Abstract

The growth in the mutual funds market in Kenya has led to great interest in the risk return relationship in this market. Various asset pricing models can be utilized in empirical testing to determine the dominant risk factors affecting returns. This study adopted the arbitrage pricing model to identify and analyse these economic factors. The Treasury bill rate, GDP growth rate, inflation size and the fund size were the independent variables selected for the model whose beta parameters were analysed. The study was conducted for the period between 2006 and 2012. This study found that a positive relationship existed between mutual funds returns and the Treasury bill rate and market interest rates. A negative beta was computed for GDP growth rate, inflation rate and fund size factors. These factors represent risk in the mutual funds market and a positive risk return relationship was computed from the model. Inflation rate, market interest rates and GDP growth rate were observed to have the greatest impact on mutual funds returns. The fund size had a lower but significant coefficient while the beta for Treasury bill rate factor was insignificant. The study found that expansionary economic policies, marketing and diversification business strategies are necessary to manage economic risks that affect returns in the mutual funds market.