

CAN THE MAGIC FORMULA BEAT THE THAI AND JAPANESE MARKETS TOO?

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ABSTRACT

This research aimed to test the validity of Joel Greenblatt's Magic Formula on the Thai, the Japanese, and the US stock markets. The magic formula uses two ratios, return on capital and earning yield, to screen the stocks. The magic formula portfolio's return was compared to the return of the market benchmark, SET index for the Thai market, Nikkei 225 for the Japanese market, and S&P 500 for the US market. Sharpe ratio analysis was included to measure risk-adjusted return. The period covered in this study was from 1993 to 2012 for 20 years. The data was extracted from Thomson Reuters's Datastream.

The results of this study indicate that the magic formula beat all the three markets of Thailand, Japan, and the USA. The outperformance of the magic formula on the Thai market was particularly remarkable. Although the magic formula did not excel on the Japanese market, it managed to yield a higher annualized return than the market. The magic formula's higher return on the US market was partially from having higher risk. In conclusion, this study suggests that the magic formula is a solid investment model especially given its simplicity. The magic formula's two factors, return on capital and earning yield, are important indicators for securing "margin of safety."

KEY WORDS: VALUE INVESTING/MAGIC FORMULA/JOEL GREENBLATT

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