

# INDICATORS OF ROMANIAN MUTUAL FUNDS PERFORMANCE

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*The Romanian capital market seems to continue a positive process of convergence to other European markets in terms of market indicators and market infrastructure as it benefits from harmonized regulation to best standards and practices, which stimulate growth. Mutual funds represent a very strong investment vehicle by offering investors access to the stock-exchange growth and the monetary market with less effort, money and risks than the direct investment. These investment vehicles raise a great number of questions, most of them related to their performance evaluation. The main question is whether actively managed mutual funds managers are able to add value for their investors. We will analyse in this paper Romanian mutual funds performance indicators and their evolution during the last years. Romanian mutual funds industry is poorly developed, mutual funds assets detaining an insignificant percent in the GDP.*

*Keywords: active management, mutual fund, performance evaluation, performance indicators*

## **Introduction**

Comparative to the situation in other member states, Romanian investment funds hold an extremely low market share in the financial intermediation institutions structure. At a global level the net active value of mutual funds has doubled in the last seven years especially due to an impressive increase in Europe and Asia. In Europe a substantial increase of almost 30% has taken place in 2006 (from \$ 6 trillions in December 2005 to \$ 7.7 trillions in December 2006), Europe controlling 36% of mutual funds global actives comparative to the share of 34% in 2005.

Even if in Romania the growth ratios of mutual funds actives have been very raised in the last years, there value is still extremely low in comparison to other European member states. In our opinion this is not a reason of concern since Romanian mutual funds begin to regain investor's trust and to become an attractive investment vehicle for all categories of investors. More than that Romania's integration in the UE facilitates Romanian investors' access to foreign mutual funds and raises the competition and creates the premises of an adequate functioning framework more rigorous and in the same time more flexible towards the investment policy.

At the end of 2006, UNOPC was reporting a total number of 32 open-ended funds: two monetary funds, seven bond funds, eleven balanced funds and twelve equity funds. Most of them are young funds which have started to function after the year 2000 on a small capital market, characterized by poor transactions, low liquidity, legal instability and investors' lack of trust. We will try to follow the evolution of Romanian mutual funds through performance indicators using data furnished by UNOPC in its annual reports.

## **Evolution of the main performance indicators**

Romanian mutual funds performance indicators registered an accelerated rhythm of growth during the last years due to the positive evolution of the capital market, corroborated with the improvement of the management quality and the increase of investors' interest in these entities.

The development of financial instruments on the capital market and the enlargement of the selection area of investments for mutual funds' managers favored the introduction of strict classification criteria of these investment vehicles. Mutual funds managers operated during the last years severe portfolio' structure adjustments dictated by the increase of investors' toleration of risk and a reorientation towards the capital market after past unfortunately experiences.

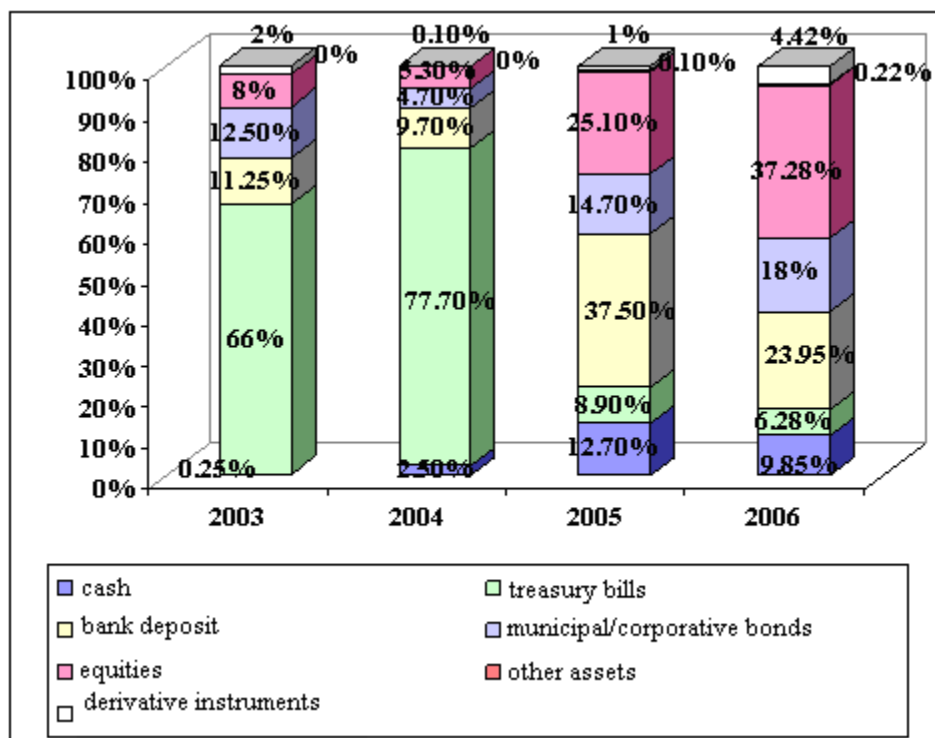
*Tab. 1 The dynamic of the global portfolio structure during 2003-2006*

Assets' structure	2003	2004	2005	2006
cash	0.25%	2.5%	12.7%	9.85%
treasury bills	66%	77.7%	8.9%	6.28%
bank deposits	11.25%	9.7%	37.5%	23.95%
municipal/corporative bonds	12.5%	4.7%	14.7%	18%
equities	8%	5.3%	25.1%	37.28%
derivative financial instruments	0%	0%	0.1%	0.22%
other assets	2%	0.1%	1%	4.42%

Source: UNOPC Reports at the 31 of Decembre of each year.

In 2005 and 2006 an equilibration of different assets classes weights in the global portfolio took place by the augmentation of quoted financial instruments weights to the prejudice of money markets instruments which dominated the market in the previous years.

**Graph. 1 The evolution of the global portfolio structure during 2003-2006**



Source: Author's processing.

Investors' preference for traded financial titles is justified both by their superior return and the decrease of interest rate for bank deposits and treasury bills. The increase of mutual funds total assets is the result of launching new funds, attracting new investors and also the result of assets value appreciation.

**Tab. 2 Main indicators characterizing mutual funds performance during 2003-2006**

Indicatori	2003	2004	2005	2006
Number of UNOPC funds	20	19	23	32
Net assets (mil. lei)	93,2996	209,959	339,12	633,201
Growth of net assets (%)	2,84%	125,04%	61,52%	86,71%

Number of investors	58.017	62.082	70.978	78.380
Net assets/investor (lei)	1608,14	3381,96	4777,82	8078,6
Growth of net assets /investor (%)	-1,49%	110,3	41,27%	69,08%

Source: UNOPC Reports and author's calculation.

The tendency of growth of mutual funds performance indicators and especially the performance generated by these investment vehicles will lead in the following years to their confirmation as viable alternative of investing available capital. Managers of actively managed portfolios are expected to consistently outperform the index or the benchmark. In order to prove their ability in generating excess returns, managers have to rely on their past performance. Financial industry spends considerable amount of resources in measuring and ranking the performance of actively managed portfolios.

We present below the evolution of the Romanian mutual funds performance in the last four years compared to inflation rate and the growth rate of BET, which is the Romanian capital market index. The average performance is calculated as the average variation of the unitary value of mutual funds (we include all Romanian mutual funds regardless their investment policy) net assets taking into account the market share of each mutual fund.

**Tab. 3 Mutual funds performance evolution during 2003-2006**

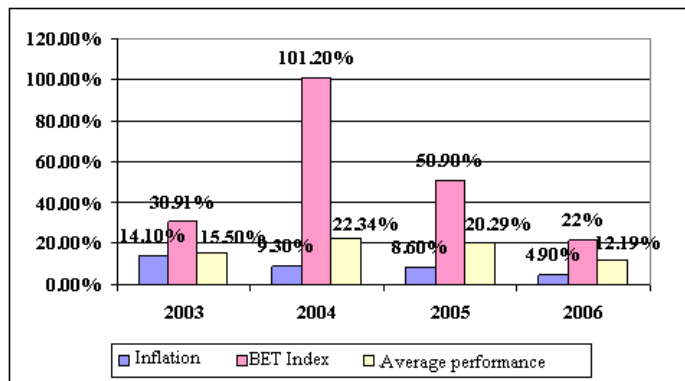
Indicator	2003	2004	2005	2006
Inflation ratio <sup>1)</sup>	14,1%	9,30%	8,60%	4,90%
BET Index <sup>2)</sup>	30,91%	101,20%	50,90%	22%
Average mutual funds performance <sup>3)</sup>	15.5%	22,34%	20,29%	12,19%

Source: 1) www.bnro.ro; 2) www.kmarket.ro; 3) author's calculation.

Mutual funds average performance exceeded the inflation rate each year and was exceeded by the BET Index. This high positive variation of the market index is due to under-evaluated stocks on the market. As the capital market matured the evolution of the index stabilizes. Meanwhile mutual funds adopted a more prudent strategy and balanced their portfolios by investing in monetary instruments with low risk and return characteristics. Each mutual fund has a specified investment policy, which is described in the fund's prospectus. Equities, bonds and money market instruments are major assets categories, largely used by long-term portfolio investors. The safety of any mutual fund is determined by the fund's strategy, activities and investments. The risk is the same whether it is sold by a bank, stockbroker, financial adviser or other marketing organization.

Taking into account that BET Index is composed of the 10 most liquid stocks on the market which have also registered the highest performance, that mutual funds diversify their portfolios and that we don't expect managers to have had high selectivity capacity, the discrepancy between BET and average performance is understandable. Anyway, the declared objectives in the prospectus of each Romanian mutual fund are connected to the increase of assets' value and return exceeding the inflation rate without mentioning a target related to the capital market.

**Graf. 2 Performance of the global portfolio versus inflation and BET Index**



Source: Author's processing.

According to the funds' stated objectives, the National Union of Collective Investment Schemes, classifies them into four classes:

- Equity funds are mainly orientated to listed stocks. These funds represent a very strong investment vehicle by offering access to the stock-exchange growth. Investing in such a fund implies less effort, money and risks than the direct investment on the stock-exchange. They offer smaller investors the benefit of diversification and professional management. They include different investment styles such as growth, value or growth and value, and concentrate in alternative-sized firms, including small-cap, mid-cap and large capitalization stocks. The investment term is long and very long. The criteria of funds enclosure in this category is a minimum investment of 45% in stocks.

**Tab. 4 Main indicators characterizing equity funds during 2003-2006**

Indicators	2004	2005	2006
Market share	8,9%	21,3%	32,3%
Number of funds	5	8	12
Net assets (mil. lei)	18,77	72,28	204,283
Growth of net assets (%)	-	285,08%	182,63%
Number of investors	6.945	11.860	15.417
Net assests/investor (lei)	2.703	6.094	13.251
Growth of net assets /investor (%)	-	125,45%	117,44%

Source: Author's processing after UNOPC Reports at the end of each year

- Bond funds or fixed income funds that invest in long-term government, corporate or municipal bonds. The enclosure criteria is an investment of more than 90% in bonds and money market instruments. These are investments on the medium term implying small risks. They address to investors with high risk aversion and also to stock investors who aim an equilibration of the global portfolio and risk diminution.

**Tab. 5 Main indicators characterizing bond funds during 2003-2006**

Indicators	2004	2005	2006
Market share	12,1%	14,9%	9,7%
Number of funds	6	6	7
Net assets (mil. lei)	25,361	50,608	61,285
Growth of net assets (%)	-	99,55%	21,1%
Number of investors	8.854	8.437	9.038

Net assests/investor (lei)	2.864	5.998	6.781
Growth of net assets /investor (%)	-	109,43%	13,05%

Source: Author's processing after UNOPC Reports at the end of each year

- Balanced funds invest both in fixed income instruments and in stocks, adopting a balanced strategy in order to obtain high returns but keeping a medium risk level. They invest between 10% and 45% in stocks and the rest in fixed income instruments. They address to investors who aim performances above interest rates without exceeding a medium level of risk.

**Tab. 6 Main indicators characterizing balanced funds during 2003-2006**

Indicators	2004	2005	2006
Market share	22%	31,9%	37,9%
Number of funds	6	7	11
Net assets (mil. lei)	46,105	108,22	239,72
Growth of net assets (%)	-	134,72%	121,52%
Number of investors	41.098	45.900	49.540
Net assests/investor (lei)	1.122	2.358	4.839
Growth of net assets /investor (%)	-	110,16%	105,21%

Source: Author's processing after UNOPC Reports at the end of each year

- Money market funds invest above 90% of the total active in money market instruments deposits, deposit certificates, treasury bills. They are short term investment and represent cash management instrument. They appear to individuals as an alternative to bank savings accounts because they are safe and provide yields above what is available on most savings accounts, are available in any moment without losing the accumulated gains.

**Tab. 7 Main indicators characterizing monetary funds during 2003-2006**

Indicators	2004	2005	2006
Market share	57%	31,9%	20,2%
Number of funds	2	2	2
Net assets (mil. lei)	119,723	108,012	127,913
Growth of net assets (%)	-	-9,78%	18,42%
Number of investors	5.185	4.781	4.385
Net assests/investor (lei)	23.090	22.591	29.171
Growth of net assets /investor (%)	-	-2,16%	29,12%

Source: Author's processing after UNOPC Reports at the end of each year

## Conclusions

The Romanian mutual fund industry registered in the last years a constant growth in assets but most important is the consolidation of the market with respect to such investment. After huge frauds in the industry finally we have a law and an authority that supervises these institutions. A solid infrastructure will ensure future development of these investment companies which will have to face in the nest years a strong competition with funds from other European countries.

At European level a new regulating framework is conceived in order to simplify the functioning of investment funds whose objectives pass beyond the origin country. The 85/611/EEC Directive with the subsequent amendments, which as we have shown, created the juridical harmonized framework for

facilitating cross border investment fund marketing, is being revised in order to facilitate the construction of a perfectly integrated European market for investment funds. The following aspects are aimed:

- simplifying the procedure of **launching a fund** on another member state market;
- eliminating the discrimination between contractual funds and corporative funds as far as the **company passport** is concerned (it is at present valid only for corporative funds);
- regulating the functioning of investment schemes that allow for the co administration of several member state mutual funds' assets (**entity pooling**);
- **simplifying funds prospectus**;
- a better **cooperation** between member states' supervising authorities as far as the legislative framework is concerned.

Romanian mutual funds represent a young industry with a high potential of growth in a safe profitable investment environment. Such an environment also implies a developing economy. We remark and appreciate CNVM efforts of assuring the compatibility with the highest European standards and directives in order to frame the Romanian capital market in the developing tendencies of the unique market.

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