and 2009-2011.

While analyzing the whole data it is suggested that investor should be advised by a professional investment guide before implementing DoD strategy.

As the result shows potential of outperformance by all indexes except S&P during 2002-2005. It is not decisive evidence that for a long time period strategy DoD will outperform.

January- December data is taken here in this study, annual modification for six, eighteen, or twenty four months may give different results. For further research work allowance for tax capital gain and dividend can be made.

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