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SHIFTING INVESTMENTS STRATEGY FROM EQUITY FUNDS TO MONEY MARKET FUNDS – THE CASE OF ROMANIAN OPEN - END FUND MARKET DURING THE FINANCIAL CRISIS

I. RADU[1] C. C. SAVA[2]

Abstract: *Mutual funds are one of the key suppliers of liquidity in Romanian capital market. This paper uses quarterly data on Romanian open-end funds starting with 2006 until 2010. We find that significant negative flows (outflows) were registered beginning with the end of 2007 (equity funds), during 2008 (equity funds, balanced funds, other funds and bond funds in the last 2 quarters of the year) and from 2009 to 2010 (in the case of money market funds). There is evidence that the changing market conditions attract differently the incoming flows in these mutual funds. This is the reason why such perturbations affect investors' confidence for these investment vehicles and impose the reorientation of the investment funds and of their investors to other alternatives in order to preserve their capital.*

Key words: *mutual funds, equity funds, money market funds, fund flow mutation.*

1. Introduction

This paper explores the annual pattern of open-end fund flows in Romania during 2006-2010 and examines the sheer volatility of flows as investors may enter and exit funds at any time.

We focus our study on a data set from the Romanian National Securities Commission (abr. CNVMR), that maintain investors' quarterly purchase and sale of country funds.

This study provides two contributions.

First, it provides an overview of the recent total fund flow patterns in Romania, which might be a source of growth for mutual fund industry. Second, it provides an analysis of investors flows into mutual funds in Romania. Thus far, little is known about the behavior of investors' flows into Romanian mutual funds.

The paper is organized as it follows. Part 2 presents the global trend observed in the last 5 years, review that identifies the pattern of a general strategy applied all over the world. Next sections relate the Romanian market evidence on the transfers of investments between equity funds and money market funds, and the following section 6 concludes.

[1] PhD. Student in Finance, *Babes Bolyai* University of Cluj Napoca.
[2] PhD. Student in Economics, *Lucian Blaga* University of Sibiu.

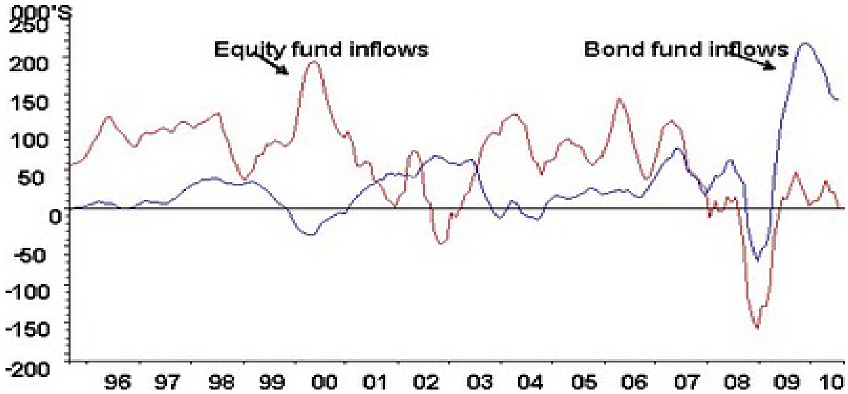

Fig. 1. *The capital inflows in global equity funds and bond funds 1995-2010*
Source: Montier J. (2010), www.behaviouralinvesting.com

2. A review on the Global Pattern

Analyzing the economic situation in the time period 1995-2010 and the additional capital flows in/out from the investment funds, J. Montier (2010) notes that one category, namely equity funds have experienced a steady growth beginning with year 2000 (the year of information technology sector expansion, the start of „era dot.com") until 2009, when an investment transfer from equity funds to bond funds take place, the last ones performing the highest increase of capital inflows at the time.

However, the boom of bond funds registered during 2009 (figure 1) hasn't depended only on the additional volume of capital flows, but also, on the overall performance of the securities (higher yields/returns and safe placements).

Based on the analysis of returns offered by these two investment instruments (share/stock and bonds), the ICI study [1] demonstrates that the demand for stock funds, respectively capital inflows were higher than the one in the equity funds, although the shares yield (showed by the MSCI World Index variation) was surpassed the stocks yield (showed by the variation of Citigroup Board Investment Grade Bond Index).

Therefore, from 2009 to 2010, the Figure 2 points out that, when the average yield was 6% for the corporate bonds and 4% for the municipal bonds, the investments in bond funds increased significantly at about 20 billion USD, while the equity funds marked a substantial decrease of the capital inflows. Moreover, the equity funds started to register outflows at 39 billion USD in 2009 and about 96 billion USD in 2010, even though the MSCI World index grew annually at an average rate of 25% from late 2008 until late of 2010.

The shift from stock funds into bond funds was duly generated by changing the investors risk tolerance as a response to the global economic climate changing. In addition, ICI emphasizes that the recent growth of bond funds related to the historical evolution, is attributed to other important factors. Thereby, the development of bond funds market was ruled even by demographic facts such as: an aging population, a decreased appetite for risk for all age levels and the expansion of selective allocations of capital in funds (i.e. funds of funds).

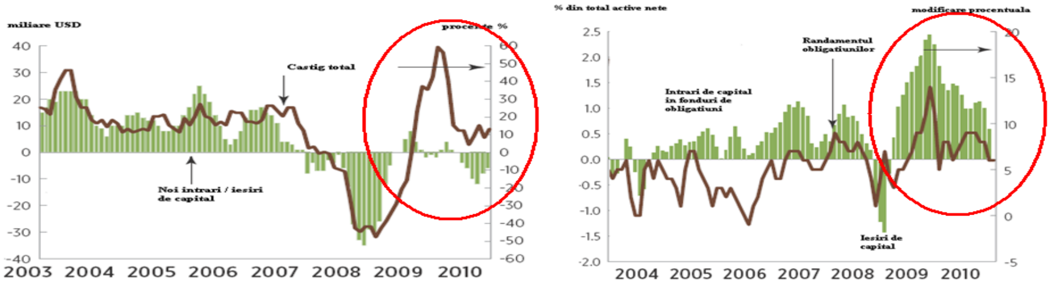

Fig. 2. *The capital inflows in equity and bond funds related to their returns*
Source: ICI Factbook 2011

Directly related to the aging population factor, were identified other influential items for bond funds preference, like: the retirement of the 40s generation (so called, Baby Boom Generation), the provision for risk reduction due to age and the need to ensure a stable benefit.

Beside this, the reducing risk tolerance shown in all age groups, leads the investments in bonds, as long as the economic environment proves to be unstable.

As a consequence to the changing investment strategy, from equity funds and even from balanced funds into bond funds or money market funds, the emerging economies of Asia and Africa were advantaged since the investors were concerned of new investment alternatives. Moreover, the imposition of such measures was needed in order to avoid crossing a period of maximum regress.

In fact, the avoidance of the plummeting of international share prices during 2007 and 2008 imposed any opportunities to redirect investments from high risk funds toward those with strong prudential strategies, such as bond and money market funds. But, by the time when the global economy reconverts, we can expect a new divert of investments, from bond funds into the high yield ones – equity funds.

3. The dynamics of Romanian mutual fund market during the financial crisis

Since 2005, on the background of a "functional market economy" declared status and the accession of Romania into EU, have emerged the premises of economic stability and attractiveness to new investors. Nevertheless, promoting high returns in investments funds than the interest rate for bank deposit accounts, also have generated a growing incentive of investors (individuals and institutional) in these type of investment vehicles. As a consequence, even banks have expanded their range of services by launching subsidiary entities that manage investment funds, the so called Asset Management companies (abr.SAI).

The advantages (e.g. professional management of investments) and the association with popular names of Romanian banking system (e.g. BCR, BRD, Raiffeisen, Banca Transilvania, OTP, Bancpost, Carpatica, etc) were factors that have corroborated to the seizure of a significant weight of domestic mutual fund industry by increasing the investor confidence in these alternative investments. Thus, it can be observed by the increasing number of investors after 2000. However, the investors' trust has been gradually gained following the major crises that have damaged investors' confidence (first in 1994 – the collapse of FMOA [2] and second in 2000 the case of FNI [3] and FNA [4], both managed by SOV-Invest).

As a result, the active open-end funds in 2010 embedded a total of 211.122 individual and institutional investors which accounts an aprox. 3 times increase than 70.978 investors in 2005. For the whole analysed period of 5 years, the Romanian mutual funds attracted additional institutional investors with an average rate of 2,39% and individuals with a share of 97,61%.

In addition, the investors increasing trust can be explained due to: the investment policy of the open investment funds, the level of efficiancy achieved (high yield return), their high liquidity and solvency, investors' confidentiality, the guarantee of invested amount by a certain level of compensation, to which is added the tax exemption of gains from selling the units in 2009 (highest rate of incresing the number of investors with 74,64% over 2008 – which comprise +162,74% for institutionals and +72,60% for individuals) and the differentiate tax rates from 2010, compared with the holding period.

Using the structure of the mutual fund industry, the *balanced funds* held for the entire analysed period, the highest market share among total number of investors, with an annual average rate of increase of 144,93%, while the *bond funds* increased with an annual average of 37,7%, the *equity funds* with 3,63% and the *other funds* with a multiplier of 61 times in 2010 from year 2007. This notable increase is caused by the fact that it was not defined as structure until 2007 and it might comprise funds that have been retreated from the predefined categories of funds. Therefore, this situation can explain the reduced rate held by the equity funds, which have been transferred to the other funds category while they don't fulfill the category conditions.

Overall, the last 3 years reporting on the evolution of the total number of investors conducted to appreciate the fact that investors in Romanian prefer the following order of open-end funds: first, monetary funds, second – balanced funds, third – bond funds and equity funds. However, for ordering the investors' preferences is necessary to take into account other determinants (i.e. the value of assets managed by the funds, total amounts of subscriptions and redemptions, etc.), as it follows in the next section.

4. Money market and equity funds evidence on Romanian mutual fund market

4.1. Money market funds expansion

The dynamics of money market funds began with the decrease of interest rate on Treasury Certificates and bank deposit accounts in 2005-2006, a situation that led to reducing the classic investments with aprox.10pp in 2006 from 2005s' share. Beside this, the scarce development of fixed income instruments and funds has impaired the development of money market funds in Romania (Filip A., 2008), favoring on the other hand, the proliferation of other categories of investments (i.e. balanced funds and equity funds). Therefore, not only the investors have shifted their capital from one category of funds to another, even funds and portfolio has changed, turning their holdings into bond funds, as it is the case of Stabilo Fund. [5]

However, the 2007-2010 crisis, led investors to shift their investment funds from other categories that have gained ground during 2005-2006 into monetary funds market which has grown to encompass a number of 5 funds in 2009 with a quote of 53,35% of the total assets managed by the Romanian mutual funds.

Money market fund statistics – Romanian domiciled mutual fund market Table 1

Indicators/years	2004	2005	2006	2007	2008	2009	2010
% money market funds assets in total market assets	57,12%	31,85%	20,20%	13,83%	37,14%	53,35%	57,12%
Annual increasing rate n+1/n	-	-9,78%	18,42%	3,21%	164,67%	411,57%	70,97%
% of total number of funds	10,53%	8,70%	6,25%	7,32%	9,62%	9,80%	n.a
% of investors	n.a	6,74%	5,91%	5,00%	12,41%	42,26%	50,13%

Source: authors' own calculations on AAF data and CNVMR statistics

The affiliation of the 5 money market to banks has revive the investment fund market in Romania starting with year 2007. For example, BCR Monetar and Raiffeisen Monetar funds ended up attracting a 6 times higher number of investor in 2009 and 10 times higher in 2010 than in 2008. Also, these two funds, had draw in 2008 and 2009 the largest capital inflows of aprox. 31% annualy of the total underwritings in money market funds.

The establishment of two new funds in 2010 (i.e. iFond Monetar and Certinvest Monetar) and the conversion of Fortuna Gold bond fund into monetary fund, shows the redirecting strategy of asset management companies to the new needs of the investors. As a result, in 2010, all the seven [6] active monetary funds, reached to manage 55,68% of the Romanian total assets of open-end funds (i.e. 3056,12 million RON).

For the analyzed period (2007-2010) the money market funds experienced a high liquidity on the account of the underwritings and redemptions made in unit funds (placing the money market funds on the second rank of highest flows), both affecting the total amount of subscribtions made in the Romanian UCITS funds (in rou. OPCVM) within a proportion of over 50%.

Even though by 2007 equity funds drew the largest inflows of capital (holding 61.84% of the total net sales), the following period 2008-2010, due to a increased market volatility and the undervaluation of financial instruments, forced the withdrawal of a great number of investors and increased the level of outflows (buybacks) of fund units. Nevertheless, the balanced funds have been affected by the investors panic, recording significant outflows with 23 million RON beyond the subscriptions level. In 2009 and 2010, the situation remained unchanged, money market funds accounted for the majority quote in the new net sales with a percentage of 62.67% of the mutual market data. Thus, we can say that money market funds maintained their place in investors' preference and adjudicating an average market share of 47.48%, by attracting and managing mostly investments allocated in Romanian mutual funds.

In conclusion, the majority of market share held by the money market funds is mainly due to the 2008-2010 climate, while the emergence of the crisis was "reluctant" to investors and it presumed the shift toward other investments that guarantee safer at a low risk return as those offered by traditional bank deposits.

4.2. Equity (share) funds short breakdown

Romanian open-end equity funds represent 28.02% of the Romanian mutual fund market, managing total assets of 17.58% and attracting 13.21% investors of the market (*note.* the rates are calculated as an average for the analyzed period).

The specificities of these investment funds (i.e. indirect access to shares listed on the Stock Market and their returns; assuming a lower risk than direct investments; high exposure to stock market instability and respectively high vulnerability of share market compared to other categories of funds) (Filip A., 2008) – have forced this equity funds to reduce significantly the inflows volume in the period ahead of the last quarter of 2007.

Equity funds statistics – Romanian domiciled Mutual Fund Market 2004-2010 Table 2

Indicator/year	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**Average rate of increase**
% Equity funds assets in total asset	9,0%	21,3%	32,3%	41,8%	9,1%	5,6%	4,1%	**17,58%**
Annual increasing rate n+1/n		285,08%	182,63%	95,09%	-78,58%	119,11%	20,36%	
% of total number of funds	26,32%	34,78%	37,50%	34,15%	21,15%	17,65%	24,56%	**28,02%**
% of total number of investors		16,71%	15,21%	20,82%	13,27%	7,74%	5,54%	**13,21%**
Changing rate of investors			-4,77%	51,03%	-26,77%	1,83%	-3,16%	

Source: processed by authors using AAF data

Before the financial crisis, equity funds gathered most of the new inflows of capital in Romanian mutual funds (with an average rate of 61.84% of total net sales), mainly through one funds, i.e. BT Maxim Fund. Instead, the 2008 market conditions led to a substantial reduction in inflow volume only at 6,051 million RON from 52,511 million RON in 2007. Most of the share funds were unable attracting new investments, i.e. Raiffeisen Actiuni and Investica Altius, which have been regrouped in "other funds" category.

Although in 2004-2007, the equity funds showed a steady increase under the impact of positive development of the Stock Market, increasing investors' risk appetite and due to the decrease of interest rates on deposits, Treasury bills and other savings products – in 2008, the funds market has shrunk substantially, reaching slightly above 2006 levels, while the value of assets managed by equity funds were reduced to 85,385 million RON, down by 78.58% from 2007, when the funds managed 398,536 million RON. Instead, in the next years - 2009 and 2010 - while significantly increases have resulted in the total asset volume and in number of funds formed as equity funds, they didn't overcome the results achieved in 2007. This indicates low reluctance of investors for these types of investments, caused indirectly by the financial crisis, and directly by the poor performance of equity funds' backed companies that directly is thrown over the investment fund portfolio performance. As a fact, the investors' number was being reduced with 26.77% in 2008 compared to 2007, and down by 27.78% in 2010 compared to 2007. However, this restricting activity of open-end share funds directly depends on the changes made in the structure of the investment portfolio for these funds. For instance, 2008 and 2009 capture a restoration into "other funds" category of a large part of equity funds, on behalf of non-compliance with specific criterion of equity funds classification.

The restructuring of equity funds was required duly to the high volatility of shares market during the financial crisis period, which leads to a conservative share valuation and to a substantial decrease in performance of investment funds. As a consequence, in order to avoid panic on the market, asset management companies have appeal to altering the structure of equity funds portfolios, by opting to transfer their assets to other categories or to merge to another (this is the case of Premio Fund which has been merged with Integro Fund in 2008, and re-categorized into diversified funds).

Year 2010 restores the number (i.e.14 funds) of the functional equity funds, as it was in 2007 and awards its second position on the open-end fund market (1st – balanced funds), with a share of 24.56%

of all 57 Romanian open-end funds. Among these, 5 equity funds include more than 80% of the total assets allocated in Romanian equity funds, with the following rates: BT Maxim 27.98%, KD Maximus 18.93%, Raiffeisen Prosper 15.68%, BT Romanian Index ROTX 10.36% and Raiffeisen Actiuni with 7.78%.

5. Trend pattern, seasonality and cyclical presumptions

The previous overview of the evolution of the money market and equity funds identified a different dynamics on their development during the analyzed period.

Also, the analysis implies applying analytical methodology on verifying any trend patterns.

First, the correlation analysis between the two funds, indicates the existence of a significant reverse linkage between money market funds (0.015 for a level of significance of 0.05), and a negative correlation in the case of equity funds.

Second, the seasonality analysis for the investment flows in money market and equity funds, revealed that:

- equity funds maintain during 1st, 2nd and 3rd quarter a constant level of net flows of capital, while the last quarter highlights almost every year an increasing rate of inflows, except year 2008;
- the oscillating flow in money market funds exposes two positions: first, between 2006-2007 increasing inflows and second, beginning with 2008 to 2010 increasing outflows.

Closely related to money market and equity funds, the “other funds” category explains some of the inflexions observed in the changing rate of capital inflows and outflows. By applying Kendall correlation coefficient, it has been note the fact that between the evolution of money market and equity funds and this category is a symmetric inter-correlation (i.e. Kendall coef (aF,FA)= 0,328, for a signif.of 0,044 and Kcoef (aF, FM) = 0,444, for a signif.of 0,006).

By removing the seasonality disturbance effects, cyclical indices have been determined. Both values registered, above or below one, marking the expansion of investments in mutual funds, respectively noting the intensity of the industry recession (between the 2nd quarter of 2007 and 1st quarter of 2009, mainly on the case of equity funds). Moreover, equity funds act cyclical, recording two waves during the analyzed period (2006-2008 and 2008-2010).

As expected, the money market funds encountered a peak during the 5 year analysis, defined by wide amplitude in the 4th quarter of year 2008 when these funds attract additional capital of 14 times higher than previous period.

Knowing the inverse correlation of money market funds with other funds, the spectacular growth of capital inflows can be explained on the sustained contraction of the others.

However, whereas the series of data on mutual funds was summarized in only 5 years and a poor history of records, we can’t deliver an exactly analysis of the evolution of this fund flows.

6. Final remarks

Taking into account the fact that all markets are cyclical, it is important to identify the market trends to prevent any disturbances of the market and of the entire economy that can affect investors’ capital.

For now, it’s important identifying the reorientation of investments once the market is rearranging, and the reverse strategies might be applied.

Notes

[1] ICI Factbook, 2010.

[2] FMOA stands for Business Professionals Investment Fund (literally translation).

[3] FNI – National Investment Fund.

[4] FNA – National Administrated Fund.

[5] In 2006, Stabilo Fund has moved from Monetary Fund classification into Bond Funds.

[6] Simfonia 1, BCR Monetar, OTP ComodisRO, Raiffeisen Monetar, Fortuna Gold, iFond Monetar, Certinvest Monetar.

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