FUNDS INVESTMENT STRATEGIES ON CAPITAL MARKETS
FROM EASTERN EUROPE

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Abstract
The purpose of this paper is the understanding of how to establish investment strategies of investment funds depending on the area, sector of investment, and time horizon, and the management involvement in investment decisions making. There have been considered funds from Trustnet, investing in Eastern Europe. For each investment fund, the sector and also a set of indicators to measure performance and risks have been analyzed: dynamics, beta, alpha, Sharpe ratio, info ratio and R-Squared.

Key words: investment strategies, active strategy, passive strategy, investment fund, investment sector

JEL Classification: G10, G11

1. Introduction
Decision making for the selection of investment strategies involves a complex process that shapes specific elements of the general decisional framework in which the economic subject operates. The desired level of yield / risk pair, information available to the decision maker (in terms of structure, relevance, timeliness and cost of obtaining and use), restrictions arising from the economic environment, give specific content of investment selection decision.

Trading strategies can be classified according to a complex multi-criteria set.

In our opinion, at least two criteria are relevant for this classification:
1. as the strategy follows the market trend (trend follow approach) and counting on reversals in current trends (mean reverting approach) and, respectively,
2. the temporary horizon taken into account for building and managing portfolios of financial assets.

In light of the first criterion, strategies based on following the general market trend of the financial asset can be considered as passive strategies while strategies based on the assumption that the current market state is a deviation from the equilibrium, as induced by fundamental variables underlying the structure of supply and demand, are active strategies. In light of the second criterion, strategies implemented and run on “temporary short horizons” (from intraday to one month) are active strategies while strategies that take into consideration “temporary long horizons” (from a quarter up) are passive strategies. It is worth noting that within the second approach mentioned, each of the two strategies can be designed both in trend follow approach and in mean reverting approach.

It is noted that a key factor for discrimination between these potential approaches is the investor position in relation to efficient market hypothesis. Thus, if the investor agrees to this hypothesis, it will be considered that the market has efficient mechanisms for processing and incorporation in financial asset prices and that any deviations of prices from equilibrium level are only transitory. In this situation, strategies based of following the trend determined by fundamentals factors and longer trading horizons are preferred. In correlation, if a different vision about functioning of the market is adopted (such as the one represented by adaptive market hypothesis) the investor will believe the market can cross areas of inefficient information and these may have a persistent character. In this situation, there may be preferred strategies aimed at systematic exploitation of any deviations from equilibrium prices and respectively temporary shorter horizons.

It is also to be noted that the choice of the trading strategy is conditional on the "risk profile" of the investor as it is shaped by its psychological-behavioural and socio-cultural particularities. More specifically, investors with an appetite for more pronounced risk characterized by values and pro-active attitudes and which put a high emphasis on individual success will have a more pronounced relative preference for active strategies that are associated with a sense of higher personal decision-making capabilities. On the other hand, investors which are characterised by a lower appetite for risk and a higher level of social conformity and which trade with the fundamental objective of generating revenue for saving will tend to adopt more passive strategies that comply with trends seen in the market.
2. Investment strategies on capital markets

Many studies were carried out regarding investment strategies (Andrews et al [1], Ansoff [2], Chandler [3], Drucker [4], Malkiel et al [5], Fernandez et al [6], Mintzberg et al [7], Mintzeberg and Waters [8], Nicolescu and Verboncu [9], Stulz [10], Quin and Voyer [11]). As a result of studies carried out by Mintzberg (1998) [7] there have been identified 10 schools: school of engineering (creation process), school of planning (formalized process), school of positioning (analytical process), entrepreneurial school (visionary process), cognitive school (mental process), school of learning (emerging process), school of politics (process based on power), cultural school (ideological process), school of environment (recreational process) and configuration school (transformation process) with respect to any investment strategy theory. First three schools represent the classic approach, and the other seven schools are the approach to alternative strategies.

First research in the strategy field has been carried out by Drucker (1954) [4], and the foundations of classical approach were being laid by publishing three important books: "Strategy and Structure: chapters in the history of the industrial enterprise" in 1962 by A. Chandler jr.[3], "Business Policy: Text and Clinical" in 1965 by E. P. Learned, C. R. Christensen, K. R Andrews [1] and W. D. Guth and "Corporate Strategy" in 1965 by I. Ansoff [2].

Thorough approach to the concept of strategy belongs to Professor Chandler (1962) [3] which labelled as strategy "determining the long-term aims and objectives of an enterprise, adoption of courses of action and the allocation of resources necessary for the achievement of the objectives". In 1965, through the work, Ansoff and Andrews carried out their differentiation between the process of elaboration of the strategy, and the strategy itself by the fact that they see the strategy as structure of the objectives, targets, major policies and plans to achieve them.

As opposed to classical approach, alternative strategies approach appears which underlines the issue with respect to the learning process. Some scientists stressed that an investment strategy is formed as a result of an emerging process (Mintzberg and Waters (1985)[8]) (is shaping in time) or as an increase in the strategic learning process (Quinn and Voyer (1998)[11]).

The characteristics of an investment strategy that can be drawn from the definitions are:

- a. The strategy aims to achieve some investment objectives which represent the motivational basis of the strategy;
- b. The strategy shall be drawn up and implemented for certain investment horizons (short, medium, long);
- c. The strategy content pursues essential elements to the investor: profitability and investment risk;
- d. The strategy is based on the correlation approach of investment environment and preferences of investors;
- e. At the basis of strategy approach lays the equi-finality principle (Nicolescu and Verboncu (1999) [9]), according to which there is more than one combination or ways in which it can be assured the achievement of an objective. As a result, both in the development and implementation of the strategy there should not be only one way or combination. Depending on the endogenous and exogenous variables implied, there may be used one of the many effective combinations.

One of the most important aspects of trading strategies refers to information efficiency of the capital market. This implies that all of the information available at any given time in the market are reflected instantly in the price of the financial instrument. As a result of this, it is impossible for investors to obtain repeatedly higher yields than those on the market. The level of the information efficiency on a market has an impact on the manner in which investors decide their trading strategies. The more efficient the market is, the more investors will be focused on passive strategies which are not intended to exceed market, but only to be in trend with that market. In an efficient information market, active strategies cannot yield higher returns than the market.

Passive strategies, as mentioned, are not intended to obtain higher yields than the market, but will seek to obtain yields similar to those on the market. The focus in the case of these strategies is on the cost of the transaction and the time allocated to it in portfolio management. Passive investors believe the market is efficient and accept the yield and the risk which the market offers, considering these results as the best estimates of price developments of financial instruments.

One of the main rationalities regarding selecting a passive strategy is that in the long run the investor will have an average between the cost-performance equal to the average on the market. Therefore, the investor will win more from investment cost savings than in an attempt to overcome the average. Also, in situations where markets are considered efficient, passive strategies are those recommended, but if all the investors should only use passive strategies the market would no longer be effective. In accordance to this paradox, the existence of investors who adopt a strategy active is a necessary condition of market efficiency. These investors will assume additional risks in the hope of greater gain. Continuity of management on the markets is justified by the existence of some "bags" of inefficiency, which appear in the short term, and from which they derive their winnings. Other explanations could be: stock anomalies, the attraction toward the stock exchange game and ignorance of actual functioning of the markets.

In the category of passive strategies are included:
- The strategy of "buy-and-hold", involves identifying and the purchasing of investment instruments which represent an attractive yield and a level of volatility between the limits established by the investor himself, keeping portfolio structure in the period of ownership and allocation of a relatively low time for portfolio management;
- The stock market index strategy type, requires the creation and management of a portfolio that will copy an index structure, when the portfolio structure is identical to that of the index; it permits covering the risk of price decreases through operations on the markets.
Investors who do not accept the efficient market hypothesis are focused on active strategies, considering that they can identify undervalued financial assets and delays with respect to market adjustment to new information. These investors spend more time and have higher costs of research and trading, but nevertheless, they consider that the marginal yield obtained exceeds the marginal necessary cost.

The active strategy requires constant forecasts of economic environment and capital market developments, the analysis of the intrinsic value of securities on the basis of present and the perspective financial performance, prompt exploitation of the anomalies which were already on the market in respect to securities prices through sale transactions. Investors who adopt such a strategy rely on a certain degree of inefficiency of the markets. They found that on short periods of time financial assets prices are not in equilibrium, and can thus profit can be obtained. Active strategies can appear both at the level of individual securities, in which case we are talking about stock picking, as well as at the level of assets classes, in which case the management is called active asset allocation. A third form is the market timing, which is based on anticipating developments in the market.

Depending on the objectives and the aversion to risk, investors who adopt an active strategy base their decisions to purchase financial assets on the following:
- Companies with a particularly aggressive development show the greatest increase in revenue and profits, taken by the financial assets price in the same direction, also known as financial assets on the rise;
- Increased profits is the main factor that affects in time the increase in the financial assets prices;
- The investment in financial assets of companies with aggressive development brings in the long-term higher yields;
- Aggressive development companies are dynamic and inadaptable to changes in national economies allowing higher yields in the long run.

Active strategies assume tryout of the investor, by taking of additional risk to exceed the reference yield a portfolio generated by a passive strategy. The investor that addresses an active strategy takes advantage of market inefficiencies through the acquisition of undervalued securities or through uncovered sale of overvalued securities.

Regardless of the type of strategy adopted by an investor, the main factors which affect yields of a portfolio are: type of instruments that make up the investment portfolio structure; degree of diversification of the portfolio; the extent to which the manager of portfolio may take credits in an attempt to increase the performance of management; the extent to which the portfolio manager is trying to synchronize market or to reduce risks by hedging operations.

3. Research methodology and results analysis

Different categories of investors may develop a variety of strategies, depending on the desired objective, the risk profile, access to information, the ability of processing of these data. Therefore, we will present types of strategies adopted by a part of institutional investors in the UK, registered to Trustnet (2012) [12]. The study will focus on strategies analysis of funds which invest in the capital market in Eastern Europe.

In view of that analysis, all the funds recorded in the Trustnet which invest on the capital market in the Middle East have been selected. For each fund there will be presented the structure from the point of view of the sector in which it invests (financial sector, industrial sector, sector of consumer goods, raw materials sector, consumer services sector, telecommunications sector, the energy sector, health sector, the utilities sector, discretionary goods sector and IT sector). There will also be presented a series of indicators to measure the performance and risk:
- Dynamic - change in percentage from a period to another;
- Beta - measures fund volatility in relation to the reference point and show us how sensitive the fund is to variations on the market. A fund which has beta around the value 1 will generally vary in the same way as the market index. If beta has values greater than 1 it means that it is less volatile than the market index.
- Alfa - determine under-performance or over-performance of the fund in comparison with the market index. This is the fund yield when it is assumed that the index yield is zero;
- Sharpe Ratio - determines additional yield obtained on the unit of risk of the fund;
- Info Ratio – evaluates the extent to which a manager uses his skills and knowledge to increase the fund yield. Generally it is considered that if the rate has a value of 0.5 the manager had a good involvement, if the rate is 0.75 the involvement is very good, and if the rate reaches value 1 the involvement is excellent;
- R-Squared - determines how correlated is the fund evolution to market index evolution. This makes it possible to determine how the index evolution has contributed to the development of the fund. The indicator varies between 0, which shows that there is no correlation, and 1, that is very rare when correlation is perfect. In general it can be said that for values less than 0.5 fund evolution is not strongly influenced by developments in the market, and for values higher than 0.7 there is a correlation of the fund with developments in the market.

By the analysis of mentioned indicators we will try to determine what type of strategies funds use, active or passive, and also the comparison of portfolio yield with the risk taken.

By analysing funds structure from the point of view of the sectors in which they invest, we shall try to determine the areas of investment of these funds in Eastern Europe.
According to the analysis of funds (see table no. 1 of the Annex) which invest on capital market from Eastern Europe, the average value of the indicator alpha is negative -0.33625. This average is strongly influenced by the negative results of the fund H that shows a an alpha value of -10.89. The funds which have recorded positive values are A (6.92), B (0.25), D (4.16), and F (2.74), which shows that those funds recorded higher yields as compared to the rest of the funds analyzed. The highest performance in relation to the price index is recorded by the fund A.

What is important to notice is that managers of funds assume different risks in obtaining these yields, so within the group of funds with a positive alpha, beta values are A (1.53), B (1.72), D (1.68), and F (1.63). Thus by changing by one unit the market index, fund A changes by 1.53, fund B by 1.72, fund D by 1.68 and fund F by 1.63. Taking into account that the evolution of the capital market in Eastern Europe has been on the rise (9.7% according to 2012 evolution of the FTSE Emerging EMEA 40 index) this strategy gave an advantage to these funds to achieve a high efficiency.

For the majority of funds, R-Square has values close to 1 which represents a close correlation of the fund evolution to the market index evolution. Only fund D has a low R-Square of 0.57 which implies a low correlation with market index compared to other funds. In this case the results presented by alpha and beta are not entirely relevant because they are calculated in comparison with the index market.

According to the analysis of the Sharpe indicator (see table no. 1 of the Annex) median of the funds is 0.10375, with the funds which have recorded above average yields being A (0.47) and F (0.23). According to this indicator they are funds which have the best yields reported to a unit of risk.
Regarding the yields of the above mentioned, managers noted that in the case of funds A (0.83) and F (0.45) the Info Ratio has the most impact values, which implies a manager’s active involvement in the fund. In the case of the other funds, the info ratio has values close to 0 or even negative which suggests that there are some questions regarding the management of the fund.

As a result of the dynamic analysis of the funds over a period of three years (see table no. 1 of the Annex) it is observed that a majority of funds recorded a good performance on both the 1 year and the 3 years timeframes. This overall positive performance trend is directly influenced by the positive evolution of the market in the Middle East. The index FTSE Emerging EMEA 40 records in the last year an increase of 9.7% and in the last 3 years an increase of 13.3%. The average price increases in our analysis on 1 year is 7.4%, and 4.19% on 3 years. The only fund which records very low results is the fund H, as highlighted by our analysis. The only funds which exceeded index evolution FTSE Emerging EMEA 40 on a 1 year timeframe are A (16.1%) and F (10.8%), and on a 3 year scale A (14.3%), D (7.8%), E (10%) and F (5.9%).

By analysing the cumulative performance obtained by the funds with all their indicators we can be established the type of strategy used by the managers of the fund.

Of the funds with above average performance, an active investment method was observed for A and F. The active implication is confirmed in the main info ratio which has values above the average, which shows direct involvement of the manager to increase its portfolio with positive results confirmed by other indicators.

In the case of funds B, C, E and G, the positive performance over the last year was derived mainly from the trend of the market, confirmed by the close correlation of the portfolio with the market index. Thus, the values of the ratios are very low, which is an indication that the strategy adopted in this situation is a passive one.
In respect to structural funds (see table no. 2 of the Annex) from the point of view of most active sectors in Eastern European markets, as shown in figure 3.10, we can distinguish particular interest in 4 major areas of activity. The funds selected for analysis investing in Eastern Europe are mainly focused in the energy sector, with an average of 40.97%, and in the financial sector with an average of 29.47%. Ranking next as sector of interest from the point of view of investors we can find raw materials with an average of 10.34%, consumer goods with an average of 7.43% and telecommunications with an average of 7.23%.

4. Final considerations

Investment strategies integrate a lot of information with regard to current aversion to risk of the investor, the expectations in respect of future yields or to the time horizon under consideration.

From an analysis of shares funds recorded at Trustnet, which invest in Eastern Europe, it was noted that the adopted strategies of managers will vary depending on the sector in which they invest, on the area in which it invests, the time horizon and its approach with regard to the involvement of active management of portfolios of investments. So, it was noted that in the case of funds where managers have been actively involved and have adopted active investment strategy, also confirmed by the value of the info ratio, the performance of funds were the highest. Additionally, the analysis of the performance over a period of 3 years showed that there have been funds with performance higher than those which have adopted an investment strategy active.

In our opinion, in order to further increase the effectiveness of the high performance portfolios, managers of funds should identify and adopt a harmonisation between strategies involving assets and liabilities. In an environment where uncertainty prevails, investors should not forget to elaborate and implement a sound investment strategy with a view to achieve the objectives of performance while not sacrificing the measurement and the protection of risk.

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