An Evaluation of Investment Managers in Nigeria: Strategy Determination

Majaji Adamu Abubakar
Department of Business Administration and Management
School of Management Studies
Kano State Polytechnic

Ibrahim Audu
Department of Accounting and Business Administration
Faculty of Humanities, Management and Social Sciences
Federal University, Katsina

Abstract
Investment Management approaches adopted by managers is fundamental to investment manager choices by investors. This paper seeks to evaluate investment management approaches in Nigeria. It aims at the determination of the investment management strategies of investment managers. Mutual Funds Managers were used as a proxy to provide the data required for strategy determination. Data requirements were met through secondary data sources in the form of annual Net Assets Values of mutual funds in Nigeria. The data was subjected to a critical test of alphas that was generated by the Jensen’s alpha. It was determined that Investment Managers of mutual funds in Nigeria predominantly adopt the passive strategy. Its major recommendation is that the Government should drive market deepening in order to promote the emergence of alternative strategies of investments in the financial sector.

Keywords: Investment Management, Mutual Funds, Strategy, Nigeria
1. Introduction

Financial decisions are unavoidable and continuous. These decisions form the basis on which the future of individuals and businesses are manifested and are subject to risks. To believe otherwise is a folly that the world keeps being reprimanded for, posits Bernstein as cited in Siegel (2009). A riskless society is “unattainable and infinitely expensive” Bernstein concludes. The recent financial meltdown of 2008 is one of such times the world is punished for its folly and this was not the worst of all financial crashes in stock market history, at least from 1871 to date; the worst occurred in 1932. (Kaplan, Idzoreck and Gambera et al., 2009). Yet we must invest. The decision to invest is a fundamental one if we, both at individual and business levels, are to have a say in the future. To ensure future financial well-being, the investment decision is most appropriately undertaken through or with the help of financial intermediaries such as Advisors, Brokers and Investment Managers. Using the first two intermediaries, the decision of what to invest in is the final responsibility of the investor albeit routed through the Broker, or on the advice of the Advisor, for a certain fee.

Investment Managers on the other hand, hold the responsibility for the approach adopted for the management of investments and therefore are responsible for the final performance of the investment. For this, and only for this, they do receive the management fees. Furthermore, the routing of investments through investment managers becomes necessary due to the following reasons as enumerated by Dalio (2009). First, the complexity of the market procedure and its products calls for a special skill. The market procedure is a tradition on its own complete with its own language and mode of dressing while the products on sale are abstract representations of differing interests. Second, there is a requirement to be registered on any stock exchange that is beyond simple investors. In Nigeria, according to the Securities and Exchange Commission Quarterly (SECQ, 2009), the Investment and Securities Act of 2007, outline the regulatory framework of investment schemes. There is a requirement of a fee and a rigorous registration procedure to obtain trading seats in the market that is beyond simple investors.

The third reason, which is partly emanating from the second, is the attainment of economies of scale especially in the case of collective investment schemes such as mutual funds. This means overcoming the prescribed fees to the government for a lower one to the manager and achieving better performance than the single investor would have achieved while investing independently, even after the payment to the manager. These reasons and a further situation of proficiency claims in stock market matters, by investment managers, compel investors to trust their investments to the care of investment managers. By implication, the expectation is to assure a “payment” of less or nothing even at the occurrence of idiosyncratic events and gaining more than the market index, as a whole, in normalcy (Fabozzi, Ferenci and Kolm, 2006).

This importance of Investment Managers compelled scholars to evaluate the investment management approaches they adopted. In Nigeria, the prominent studies conducted in this area include the studies of Akinola-Bellaw (1982), Ogolago (1994), Agiobenebo and Agiobenebo (1997), Lewellen, Lease and Shlarbaum (1997), Fubara and Agunwada (2001) and Esirim (2008). These studies have covered all types of professional investment managers of the finance and investment sector except the portfolio managers of Mutual Funds in Nigeria. This situation creates a gap in the extant literature on Investment Managers, which is appreciable by the scarceness of literature on the subject matter in the context of Nigeria. To correct the situation, Abubakar and Maimako (2014) study the investment management approaches adopted by mutual funds managers and the significance of management fees payable to mutual funds managers in Nigeria. This paper studies their management strategies adoption while the determination of management styles is an area of enquiry for the future.

The scope of this paper is therefore delimited to the ascertaining of the management strategies of investment managers of mutual funds in Nigeria. This binds the paper to the indicator that determines the adoption of a particular strategy – performance. The objective of the paper is then to determine strategy adoption through an evaluation of performance. Th
achieve this we try to validate the assertion that ‘There is no significant difference in the performance of portfolio managers of mutual funds in Nigeria’. In achieving this objective, the paper reviews the relevant literature followed by the methodology, results, findings and conclusions and recommendations in that order.

2.1 Literature Review
The prior literature on approaches to management of portfolios present Traditional and Modern portfolio management options, which are determined by the techniques of analyses adopted (Abubakar & Maimako (2014)). Both approaches lead to either the Passive or the Active strategies. This was the view of Gallant (2009), who writes for the Investopedia’s investing 101 an online investment education blog. Similar opinion is held by Sprecher (1975), Shukla (1995), Fabozzi et al (2006) Fabozzi et al (2008), Chandra (2008), Sharpe et al (2008) and Ameriks et al (2008). The distinction, as stated by Sharpe, is that passive management involves holding securities for relatively long periods with small and infrequent changes while active management involves placement of active bets on securities carried out frequently. Managers of both fundamental and modern approaches adopt either of the strategies. This culminates into one of the following styles: either fundamental manager with passive strategy, fundamental manager with active strategy, modern manager with passive strategy or modern manager with active strategy.

A - Fundamental managers with passive strategy – Analysis of securities is done intuitively mostly based on the experiences of the manager or the general industry consensus. Chandra (2008) opines that based on the objectives and constraints established for the client assets are allocated, but such asset allocation group should be done based on age of the client and wealth utilization. The alternative for the passive fundamental manager is to allocate assets to reflect the total market capitalization or a surrogate index funds. In this alternative, the best portfolio mix is that which best reflects the market capitalization or the index.

B - Quantitative managers with passive strategy. The quants face a formidable task of security analysis to derive each security’s expected return, standard deviation and covariance. With automation, this task is simplified which led Fabozzi et al (2008) to conclude that most quantitative processes allow little manager discretion and entails tight tracking, error and risk control. The quant passive strategy is much simpler in that most often, the industry consensus is adopted and portfolios are constituted from the tangent of the indifferent curve of the client on the efficient frontier.

C - Quantitative Manager with active Strategy:- For the active qualitative manager, analysis of securities to discover anomalies, so that bets would be placed on such discovered anomalies, is undertaken. Sharpe et al (2008) illustrated this strategy with a hypothetical example of an index with three stocks. The benchmark portfolios for the passive manager would include all three stocks in the same proportion as that of the market. The active manager would sell off one stock and buy another to reflect his “feelings” for the future. The active position reflects the manager’s disagreement with consensus forecast. His own analysis of the market has led him to believe that the price of the sold is falling and that the price of the bought stock is rising.

D - Fundamental Managers with active strategy – This set of managers conduct analysis of securities via the fundamentals. Janssen, Langager and Murphy (2009) opine that fundamental managers ascertain the intrinsic values of securities by looking at the balance sheet, cash flow statements and income statements. They further opine, by citing critics, that technical analyst have shorter time horizon and are mostly into trading while fundamental analysts have longer time horizon and are therefore into investment. This means that the fundamental analysts have longer-term investment goal. From the analysis conducted the manager then determines asset mix based on the objectives and constraints determined for the investor. Two popular investment styles used by this set of managers are value management and growth management reports Chandra (2008). Typically, such investment styles involve only stocks. Value stocks are those
with low earnings per share growth, low price-to-book value ratios, below average earnings growth and high dividend yields. Growth stocks are those that have higher rates of growth than so-called glamour stocks. For investors with low tolerance of risk the asset mix include gilt edged bonds and or T-bills which are said to be less risky.

2.2 Mutual Funds Evaluation

From independence to 1986, the investment house function in Nigeria was arrogated solely to banks (Menakaye, 2007). By 1990, as a result of the deregulation of the financial system under the Structural Adjustment Programme (SAP) of 1986, there emerged five Unit trust schemes. By 2002, this figure rose to twenty with Banks leading the trend at fifteen operated unit trusts (Menakaye, 2007). By December 2002, registered mutual funds collectively accounted for over Forty Million Naira as aggregate Net Asset Value. Between 2002 and 2011 new registrations increased at an average of four (4) new registrations per year with an accompanying average increase in net asset value of 10.25% per year. It is interesting to note that the development of Mutual fund in Nigeria showed inflections, dips for the periods that correspond to major world financial booms, and bursts. The Dot com crisis of 2002 and the financial meltdown of 2008 point to the dips though in the case of the latter the indication was lagged, as is the case with other major financial indices in Nigeria. Most market indicators including the All Share Index of Nigeria showed steady increase from 2002 to 2007 with a slight dip in 2005. This situation is reflected by the development of Mutual funds in Nigeria and has been documented by the literature though in an effort to stress the linkage or the contagion effect of World Economies to Nigeria (Oghuongho, Egbue, & Asuolu, 2006). Recent data (SEC, Dec 2015) indicates there are Twenty (20) Equity funds, Eleven (11) Balanced funds, Five (5) Bond funds, Five (5) Ethical funds, Three (3) REIT'Ss and Two (4) Money market funds.

Evaluations of mutual funds often take a different dimension from those of direct investment avenues. The names borne by the scheme usually is a starting point in that such names indicate the form and type of fund the scheme is proposing to be. Consider Paramount equity fund, Nigeria international debt fund and DVCPT oil and gas fund and many others. Chandra (2008) presented a number of areas under which a mutual fund should be evaluated. These are:

1. Asset mix, which is often reflected in the name of the fund. Where this is not the case the prospectus declares the number as, for example 60:30:10, which means 60%, 30% and 10% of the corpus are invested in shares, bonds and cash respectively.

2. Net Asset Value is evaluated based on per share value of investment and as a principal method of evaluating performance of the fund (Sharpe, Alexander and Bailey, 2008). As a performance evaluation method it is calculated as follows:

\[
r = \frac{v_e - v_b}{v_b}
\]

(2.1)

3. Entry and exit load, which are loads, imposed when the investor purchases units of the funds and when the fund redeems the units. This is an additional cost to the investors that represent a major disadvantage to her and is usually evaluated to determine the rate of return, to the investor, that overcomes this disadvantage. It is evaluated as follows:

\[
r_1 = \frac{1}{1 - \text{entry load in } 

\]  

(2.2)

4. Ex-ark, a statistical term of the linear regression model to explain the extent to which the return of a mutual fund is explained by a particular financial market. It is designated as R². In this category, beta and alpha should also be included as they indicate risk tone and excess return of funds in relation to particular financial markets respectively.

5. Rating schemes developed by independent bodies should also be sought for, to determine the relative position of funds, a service, which after due diligence search this paper concludes, is not popular in Nigeria.

For investors, evaluations of portfolio go beyond the determination of portfolio composition. They also seek to
determine how investment styles and their characteristics are defined and what role they play in the determination of future returns (Alp, 2010). For the more advanced financial markets, the first part is conducted by consulting relevant rating agencies but for the second part, scholars have advanced various methods for the evaluation of performance and the likelihood of persistence of present performances in to the future. Usually the first step is the determination of selected approaches to investment management in general, followed by the determination of strategy and finally, the particular investment style adopted.

To determine the options chosen by the manager of a portfolio scholars have used a number of methods. The first is by the determination of persistence of performance, based on the reasoning that consistency of performance cannot be from luck but from particular consistently applied practices. Portfolio performance persistence has attracted an unusually high level of attention from scholars with different interests. In the field of portfolio management, the prominent studies are those of Hendricks et al. (1993), Goetzman and Ibbotson(1994), Brown and Goetzman (1995), Carhart (1997), Cheng, Li and Wort (1999), Bollen and Busse (2004) and Lai and Lau (2009).

The second method, which Fama (1969) is the pioneer, involves the determination of tracking error volatility, which is based on the reasoning that any deviations from the volatility of an index being tracked, of a portfolio, represent an active decision of the manager. The third method, which is based on similar reasoning with the second method, is that of the determination of active index being tracked. Active shares are individual share holdings, of a portfolio, that differ, in weight from that of the index being tracked.

The methodologies of the studies cited above, included parametric and non-parametric methods. The parametric methods used are adaptations of the Fama (1969) multi-factor model and those based on either or all the three models of market equilibrium developed by Treynor (1965), Sharpe (1966) and Jensen (1968). The parametric methods, as accounted by Goec (1996), fully utilise the consistency offered by large samples especially in the ordinary least square model (OLS). Non-parametric tests suitable for test of performance persistence are the Z – test of Malkiel (1997), the cross-product ratio of Brown and Goetzman (1995) and the chi-square test of Khan and Rudd (1995). Giourouidis and Sakellarou (2009) used all the three models in testing for persistence in Greek mutual funds, though not for want of sample size, and found out that all three methods are robust to a sample size of less than thirty. The models returned the same conclusions for Giourouidis and Sakellarou, indicating the benefit of choice.

Performances of funds are further evaluated in the context of some other criteria, especially that of efficiency of the obtained result. In the traditional approach, comparisons are undertaken in terms of utility, a subjective measure. Percentage return is therefore basically adopted in such comparisons. The higher the percentage return from an investment the better. For modern portfolio management, such comparisons are based on the twin criteria of return and risk. The higher the return for a given level of risk borne the better the performance. Conversely, the lower the risk borne for a given return the better the performance of the investment manager. In both situations, a ranking of management performances is obtained. Past empirical studies in this area have tested the differences by analyzing the risk tones of mutual funds portfolios, as did Leggio and Lien (2003). Leggio and Lien used the Sharpe ratio, which is a performance rating based on the risk level borne by a portfolio as compared to the systematic risk. This study would make use of the Jensen’s alpha, for having the same potency and an additional reason of obtaining a measure that has incorporated the market performance rating in it. Passive approaches seek for returns, which, at equilibrium state of the market, is the same as that of the total market portfolio. Jensen (1968) submits that managers tend to either vary the risk of their portfolio in order achieve a higher return than the market or maintain the same risk tone to obtain the market return. The former is referred to as active strategy to management and the latter is the passive strategy to management. To differentiate the two possible approaches, the market performance is pegged at zero and a test for significant differences, through Linear Regression of variance of funds on
the market performance, is carried out. The existence of significant differences indicates the adoption of the active strategy over the passive concludes Jensen (1968). This method has been utilised by Jensen (1968), Grinblat and Titman (2003) and Leggio and Lien (2003) and the latter two have shown it to be robust to small samples with a minimum of four annual returns.

3. Methodology
The population of the study consists of all operational funds in Nigeria by December 31, 2014 that, according to SEC 2015, is up to Forty-five funds managed by Twenty-five managers. A sample of sixteen managers (represented by thirty eight funds) were selected based on the twin criteria of being operational by December 31st 2014 and being old enough to provide a minimum of four annual accounting periods. Data required are the annual pooled data on annual Net Assets Values of Mutual Funds publicly available from the SEC website. The data is then transformed into annual return using (2.1). The method selected for the test is the critical t test of alphas generated as the Jensen’s alpha. To test our assertion that “There is no significant difference in the performance of mutual funds in Nigeria”, it is then restated in terms of Jensen’s alpha at market equilibrium as follows;

\[ H_0: \alpha = 0 \]

For values of

\[ t(\alpha) = \frac{\alpha}{\sigma(\alpha)} \]  
(3.1)

from a range of alpha values of the sample;

Where

\( \alpha \) = mean of alphas of sample members
\( \sigma(\alpha) \) = standard deviation of alphas for the sample

Any deviation from the predicted value at the chosen level of significance indicates a deviation from a range of market parameters – in our case active management from passive management. The decision rule is that for a critical value \( t(\alpha) \)

of 5%, if alpha of a portfolio is not equal to zero then we may fail to accept the assertion.

Variables

\[ H_0: \alpha = 0, \]
\[ H_1: \alpha \neq 0. \]

From

\[ \alpha = R_p - [R_f + \beta_p (R_m - \bar{R_p})] = 0 \]  
(3.2)

Where

\( \alpha \) = the regressand
\( R_p \) = the regressor.
\( R_f \) = risk free rate
\( \beta_p \) = idiosyncratic risk of each portfolio
\( R_m \) = Market returns

4. Findings and Conclusion
To test the hypothesis, the annual portfolio returns of managers in the sample in order to compute the average portfolio return of each manager and variance of its portfolio for the period of this study. This is shown in table 1. Alpha of portfolio (\( \alpha \)) was computed from Jensen’s alpha (equation 3.2) with ASI as the market return and 3-months T-bill coupon as the risk free rate obtained from Nigerian Stock Exchange and the Central Bank of Nigeria. The output is presented in Table 2 (see appendix). The output was generated via Megastat version 10, which is an excel add in.

Table 2 shows a coefficient of determination (\( r^2 \)) value of 0.881 or 88.1% indicating the systemic component of mutual funds in Nigeria. This risk cannot be diversified away, for which the investors must receive a premium. The table also shows a coefficient of correlation (\( r \)) value of 0.938 indicating that there is a high and positive linear correlation between the general market returns represented by the ASI and the returns of mutual funds in Nigeria. The alpha intercept is significantly different from the predicted alpha at this extreme p-value. This points at the significance of the differences between the performance of mutual funds in Nigeria, which is an indication of predominant adoption of the Active strategy by mutual funds managers in Nigeria.
The finding of this study, that mutual funds’ managers in Nigeria predominantly adopt the active strategy to investment management, is perhaps more from necessity than by design for the following reasons. The number of investible instruments in the Nigerian market is low and a manager would not be hard put to recall them by name. In such a situation, it is more prudent to follow the market consensus, in terms of performing sectors and their attached risk levels, instead of passively selecting the market. In addition, the choices available to differentiate one portfolio from another are limited. A manager can only select from equities, bonds, real estate or cash; no other alternatives. A more obvious reason is that more money goes to the investor because of lower running expenses from less information search. This is a very strong motivation for participation in mutual funds with its attendant advantages to the Nigerian economy. The indication of the finding that managers of mutual funds in Nigeria adopt the active strategy and the position of high co-linearity with ASI indicated by the coefficient of correlation is a pointer to selective buy and hold rather than a full-blown active strategy. It is a fact that the banking sector has outperformed all other sectors of the financial markets in Nigeria and there are sectors that have been almost dormant. As Simusi (2011, p.2) puts it “The market has been predominantly equity-driven with the Banking sector making up an important proportion of the total market capitalisation”. This kind of situation promotes the avoidance of the less active sectors and show up in similar tests as an active strategy. In this case, the test result indicates a high similarity between market composition in Nigeria and the composition of mutual funds (coefficient of determination \( r^2 \) stands at 88.1% and coefficient of correlation \( r \) of 93.8%). Thus, it is the opinion of this paper that the Investment Managers in Nigeria that manage Mutual Funds predominantly practice the passive strategy albeit with a high bias to the more active sectors of the Nigerian market.

5. Recommendations
This paper advocates the presence of managers with both the active and passive strategy, in a market. Their presence brings about more rapid advancements in market depth and efficiency. There is more to risk than what the general market awareness can show. Managers should endeavour to educate themselves in modern scientific models of risk assessment. The simple avoidance of perceived low performing instruments is not active management enough. An improvement of the quality of management would ensure better effectiveness and efficiency of collective investment schemes in Nigeria. Paper qualification is the bottom line, but performance should be the ultimate criteria for maintaining a manager at the helm of funds. There should be realistic short-run targets to avoid catastrophic long-run failures.

References


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### Appendix

#### Table 1 Regression Variables of sample

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<td>1</td>
<td>Standard Unit</td>
<td>5%</td>
<td>6%</td>
<td>7%</td>
<td>8%</td>
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<td>0.04396</td>
<td>0.62</td>
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<td>-5%</td>
<td>-6%</td>
<td>-7%</td>
<td>-8%</td>
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<td>0.033245</td>
<td>0.37</td>
<td>0.24</td>
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<td>3</td>
<td>Chapell Hill</td>
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<td>10%</td>
<td>10%</td>
<td>10%</td>
<td>10%</td>
<td>0.005</td>
<td>0.007224</td>
<td>0.98</td>
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<td>Sterling Capital</td>
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<td>13%</td>
<td>14%</td>
<td>15%</td>
<td>-0.02</td>
<td>0.013197</td>
<td>0.19</td>
<td>0.12</td>
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<td>Zeal Bank Plc</td>
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<td>12%</td>
<td>13%</td>
<td>14%</td>
<td>15%</td>
<td>-0.04</td>
<td>0.034179</td>
<td>0.30</td>
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<td>6</td>
<td>Assets and Resources Mag Co Ltd</td>
<td>24%</td>
<td>23%</td>
<td>22%</td>
<td>21%</td>
<td>20%</td>
<td>0.09</td>
<td>0.048968</td>
<td>0.65</td>
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<td>FDMS Asset Mgt Ltd</td>
<td>15%</td>
<td>16%</td>
<td>17%</td>
<td>18%</td>
<td>19%</td>
<td>0.044</td>
<td>0.039774</td>
<td>0.42</td>
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<td>Cadence Asset Mgt Ltd</td>
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<td>20%</td>
<td>19%</td>
<td>18%</td>
<td>0.035</td>
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<td>Koko Omega Asset Mgt Co Ltd</td>
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<td>23%</td>
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<td>25%</td>
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<td>28%</td>
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<td>34%</td>
<td>33%</td>
<td>32%</td>
<td>31%</td>
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<td>Equity Fund Plc</td>
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<td>34%</td>
<td>33%</td>
<td>32%</td>
<td>31%</td>
<td>0.042</td>
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<td>Union Trustees Capital Ltd</td>
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<td>4%</td>
<td>4%</td>
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<td>-0.011</td>
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<td>CSD</td>
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<td>24%</td>
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Source: Author Computations

#### Table 2 Restricted Regression Output for Sample

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<th>Regression Analysis</th>
<th>n</th>
<th>r</th>
<th>r2</th>
<th>Std. Error</th>
<th>Source</th>
<th>df</th>
<th>MS</th>
<th>F *</th>
<th>p-value</th>
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<td>ANOVA</td>
<td>16</td>
<td>0.881</td>
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<td>0.0592</td>
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*Regression with 1 degree of freedom.*
<table>
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<th>Variables</th>
<th>Coefficients</th>
<th>Std. error</th>
<th>t(df=14)</th>
<th>p-value</th>
<th>95% confidence interval</th>
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<td>Intercept</td>
<td>0.0586</td>
<td>0.0115</td>
<td>5.484</td>
<td>0.000</td>
<td>0.0349 - 0.0828</td>
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<td>Ap</td>
<td>0.7283</td>
<td>0.0720</td>
<td>10.166</td>
<td>0.000</td>
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Predicted values for x = Ap

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<th>95% Prediction Interval</th>
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<td>0</td>
<td>0.00859</td>
<td>0.00583 - 0.01759</td>
<td>0.00720 - 0.01819</td>
</tr>
</tbody>
</table>

Source: Generated by Megastat version 10