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Fiduciary finance and the pricing of financial claims: a conceptual approach to investment

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FIDUCIARY FINANCE AND THE PRICING OF FINANCIAL CLAIMS: A CONCEPTUAL APPROACH TO INVESTMENT

A thesis submitted in fulfilment of the
requirements for the award of the degree

DOCTOR OF PHILOSOPHY

from the

UNIVERSITY OF WOLLONGONG

by

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Bachelor of Business (Accounting & Finance)
Graduate Diploma (Applied Finance & Investment)

SCHOOL OF MATHEMATICS & APPLIED STATISTICS

2007

CERTIFICATION

I, Martin Lionel Gold, declare that this thesis submitted in fulfilment of the requirements for the award of Doctor of Philosophy in the School of Mathematics & Applied Statistics, Faculty of Informatics, University of Wollongong, is wholly my own work unless otherwise referenced or acknowledged. The document has not been submitted for qualifications at any other academic institution.

Martin Lionel Gold

7 June 2007

The highest degree of rational belief, which is termed certain *rational belief, corresponds to knowledge. It is preferable to regard* knowledge *as fundamental and to define a* rational belief *by reference to it (John Maynard Keynes, 1952: 10).*

Both wise men and foolish, will trade in the market, but no one group by itself will set the price. Nor will it matter what the majority, however overwhelmingly, may think; for the last owner, and he alone, will set the price. Thus marginal opinion *will determine market price (John Burr Williams, 1938: 12).*

CONTENTS

LIST OF TABLES

LIST OF FIGURES

LIST OF APPENDICES

ABBREVIATIONS/ACRONYMS

ABS	Australian Bureau of Statistics
ALM	Asset-liability management
ASIC	Australian Securities and Investments Commission
ASX	Australian Securities Exchange
ASX CGC	Australian Stock Exchange Corporate Governance Council
APRA	Australian Prudential Regulation Authority
CAPM	Capital Asset Pricing Model
CMI	Constant Market Index
EMH	Efficient markets hypothesis
ETF	Exchange-traded fund
Finsia	Financial Services Institute of Australasia
FSR	Financial Services Reform Act (2001) C'wealth
FUA	Funds under advice/administration
FUM	Funds under management
GIC	Guaranteed investment contract
IFSA	Investment and Financial Services Association
IPO	Initial public offering
ISS	Institutional Shareholder Services
NAV	Net asset value
PDS	Product disclosure statement
PGI	Poor Governance Index
RBA	Reserve Bank of Australia
REIT	Real estate investment trust
SEC	US Securities and Exchange Commission
SIS	Superannuation Industry (Supervision) Act 1993 C'wealth
SSRN	Social Science Research Network

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ABSTRACT

Australians have over $1 trillion invested in fiduciary products such as pension funds (ABS, 2006a). Since the early 1980's, the policies of successive governments have compelled most of the working population to seek its fortune in financial markets. Over the same period investment has emerged, in its own right, as an important business discipline. Scholars have largely avoided critical examination of the discipline's scientific status, choosing instead to concentrate their efforts on refining tests of market efficiency. However, corporate debacles and episodic volatility in financial markets have fostered incredulity amongst stakeholders as to how the market actually operates. The overarching purpose of this thesis, therefore, is to evaluate the science of investment and to espouse a conceptual approach to investment which brings the scholarship and applied practices into closer alignment. Particular emphasis is placed on the funds management operations in the market.

Existing scholarship has analysed pricing outcomes assuming that economic norms are reflected in investing practices and financial markets overall. Critiques of the discipline's flagship theoretical models, however, find that they are disguised tautologies which have not imparted new knowledge, and as such, are pseudo-scientific. Little progress, it is argued, appears to have been made in the discipline since the formative precepts of investment were promulgated in the 1930s and 1950s. Despite the investment industry's economic stature, its microeconomic setting, product structures, and interactions with financial markets, have not been integrated into academic research. Ultimately, the vast majority of investors, being secondary investors, are captives of the industry's "gatekeepers". Winning the "investment game" is not, as investors might suppose, a strategy of maximising investment returns: in fact it is a risk-averse strategy of tracking average market performance overseen by the industry's gatekeepers. It is only the relative minority of primary, non-institutional, investors who need superior information of the industry's endogenous forces and constraints to outperform the market averages.