

GLOBAL TENDENCIES IN INVESTMENT FUNDS MARKET DEVELOPMENT

Prof. Ioan E. NISTOR, PhD.
Ioana RADU, PhD student
“Babeş-Bolyai University”, Cluj-Napoca

1. Last 5 years evidence

The outbreak of the recent economic and financial crisis during 2006 – 2009 forced the decline of the entire economy and investment funds activity due to the panic among investors and their reticence imposed by this economic impasse status. This situation led inevitably to a resizing process of the global investment fund industry.

The development of investment fund market over the last 5 years shows exactly its dynamism by reaching a climax in 2007 with total assets managed worldwide of 26,130 billion USD, also followed by the largest contraction (of 8.48%) in the last decade.

Although the end of 2007 marked the biggest contraction in the last decade, the worldwide net asset of the mutual funds was approx. 3 times larger in the last 5 years, due to the surprising development of the European and Asian investment funds.

A short overview of the records on the international market of investment funds has identified the following notable aspects:

- 53% of the worldwide assets are managed by American investment funds, from which 90,97% is defined by the investment funds from United States of America (US). As a fact, the assets managed by the US investment funds reached in 2009 an amount over 11,000 billions USD, extent that hasn't been reached by any other state. Therefore, the

US investment funds precedents and its dynamism generated a model of guidance for the all other states;

- year 2007 records the largest contraction along the historical development of the investment fund industry. The 2007 collapse has overcome the 2002 crisis;

- the investment funds located in Asia-Pacific area ranks the 3rd place among the investing preferences for the allocation of capital (with a rate of 38% of the worldwide assets). The area is defined by the investment fund markets from Australia, Japan and Hong King, which totalize a rate of 70% of the Asian market. However, in relation to the active funds number, the Asian market is concentrated around Korea and Japan, with a total rate of 80% (58,97%, respectively 21,91%).

- other economies where favored during the global economic crisis. For example, the Communist Chinese economy, recorded a steady growth of 8,7%, creating conditions to attract the investors from the areas affected by the crisis; Therefore, the strengthening of the emerging economies, will refocus the investors and their strategies into these areas. Also, the Asian market and other emerging markets expansion will generate the multiplication of the funds number in these areas and will attract significant amounts of capital.

2. Global review

2.1. Transfers between funds

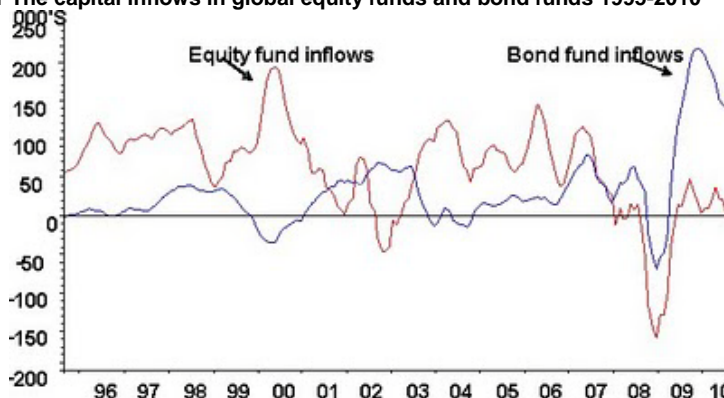
Analyzing the economic situation in the time period 1995-2010 and the additional capital flows in/out from the investment funds, J. Montier¹ notes that one category, namely equity funds have experienced a steady growth beginning

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

Figure 1 The capital inflows in global equity funds and bond funds 1995-2010



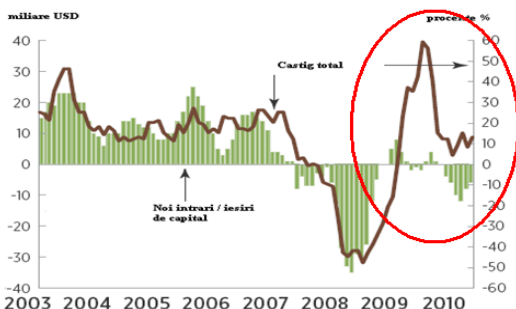
source: Montier J. (2010), www.behaviouralinvesting.com

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

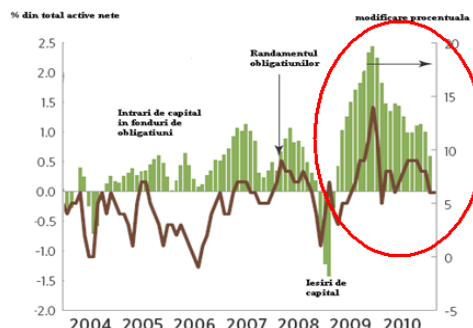
instruments (share/stock and bonds), the ICI study² demonstrates that the demand for stock funds, respectively capital inflows were higher than the one in the equity funds, although the shares yield (showed by the MSCI World Index variation) was

Figure 2 The capital inflows in equity and bond funds related to their returns

Evolutia intrarilor de capital in fondurile de actiuni in raport cu performanta globala a titlurilor - indicele MSCI World



Evolutia fluxurilor de capital in fondurile de obligatiuni in raport cu randamentul acestora - variatia indicelui Citigroup Broad Investment Grade Bond Index



source: ICI Factbook 2011

¹Montier J. (Aug.31, 2010) – The bond bubble - a sterile debate on semantics, online at: <http://behaviouralinvesting.blogspot.com/2010/08/bond-bubble-sterile-debate-on-semantics.html>

surpassed the stocks yield (showed by the

² ICI Factbook,2010

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).

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 to the ensure of 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.

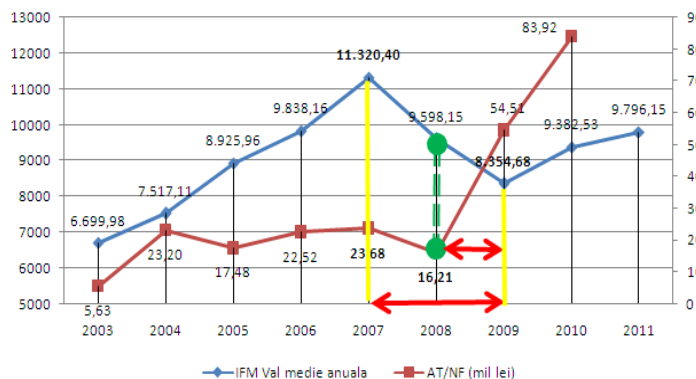
As a consequence to the changing investment strategy, from equity funds and even from balanced funds into bond funds or money market funds, the emerging economies of Asia and Africa were advantaged since the investors were concerned of new investment alternatives. Moreover, the imposition of such measures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

2.2. Short prior to national investments

Given that the global economy is on the mend for rebalancing, it is assessed a reorientation of international investments into investments in national companies which have achieved low performances

Figure 3 Mutual funds total asset in relation to Mutual Fund Index – case of Romanian Mutual Fund Market (yearly data)



Note: The annual IFM was calculated as an average of the weekly indices, source: kmarket.ro

(profits) during the crisis, but those with the main activity among the economic sectors that are following the sector economic cycles.

An obvious case of this strategy can be exposed by the evolution of net assets of open-end investment funds (mutual funds) in Romania, depending on the Mutual Fund Index (abr. IFM). By visualizing their dynamics in the period 2007-2010 (as seen in figure 3), we can definitely identify the reorientation of investments once the index is decreasing, leading to an impairment of quotation of the unit funds (event that shaped the market trend assumptions and speculation).

2.3. Altering the investing sector

Based on different models of analysis of business cycles – Dow Theory, Elliot’s waves, Kondratyev long economic cycles

lengths of the expansion and contraction stages, Stovall S. has shown⁴ that at certain moments of expansion some sectors are ahead of the average level of economy growth, observing that during the four stages of a cycle were noticed positive returns, as follows in figure 4.

The Stovall strategy of alternating capital allocations between industries/sectors depending on the length of the cycles provides a guidance for investors to those sectors or areas that might experience a positive development, suggesting to redirect their investments to others once a sector has reached maximum development.

The Stovall model is considered to be relevant to the extent that the global market is affected by the emergence of disturbing events with a delay of 1 month (Montier J. et al, 2007, Stangl J. et al. 2007, Jacobsen B. et al., 2009) and comprising 3 to 6 months, so that

Figura 4. The grouping of sectors on economic cycle stages

Period of Expansion			Period of Recession	
Early Expansion - Stage I	Middle Expansion - Stage II	Late Expansion - Stage III	Early Recession - Stage IV	Late Recession - Stage V
Technology: Computer Software Measuring & Control Equip Computers Electronic Equipment Transportation: General Transportation Shipping Containers	Basic Materials: Precious Metals Chemicals Steel Works Etc Non-Metallic & Metal Mining Capital Goods: Fabricated Products Defense Machinery Ships & Railroad Equip. Aircraft Electrical Equipment Services: Business Services Personal Services	Consumer Staples: Agriculture Beer & Liquor Candy & Soda Food Products Healthcare Medical Equipment Pharmaceutical Products Tobacco Products Energy: Coal Petroleum & Natural Gas	Utilities: Gas & Electrical Utilities Telecom	Consumer Cyclical: Apparel Automobiles & Trucks Business Supplies Construction Construction Materials Consumer Goods Entertainment Printing & Publishing Recreation Restaurants, Hotels, Motels Retail Rubber & Plastic Products Textiles Wholesale Financial: Banking Insurance Real Estate Trading

source: Stovall (1996)

and the NBER model, Stovall S.³ in 1996, using historical data from 1854, demonstrated that the economic sectors follow a cyclical evolution like the economy development status.

Regarding the Standard & Poor’s nine industrial sectors in relation to the economic cycles and to the related

investors could act in time to prevent risk. This sector rotation model related to the cycle stages development, can generate a combined investment strategy by segmenting capital in many industries,

³ Stovall S. (1996) – *Standard and Poor’s Sector investing*, McGraw-Hill, 1996

⁴ prin observarea abaterii frecvențelor performanțelor diferitelor sectoare în raport cu evoluția indicelui industrial S&P 500, cu mențiunea utilizării unor durate aproximativ egale între stagiile ciclurilor de dezvoltare identificate în perioada 1948-2006

and then, reversing them from one sector to another in relation to the stage of development.

Similarly, the Morgan Stanley Capital International (MSCI) has reported a study⁵

utilities and even energy sector) are correlated in an inverse relationship showing their defensive character to the economic cycles, favoring the economic recession.

Table 1 Correlation of MSCI Regional Index and CLI Index created by OECD for 10 economic sectors according. Global Industry Classification Standard - GICS

Index	Energy	Materials	Industrials	Consumer Discretionary	Consumer Staples	Health Care	Financials	IT	Telecom	Utilities
MSCI World	-0.27	0.22	0.24	0.24	-0.53	-0.54	0.09	0.28	-0.14	-0.47
MSCI USA	-0.17	0.18	0.26	0.17	-0.45	-0.48	0.06	0.26	-0.18	-0.40
MSCI Europe	-0.25	0.26	0.29	0.24	-0.39	-0.40	0.12	0.25	0.00	-0.26
MSCI Japan	-0.12	0.16	-0.06	-0.07	-0.39	-0.26	0.19	0.28	-0.09	-0.50

Source: MSCI Barra and OECD, monthly data

on account of historical data of over 33 years (1976-2009), depending to their identified expansion and recession periods defined by the OCDE by the variation of composite development indicator (CLI) and comparing them with the MSCI World Index grouped by different categories of industries.

By analyzing the relationship between the performance of different economic sectors closely with the economic cycles, they found that some of these areas entail a cyclic evolution synchronized with the expansion of the economy (the case of industrial production, consumer discretionary, IT), while others were defensive to this development (consumer staples, health care and utilities). Moreover, the regional analysis on US, Europe and Japan with the related MSCI indexes have identified that these indexes have a different behavior in correlation with the CLI index. More precisely, the defensive sectors significantly exceed the performance of cyclical sectors.

According to the results obtained in table 1, the positive correlation with the economy can be observed for the dark green highlighted sectors (IT, industrials, materials, financials and consumer discretionary), while other three sectors (consumer staples, health care products,

However, by referring to the current economic conditions, we appreciate that certain industries under early development such as telecommunications will be those that will attract the largest investments.

3. Current impact on mutual fund market

Taking into account the fact that all markets are cyclical, the market expectations during the last 5 years have demonstrated that the worlds market leadership is shifting since the emerging world is no longer perceived to be a „sweet point”, especially the emerging markets of India and China.

Beside these, the outlook for 2011 (Dexia Asset Management) assures the following changes:

- as H1 will be dominated by inflation, cyclical and momentum growth stocks will lag;

- H2 will be dominated by the US bond market, and GARP (Growth At a Reasonable Price) stocks will make a comeback to regain their market leadership.

Therefore, in order to preserve the capital, investors started to change their investment styles and their allocation into investment funds.

The good economic news flow in developed market economies (US, Germany) over the last couple of months in 2011, along with more positive echoes from the European authorities around the

⁵ MSCI Research Bulletin 2009 - http://www.msicibarra.com/research/articles/2009/Sector_Performance_Across_Business_Cycles_Nov_2009.pdf

sovereign debt issue, appears to have given the market increased confidence with regard to the economic cycle.

Therefore investors are finally rotating into value, which traditionally performs well at this stage of the cycle.

The most important shift we can see in 2011, year-to-date, is that from growth into value. As growth was clearly scarce during this period, investors ploughed their cash into any stock with a sustainable growth scenario. As a consequence, the predilection for growth stocks had become overdone and the spread between value and non-value stocks had become extreme.

We can also highlight the shift between global companies (especially those with a strong foothold in emerging markets), which outperformed significantly in 2010, and domestic companies, which underperformed dramatically, especially those on the European periphery (Italy, Greece, Spain, Portugal and Ireland).

4. Final remarks

During an ever-changing environment, the evolution of mutual fund market highlights the dynamic nature of the financial services industry.

Being aware of the evidences on the market trends, we can indentify four tendencies in the global market of the investment funds:

1. the shift of investments through transfers between funds (i.e. from equity funds into bond funds and vice-versa);
2. the refocus of short-term investments to national investments;
3. the sector rotation in relation to the stages of the economic cycle, and
4. targeting investments to emerging areas as Africa and Asia (as China emerged as the new global growth engine).

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