

# Relative Benchmark Rating and Persistence Analysis: Evidence from Italian Equity Funds

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**ABSTRACT** *The recent introduction into the Italian mutual fund market of Morningstar performance rating of private institutions gives rise to the question of what is the relation between this relative benchmark measure and the other traditional performance measures. This paper provides a comprehensive analysis of the relative benchmark performance measure (Morningstar rating) applied to Italian equity funds. It is found that this performance measure is highly correlated with the classical performance measures (Sharpe ratio, Sortino ratio and Treynor ratio) and poorly correlated with the customized benchmark measure (Information ratio). Furthermore, performing a persistence analysis, using non-parametric methods Cross-product Ratio and Chi-squared test, it is observed that only the Morningstar rating measure generates a strong degree of persistence. These results deviate from most European studies, which argue that Italian mutual funds display weak persistence.*

**KEY WORDS:** Mutual funds, performance evaluation, persistence analysis, Morningstar rating

## 1. Introduction

Mutual funds are now the preferred way for individual investors and many institutions to participate in the capital markets, and their popularity has increased demand for evaluations of fund performance. Some private institutions recently introduced a system classification of mutual funds based on performance measure like the 'Morningstar rating' measure, and this gives rise to some questions on the relation between the relative benchmark Morningstar measure and traditional performance measures. Previous empirical work on the Italian mutual fund industry (Cesari and Panetta, 1998; Grande and Panetta, 2002; Otten and Bams, 2002; Beltratti and Miraglia, 2001; Casarin *et al.*, 2002) does not take into account this relative 'peer group benchmark' performance measure, while in Carluccio (1999) the importance of an analysis based also on relative peer group benchmark measures in the Italian market is suggested and only theoretically discussed.

Several studies analyse the ability of fund managers to generate positive performance persistently over periods. In the literature, this kind of study is referred to as performance persistence analysis. Grinblatt and Titman (1992), Goetzmann and Ibbotson (1994) and Hendriks *et al.* (1993)

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