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Trends of the Investment Fund Industry Development

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The research object of the present work is one of the elements of the financial system, the so-called alternative investment instrument – investment fund. The concept of investment fund is used here in the sense of publicly offered open-ended funds invested in transferable securities and money market funds, which refers to "mutual fund" in the US and UCITS[1] in FEFSI's[2] statistics on the European investment funds industry. In Lithuania, the equivalent of investment fund is a variable capital investment company.

Under the conditions produced by globalization when the spectrum of services and financial instruments is widening dramatically, competition between financial institutions is growing and mergers appear, the development of a financial system and its sensitivity to changes in global finance is an actual problem for Lithuania; as the financial system develops, the level of living and the average gross monthly earnings increase, the need for investing arises. The trends of the Lithuanian investment fund industry are analysed in relation to the European experience, that's why the history and factors of development, allocation of assets between different fund types of the European investment fund industry are examined.

The purpose of this article is to examine the origin and rapid development of investment funds and to analyse trends of investment funds industry development.

The methods used: analysis and generalization of scientific works and statistical data.

Introduction

Questions of which stock or bond to select, when to buy, and when to sell have plagued investors for as long as there have been organized capital markets. Such concerns lie at the very heart of the investment fund concept and in large part explain the growth that investment funds have experienced. Many investors lack the time, know-how, or commitment to manage their own portfolios, so they turn to professional fund managers and simply let them decide which securities to buy and when to sell.

An investment fund is a type of financial services organization that receives money from

[1] Undertaking for Collective Investment in Transferable Securities.

[2] FEFSI (Fédération Européenne des Fonds et Sociétés d'Investissement) – European Federation of Investment Funds and Companies.

its shareholders and then invests those funds on their behalf in a diversified portfolio of securities. An investment in an investment fund really represents the ownership position in a professionally managed portfolio of securities [5]. Buying shares in an investment fund, an investor becomes a part owner of the portfolio of securities.

Over the last decades the assets under management of investment funds were continually raising. The growth of their importance in the economy is reflected by their development history. The founding of the *"Foreign and Colonial Government Trust"* in 1868 is often regarded as marking the beginning of modern day investment funds. At its formation over 130 years ago, the Foreign and Colonial declared its intention *"to give the investor of moderate means the same advantages as the large capitalists, in diminishing the risk of investing in foreign and colonial stocks, by spreading the investment over a number of stocks"*. Other sources point that the first investment fund was set up in 1849 in Switzerland and was called *Société civile Genèvoise d'emploi de fonds* [3].

However, by that time investment trusts had been in existence in Holland for almost a century. In 1774 the Dutch merchant A. Van Ketwich invited subscriptions from investors to form an investment trust under the name *Eendragt Maakt Magt* (translated as Unity Creates Strength), and in 1779 Van Ketwich started his second trust under the name *Concordia Res Parvae Crescunt* (Small Matters Grow by Consent). *Eendragt Maakt Magt* was liquidated in 1824, but *Concordia Res Parvae Crescunt* existed for 114 years until 1893, when it was officially dissolved [17]. The first US fund, the *Boston Personal Property Trust*, was set up in 1894 and the Germans followed in 1923 with the *Zickert'sche Kapitalverein*. All early funds were of the closed-ended type, in other words, with a fixed number of shares that were quoted on an exchange. The first open-ended fund *The Massachusetts Investment Trust* was set up in 1924 in Boston (US) and it's still in business today, as well as the Foreign and Colonial Government Trust. By 1940 the number of investment funds had grown to 68, and by 1980 there were 564 of them. But that was only the beginning: the next years saw an unprecedented growth in the investment fund industry, as assets under management grew from less than $100 billion in 1980 to over $4 trillion in 1997. Indeed, by 1997 there were more than 8500 publicly traded investment funds in the US market. The fund industry has grown so much that it is now the largest financial intermediary in the country – even ahead of banks [10]. It should be noted that the emergence of new products in the market influenced the tremendous growth of investment funds both in number and assets in the 7th decade. At present, almost €11 trillion are invested in more than 53000 investment funds all over the world [7].

The historical development has determined a variety of investment fund types. They can be classified according to their legal form, operational structure or investment objectives. The below classification of investment funds according to their investment objectives is used in Européan and US statistics [3, 10, 16].

Money market funds invest a sizeable portion of the fund's portfolio in short-term bonds, money market instruments, cash. The fund's average maturity usually does not exceed one year and therefore a money market fund is less vulnerable to interest rate fluctuations, whilst credit risk is expected to be negligible.

Bond funds invest in fixed interest rate securities as a sizeable portion of the fund's portfolio. An important distinction is that individual bonds have final maturity dates, whereas bond funds do not.

Equity funds invest in the stock market at a significant portion of the fund's portfolio. They always reflect the characteristics of the market.

Balanced funds spread their portfolio over the three main asset classes described above (money market instruments, bonds and equities). The more these funds invest in money market instruments and fixed income instruments (bonds), the less risk they bear, the more equity exposure they have, the higher the risk profile of the fund becomes.

Continuing the analysis of the growth of investment funds industry, some reasons for such a rapid growth and tremendous interest of investors should be discussed. First of all, the advantages that they offer could be mentioned, as they contribute to explain the success of investment funds as saving instruments. The mentioned advantages are important in the Lithuanian investment funds development as well.

The attractions of investment fund ownership are numerous. One of the most important is diversification: it benefits investment fund shareholders by spreading out holdings over a wide variety of industries and companies, thus reducing the risk inherent in any one investment [5].

Another appeal of investment funds is full-time professional management, which relieves investors of many day-to-day management and record-keeping chores. What's more, the fund may be able to offer better investment talents than individual investors can provide. Besides, under the conditions of the modern information society large and complex information flows aren't often comprehensible to an individual amateur investor, whereas investment fund specialists understand investment problems better than individual ones do [18].

Still another advantage is that most investment fund investments can be started with a modest capital outlay. Sometimes no minimum investment is required, and after the initial investment has been made, additional shares can usually be purchased in small amounts. This factor is particularly relevant to a small investor who experiences considerably larger expenses buying and selling the portfolio of securities independently, because in most markets contract expenses depend on size.

Another appealing characteristic is liquidity. Investment funds are required by law to redeem shares on a daily basis, making investment fund shares a very liquid investment. The price per share at which shares are redeemed is known as the net asset value (NAV). NAV is the current market value of all the fund's assets, minus liabilities divided by the total number of outstanding shares [4].

Beside other positive characteristics, investor security should also be mentioned. Investment funds must comply with laws and regulations, they have to disclose all information about their activities, possible risks to existing and potential investors.

The services that investment funds offer also make them appealing to many investors: these include automatic reinvestment of dividends, withdrawal plans, and exchange privileges. Shareholders benefit from competition in the investment fund industry. Over the past 20 years, this competition has produced substantially lower costs and an array of innovative investment products and services. So an investor can choose one out of a great number of investment funds available in the market that corresponds with his aims and acceptable risk. Finally, investment funds offer convenience. They are relatively easy to acquire – the funds handle the paperwork and record keeping, their prices are widely quoted; and it is possible to deal in fractional shares.

There are, of course, some major drawbacks to investment fund ownership. One of the biggest disadvantages is that investment funds in general can be costly and involve substantial transaction costs. Many funds carry sizable commission charges. In addition, a management fee is levied annually for professional services provided, and it is deducted right off the top, regardless of whether the fund has had a good or a bad year.

Yet, even in spite of all the professional management and advice, it seems that investment fund performance over a long haul is at best about equal to what you would expect from the market as a whole. Investment funds cannot outperform the market; if overall stock markets are experiencing a decline, then the value of an investment fund may decline as well [1].

The Lithuanian investment fund industry is very young; we can say it just makes its first steps. The first Lithuanian investment fund – the investment variable capital company NSEL 30 index fund – was formed in August 2000 and started public distribution of its shares in April 2001. Three years later, in May 2004, the Hansa money market fund started distribution of its investment units. This year the Lithuanian Securities Commission issued the permit for one more money market fund, the Nord/LB money market fund, to start its activities.

At the end of 2003 the net assets of the NSEL 30 index fund amounted to over 11 million Litas [8]; the Hansa money market fund counted the same sum at the beginning of June 2003 [6]. At present, assets held in the Lithuanian investment funds make about 26 million Litas or €7.5 million.

Seeking to highlight the perspectives and tendencies of the Lithuanian investment fund industry, the experience and trends of the European investment fund industry development are analysed.

Trends in the European investment fund industry

During the 1990s, the investment funds industry has proven to be one of the fastest growing components in the financial sectors of the European countries. Assets held in investment funds rose from less than €500 million at the beginning of the decade to €4.5 trillion by the end of 2000. Investment funds now account for a significant proportion of households' savings in every country of Europe, are important vehicles used by banks and other financial intermediaries in wealth management and play an increasingly important role in accumulating assets for retirement [3].

The European investment fund market stood at €4.6 trillion of total net assets at the end of September 2003. The most important segment of the European investment funds industry is the so-called UCITS market, i.e. the market for publicly-offered open-end funds investing in transferable securities and money market funds. The strong growth in investment funds assets over 1995–2000 reflected the development in the UCITS market, which saw the total net assets almost tripling (see Fig. 1b). This means an annualized growth rate of about 28%. €3.581 trillion invested in UCITS accounted for 77.7% of the investment funds market at the end of 2003 [14].

The non-UCITS[3] market is dominated by four types of products: the German special

[3] "Non-UCITS" is used in the sense of nationally regulated funds that are not publicly offered and/or that are closed-end funds.

funds reserved for institutional investors, the British closed-ended investments trusts, the real estate funds and the French open-ended employees saving funds (see Fig. 1a). The stock market uncertainty generated positive inflows into real estate funds, which increased by €3 billion in Germany during the third quarter of 2002 and €13 billion since the beginning of the year. Non-UCITS assets grew by 2.6% during the third quarter of 2003 to reach €1.027 trillion. Inflows into German "Spezialfonds" and real estate funds contributed to this result but slowed compared to their pace in the first half of 2003.

Another important recent development is the success of funds offering some performance guarantee or capital protection – the so-called "guaranteed" funds[4]. At the end of the second quarter of 2002 their assets had reached €125 billion in Europe, an increase of 7% on their position at the close of 2000 [15].

Driven by the strong growth, investment funds have acquired a growing importance in Europe, whether measured in relation to GDP[5] or the population. The ratio of investment funds relative to GDP has grown from 23% in 1995 to 52% in 2000. This development translated into an increase of the amount of investment funds assets per inhabitant from €4,000 in 1995 to €11,600 in 2000 [3].

Another way to measure the growing influence of investment funds in Europe is to compare the relative position of assets invested in investment funds, life insurance companies and pension funds. Figure 2 shows that at the end of 1998 insurance companies continue to occupy the first place amongst institutional investors within the European Union, but their lead over investment funds had almost disappeared, as investment funds recorded the highest proportional increases (91%) during the 1996–1998 period (as opposed to both life insurance companies and pension funds which both grew respectively by 59% and 53%) [3].

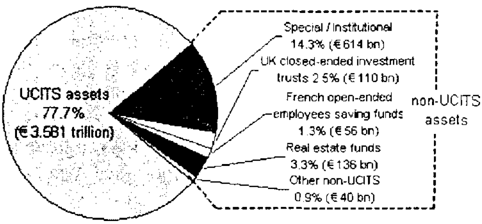
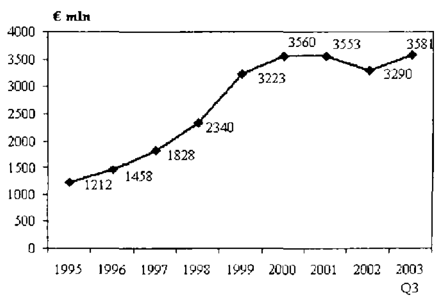


Fig. 1. a) The asset structure of the European



b) Assets of UCITS investment fund industry

[4] Funds providing an arrangement with a third party who undertakes to meet in full an investor's claim under a "guarantee" (syn. protected funds).

[5] Gross domestic product.

Households hold their savings in a mix of financial assets with various characteristics in terms of risks, return and liquidity. Typically, those assets include deposits, directly held securities (bonds and equities), UCITS, pension funds and life insurance. Figure 3 shows the distribution of those assets in a number of European countries [3].

Of course, there is a significant number of variations between the countries. Whereas pension funds and life insurance companies accounted for more than 50% of households' financial assets in the United Kingdom, the share of bank deposits reached 40% in France and Germany at the end of 1999. On the other hand, in Belgium, Finland and Italy, the major component of financial wealth (more than 45%) is held in the form of directly held securities. Figure 3 also confirms that UCITS have become attractive savings instruments for

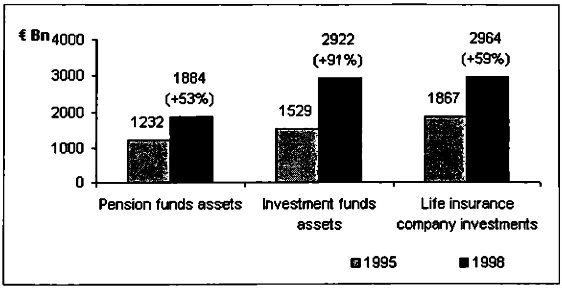


Fig. 2. Trends in the financial assets of institutional investors in the European Union

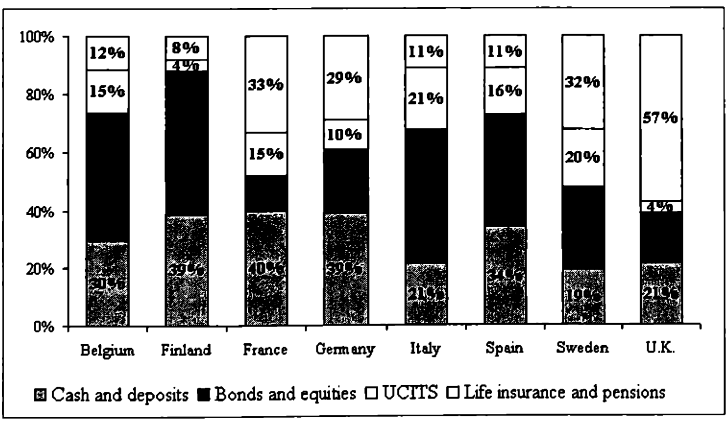


Fig. 3. Household's financial asset allocation

households in Europe. The heterogeneity of asset preferences reflects the degree of households' aversion vis-à-vis investment risks and the persistent cultural and historical differences that exist between countries in Europe, in particular in the organization of the pension system. In this respect, the relatively low level of the public pension in the United Kingdom led households to increase their personal savings for their retirement and invest in pension funds and life insurance. In contrast, in most Northern European countries, the relative generosity of the public pension system and a stronger risk aversion have contributed to favour investment in deposits and fixed-income securities. There are however forces at work that are reshaping households' views on the relative merits of financial assets and contributing to the rise in the share of equities and UCITS. The likely impact of the demographic trends on public pension systems and the growth of an equity culture among retain investors in Europe are certainly contributing to this development.

A growing preference for equity funds

As Fig. 4 shows, the share of equity and balanced funds has increased very strongly since 1995 to account for 62% of total UCITS assets at the end of 2000. During the year 2002, total assets in the investment funds market dropped by 7.5% [12]. This decline largely reflected the fall in the portfolio value of the assets held by equity and balanced funds, which were severely hit by the sharp slide in stock prices. The implied market uncertainty also resulted in net outflows from equity and balanced funds. A similar reaction prevailed during the third quarter of 2001 following the terrorist attacks of September 11 (see Fig. 5).

Till the year 2000 the growth in equity funds was supported by the strength in the major equity indices which pushed up the value of equity investments, and by the emergence of equity culture in Europe, which has been supported over the recent past by new forces, in particular [3]:

- a desire on the part of European investors and households to improve the investment performance of their savings;
- the recognition by individual investors that equity funds provide them with an efficient, liquid and effective way to take the advantage of the generally higher returns offered by equities while avoiding excessively high levels of risks thanks to the asset diversification offered by equity funds;
- the need to increase long-term savings and financial security as a result of the pressures that ageing population will have on public pension systems.

The combined assets of the investment fund market in Europe, i.e. the market for UCITS and other nationally regulated types of investment funds, increased by 2.7% during the third quarter of 2003. The overall result for the nine first months of 2003 was an increase of 8.7% (or €367 billion) in total fund assets. The increase was driven by the strong performance of equity funds. Equity funds captured €25 billion in net new money, the highest quarterly amount since the second quarter of 2001. The momentum in equity fund demand has thus continued to pick up during the third quarter, even though increases in stock market prices slowed down in the past couple of months. As a result, equity fund assets expanded by 5.7% in the third quarter.

The strong investor activity in bond funds also continued to sustain the UCITS asset growth, adding almost €18 billion in the third quarter and €92 billion since the beginning of the year. Inflows into money market funds turned negative for the first time since the end of 2000, whereas balanced funds attracted positive €10 billion inflows (see Table 1).

Funds assets by UCITS types remained almost unchanged in the third quarter of 2003 compared to the situation at the end of 2002 (see Fig. 4). The share of bond funds increased

Table 1. Net sales of UCITS in 2003[6]

Members	Equity funds		Bond funds		Balanced funds		Money market funds	
	Q3[7]	Q1–Q3	Q3	Q1–Q3	Q3	Q1–Q3	Q3	Q1–Q3
Austria	41	52	705	1273	–212	–198	353	1757
Czech Republic	5	9	32	274	–31	–191	–282	43
Denmark	272	–111	361	4644	–3	61	0	1
Finland	275	662	–66	254	57	85	236	3067
France	7400	16342	3800	12300	4600	8863	–3500	26029
Germany	220	1288	1378	5196	–152	–936	–1167	391
Greece	202	131	251	1463	22	–2651	243	4830
Italy	–252	–5529	–1401	12106	138	–6304	2706	13863
Liechtenstein	63	741	–58	1111	–34	38	138	1100
Luxembourg	13602	11739	9438	39267	2352	5246	–2286	3747
Norway	110	206	33	320	138	138	–14	541
Portugal	–47	–43	518	1122	15	–99	250	188
Spain	3827	10271	280	4856	3452	4506	916	4506
Sweden	766	2653	–83	279	264	830	198	747
Switzerland	–3090	–3053	313	369	–8	–542	599	2760
United Kingdom	1780	4023	2165	7327	292	636	6	126
Total	25174	39381	17666	92161	10890	9532	–1604	56202

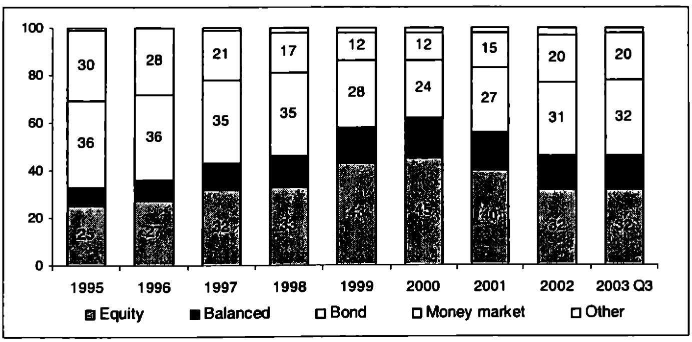


Fig. 4. UCITS assets by types of funds

[6] In EUR millions for FEFSI members for which data are available; these controlled 88% of total UCITS assets at the end of September 2003.

[7] Q3 – data for the third quarter of 2003; Q1-Q3 – data for the first three quarters of 2003.

by 1% coming up with the share of equity funds (32%) [14], which remained high compared to its level at the end of 1992 (18%) [15].

The stability of the net inflows to equity funds is considered to be an important characteristic of market development. Figure 5 shows the recent pattern of net flows into equity funds, expressed per cent of assets. One can see that the negative flows observed in 2002:Q3 were small (1.1% of assets) and comparable to what was observed in 2001:Q3 (1.3% of assets) [12].

Figure 5 is also helpful in assessing how investors respond to difficult stock market conditions, which are represented by the quarter-to-quarter percentage change in the Dow Jones Broad Europe STOXX index. Even if it is limited, the evidence reported here tends to support two important findings that have already been found in a number of studies, i.e.

- sharp and prolonged share price falls are required to induce investors to retreat from equity funds;

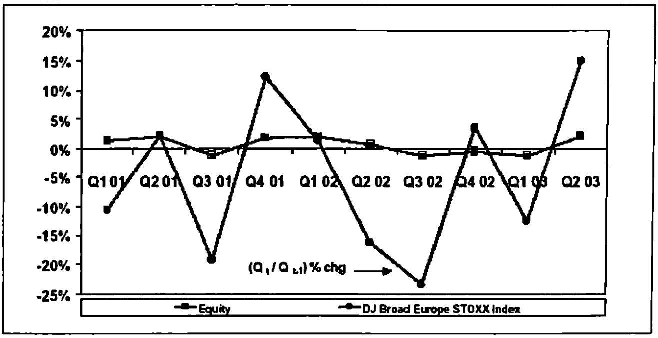


Fig. 5. Net inflows into equity funds (per cent of assets[8])

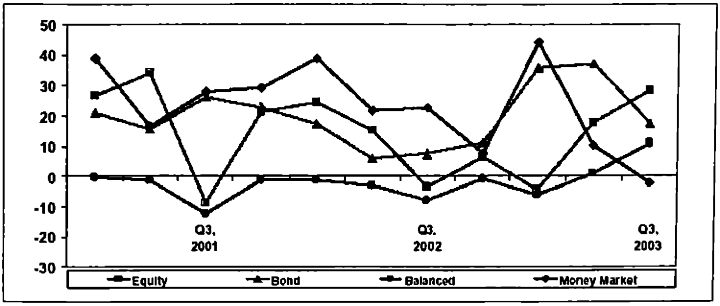


Fig. 6. Net inflows into UCITS (€ billions[9])

[8] For Austria, Czech Republic, Denmark, Finland, Germany, Greece, Italy, Luxembourg, Norway, Portugal, Spain, Sweden and United Kingdom.

[9] For Austria, Czech Republic, Denmark, Finland, France, Germany, Greece, Italy, Luxembourg, Norway, Portugal, Spain, Sweden and United Kingdom.

- when share price falls are sharp and prolonged, investors tend to react calmly, i.e. they do not redeem shares *en masse*.

In other words, while investors in UCITS are not insensitive to sustained declines in share prices, their response has been measured and gradual.

The evidence reported here indicates that the strong stock market rebound observed during the second quarter of 2003 played a key role in convincing investors to return to equity funds. The pattern shown in Fig. 5 also suggests that if stock markets manage to keep to the gains recorded in July and August, it is likely that equity funds will again post positive inflows during the third quarter of 2003. Figure 6 lets us to be convinced in that. The net result of the development in the UCITS industry since the end of 2002 was a 9.5% increase in equity and bond fund assets [13].

In parallel with the growth in the UCITS assets value, the total number of funds grew very strongly between 1995 and 2000. Figure 7 shows that the investors' shift towards equity and balanced funds was supported by a significant increase in the number of these types of funds, whereas money market funds underwent a process of consolidation.

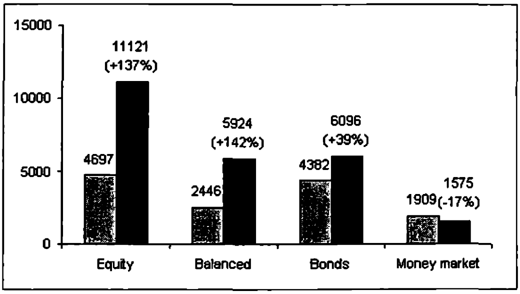


Fig. 7. Number of funds by types of assets

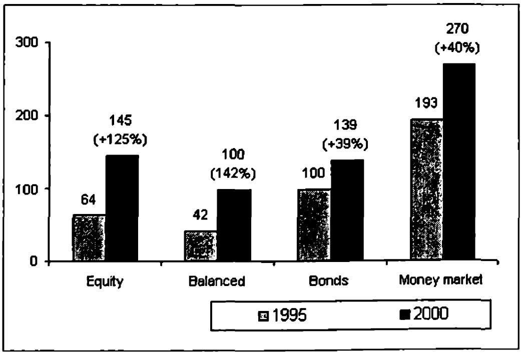


Fig. 8. Average size of funds

The average size of funds likewise saw a significant growth during 1995–2000, with money-market funds showing the biggest average size. (It should be noted however that the average fund size in Europe decreased, because the number of funds grew faster than the assets held. In the middle of 2003 there were 28028 investment funds operating in the European market). This difference reflects the persistent fragmentation of the European investment funds market and the greater international diversification in European investment funds. It can be expected however that the on-going process of integration of the European financial services will contribute to stimulating the growth of the average size of funds in Europe in the years ahead.

In accordance with the report prepared by PricewaterhouseCoopers and FEFSI [2] and renewed data of the second quarter 2003 [7], the US funds market at $6.8 trillion is roughly twice as big as the European funds market at $3.9 trillion. However, in Europe the number of funds is actually more than three times as great as in the US: 28.028 as against 8.202 in the US. This means that the average fund size in Europe is around $139 million compared to the US with $831 million.

Investment management is a business that responds to economies of scale, meaning that as fund sizes grow larger the unit cost per Euro or Dollar of assets under management actually decreases. A simple example is a fund manager running a €50m fund. Should that fund increase to €100m, there would not necessarily a need for two fund managers. Perhaps more importantly, a larger fund would be expected to have lower transaction costs and custody management charges per unit of assets under management.

Estimates and calculations vary, but on the average European fund charges are around 40 basis points higher than in the US. There are a number of reasons for this, but there is no question that the average fund size is a significant factor in increasing costs to European consumers. However, many commentators note that there are significant differences between the European and US markets. The largest differences include language barriers in Europe, the historical development of different preferences for savings between individual European countries and also, potentially, a lingering distrust of foreign-branded fund products. Estimates and calculations of the savings that might flow from a single EU investment funds market without tax and other barriers vary, and are difficult to make with any precision. Professor Heinemann concluded that there would be significant savings for consumers from a fully-functioning single investment funds market. He also concluded that there would be significant cost savings through increasing the average EU investment fund size. As the impact of economies of scale is most dramatic for the smallest funds, Heinemann found that the EU countries with the smallest average fund size would receive the greatest benefit. He estimated that the overall benefit in the EU market, if the average US fund size were to be replicated, would be in the region of €5 billion per annum, though as he states, "there is no reliable way to quantify how these cost savings would be split between the industry (profit margin increase) and the private investors (increase in net returns)".

As Fig. 9 shows, preferences for equity funds remain heterogeneous within Europe. While countries in Northern Europe show a strong preference for equity funds, the southern and central European countries maintain a much smaller proportion of equity assets. This said, there have been upward trends almost in every country, with the highest growth observed in Greece, Belgium, Norway, Germany and Luxembourg. It is also interesting to point out that the United States, with a share of equity funds in mutual funds equal to 57% at end-2000, would only rank 7th in the European ranking [3].

The growth in the UCITS industry between end of 1995 and end of 2000 was spread throughout Europe, with the Scandinavian countries attracting the largest gains together with Italy and Greece (see Fig. 10). This development reflected the process of catching-up compared to the Northern European countries where the UCITS market had already been quite developed in the mid 1990s. In the d, the strong growth performance he escalation of cross-order busi- aker growth observed in Portu- me extent in Spain, compared to thern European countries prima- the less favourable performance ds in 1999–2000.

Three countries (France, Luxembourg and Germany) continue to dominate the European investment fund industry with a global market share of 59%. Italy and the United Kingdom follow in this ranking. Together those countries represent 76% of the total market [14]. It is unsurprising that those countries have such a

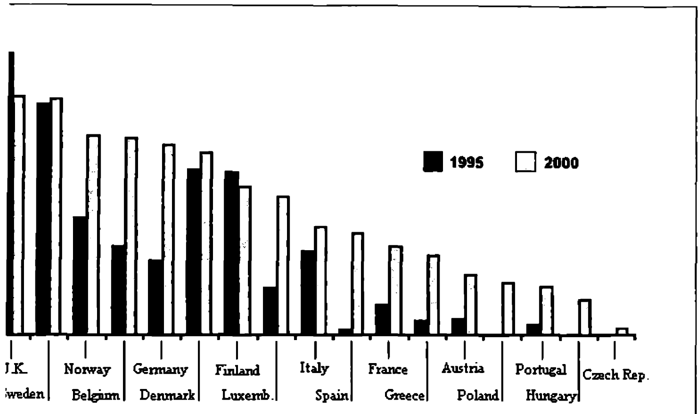


Fig. 9. Proportion of equity funds in UCITS assets

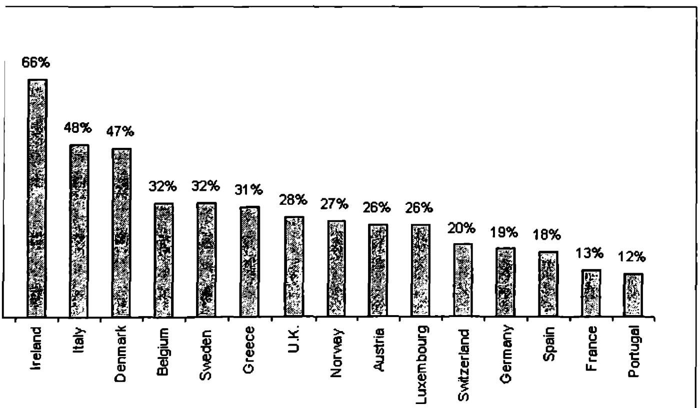


Fig. 10. Growth in the UCITS market (1995/2000)

large proportion of total investment funds assets, given that France, Germany, Italy and the United Kingdom represent about 70% of the population of the European Union. The fact that Luxembourg managed to build a leading position in the fund industry – despite the small size of its population – reflects the success of Luxembourg's strategy to establish itself as the first European centre of funds distributed at international level [3].

For the matter of interest, Europe with a market share of 32.2% is second in the worldwide ranking; the United States, with a market share of 55.2%, dominates the world market. Australia (3.5%), Japan (2.4%), Canada (2.3%), Hong-Kong (1.6%) and Brazil (1.2%) follow in this ranking (see Fig. 11) [7].

Concerning the geographical developments in the European UCITS market, the following comments may be made:

Among the fund industry's leading countries, Luxembourg recorded the highest asset growth thanks to strong inflows into equity, bond and balanced funds, which captured almost 50 percent of the total volume of new money invested in these types of funds in Europe during the third quarter (see Table 1). Spain also recorded a particularly strong asset growth, thanks to the continued strong demand for guaranteed equity funds and balanced funds. In Italy, inflows into bond funds turned negative for the first time during the last 12 months, whilst the money market funds continued to receive new money.

Scandinavian countries continued to enjoy an above-average growth, thanks to the strong performance of equity funds. Denmark and Norway also benefited from positive inflows into bond funds. In Eastern Europe, UCITS assets continued to grow remarkably in Poland thanks to strong inflows into equity and balanced fund assets. The observed decline in fund assets in Czech Republic resulted from a change in corporate taxation that penalized investment in money market funds.

The developments elsewhere in Europe were generally in line with the European average, except in Switzerland where a slight decline in total UCITS assets was observed, as one of the major Swiss management companies decided to shift the domicile of some of its equity fund assets to Luxembourg. It should also be noted that Portugal recorded a sharp rise in bond fund assets (+7%), whereas eq-

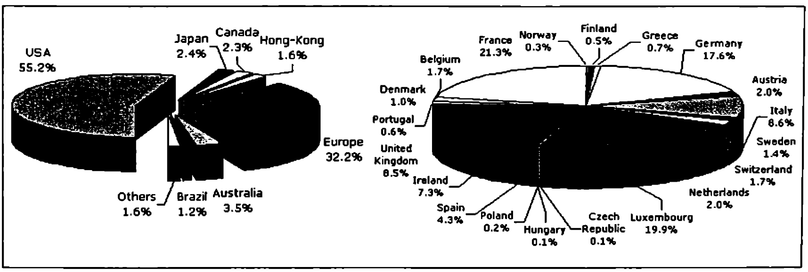


Fig. 11. a) Worldwide investment fund assets (market share) *b) European investment fund assets (market share)*

uity and money market funds in Liechtenstein recorded an increase of 9 and 10%, respectively.

Lithuanian investment fund industry

NSEL 30 index fund

The NSEL 30 index fund is the first investment company in Lithuania. The fund is an investment variable capital company formed in August 2000. The public distribution of the fund shares started in April 2001.

The fund's investment objective is to seek the average return of the Lithuanian stock market, meeting liquidity and security requirements. To achieve this objective the fund uses the indexing strategy, i.e. by investing all of its assets in common stocks issued by companies in the NSEL 30 index in proportion of their weight in the index. The NSEL 30 index is composed of 30 common stocks of companies that have the highest free-float based market capitalization and are listed on the Lithuanian National Stock Exchange. Companies included into NSEL 30 index belong to different sectors, namely banking, energetics, transport, light industry, food industry, etc. Other securities and investment instruments, as well as derivatives, may be used only in exceptional cases as auxiliary instruments for risk management with the purpose to protect interests of shareholders under unfavourable market conditions.

Therefore, the share of the NSEL 30 index fund is a portfolio of 30 stocks of the largest Lithuanian companies (by market capitalisation) traded in National Stock Exchange of Lithuania from official and current lists. Investing in the Lithuanian stock exchange, the shares of each of 30 companies could be bought by separate transactions. However, buying a share of the fund, a portfolio that includes all 30 companies is acquired. This way the portfolio is diversified (an investment that holds 30 securities in different companies and industries is likely to be less volatile than a less diversified portfolio composed of smaller number of shares) and the money on transactions is saved (only one transaction payment is done).

The NSEL 30 index is the indicator that reflects the value of the portfolio. The fund's investment portfolio is rebalanced quarterly to reflect the changes in the composition of the NSEL 30 index. The fund buys and sells securities only to rebalance its portfolio and in response to daily shareholder purchases and redemptions. This way the fund's portfolio is relatively inactive, thereby keeping the brokerage commissions and transaction costs to a minimum.

The NSEL 30 index is composed in the following order [8]:

1. Market capitalization of each company listed in the Lithuanian National Stock Exchange is recalculated according to the formula:

capitalisation of free-float shares = the number of the free-float ordinary registered shares issued by the company × share price according to the last transaction in the central market

2. 30 largest companies are selected according to the market capitalization calculated by this method.
3. The sum of free float shares market capitalization of all 30 companies is equated to 100%.
4. Purchase/sale of shares of each 30 companies is exercised in proportion to their weight in the 30 companies' list.
5. The procedure is repeated in each quarter of the year.

There is no possibility to enumerate an exact list of the thirty companies in which the investments are made, because the capitalization, composition of shareholders of listed companies change, the new companies are listed or old companies are no longer listed in the Exchange, so the composition of the NSEL 30 index changes. Then the Fund's investment portfolio is adjusted accordingly each quarter.

Securities sale and redemption prices. The fund's share price is equal to the previous business day's fund's net asset value per share. The fund's share distribution price is equal to the fund's share price increased by the fund's share distribution expenses which are not reckoned in the fund's net assets. To cover the fund's share distribution expenses, the investors pay a fee of 2% of the fund's share price.

The fund's share redemption price is equal to the fund's share price decreased by the fund's share redemption expenses which are not reckoned in the fund's net assets. At the current time the fund's share redemption expenses are calculated as follows [8]:

- for shares held for up to 1 year – 2% of the share price;
- for shares held from 1 to 2 years – 1% of the share price;
- for shares held for longer than 2 years the share redemption expenses become approximately equal to 0, so the investor does not incur any redemption expenses charge.

The fund's management company calculates the charges to cover the share sales and redemption expenses. The function of share distribution is delegated to the Vilniaus Bankas stock company. Investors may buy the fund shares through the Vilniaus Bankas fund shares distributor stock company or through distribution agents. The minimum number of shares that can be initially acquired is five.

The fund's share price, share distribution price, and share redemption price are determined and announced each business day an hour after the official results of the Lithuanian Stock Exchange trading session are announced. It can be found in every place where the fund shares are distributed and redeemed as well as on the fund's websites.

During the fund's registration 1000 shares were issued. The founder of the fund acquired all 1000 shares. The fund's share price (net assets per one share) was 1000 LTL. At the time when the public distribution of the fund shares was initiated, the fund's share price was 955.68 LTL. The table and graphs below provide information on how the fund's share price, number of investors, and the NSEL 30 index fluctuated over time.

Table 2. The main data on the fund's financial indexes

	29.09.2000 (at the time of registration)	*31.12.2000*	*31.12.2001*	*31.12.2002*	*31.12.2003*
Net Asset Value, Lt	1000000	1002903	1266316	1316997	11171022
Net Asset Value per Share, Lt	1000	1002.90	891.14	895.92	1646.91
Number of investors, in units	1	1	15	18	170
NSEL 30 Index	95.84	101.28	95.45	98.36	194.29

The dynamics of fund's share price is shown in the following chart (Figure 12).

Description of the fund's typical investor. The fund is chosen by those who wish to invest in the Lithuanian stock market for a longer period of time (2–5 years) and wish to receive the investment return corresponding to the average profitability of the Lithuanian stock market. In this case, the average return of the Lithuanian stock market is understood as a return of shares of the thirty companies that have the highest free-float based market capitalization and are listed on the Lithuanian National Stock Exchange.

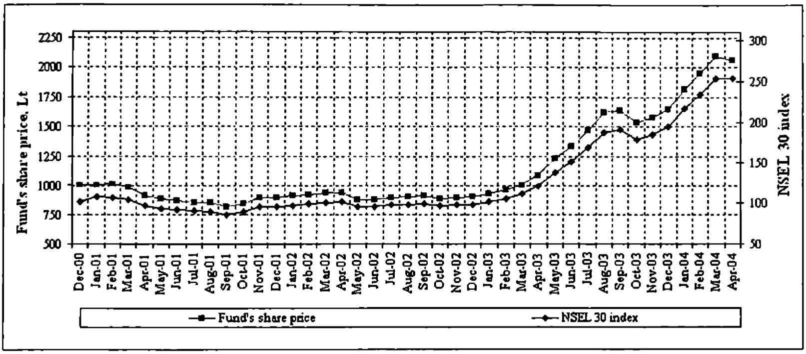


Fig. 12. Fluctuation of fund's share price and NSEL 30 index over time

A typical investor of the fund is one of the investor types enumerated below:

- with little experience of the stock market, but wishing to invest relatively safely in the Lithuanian stock market, who agrees to receive the average return of the market for modest taxes;
- with some or no experience, who does not wish to spend much time in following and analysing the stock market, to buy and sell securities, to fill in tax returns and pay taxes for the increase of the securities value;
- with some or no experience and having or not having time, but lacking funds in order to form their own rather diversified investment portfolio.

The typical investor will tolerate from the average to a relatively low risk level. In investing for a longer period of time the risk decreases. Detailed description of the risk of investing in the fund's shares is given below, after the main advantages.

The main advantages of investing in the NSEL 30 index fund [11]:

- Liquidity: investors can sell (redeem) shares at any time. Redeemed shares are paid at the latest in 7 business days but usually they are paid the same day.
- Safe and reliable investment: the activity of the fund is highly regulated by the Lithuanian Securities Commission and the Lithuanian Laws.
- Diversification: the fund's assets are invested to 30 companies from differ-

ent economic sectors. An investment in a fund that holds 30 stocks will likely be less volatile than a less diversified equity portfolio composed of a smaller number of securities.

- Convenience: participation in the long-term growth potential of the 30 stocks with one convenient, low cost investment. Investor doesn't have to follow the market every day and make buy and sell decisions. The fund's share price is provided daily on the fund's website. Dividends that are paid out by companies in the fund's portfolio are automatically reinvested into the fund so investor does not have to follow when the companies pay dividends in order to reinvest them in time.
- Efficiency (low cost): there are no employees in the fund. The fund is managed by the management company to whom the fund pays 1% of annual average net assets. Investments are passive following the NSEL 30 index. Investment portfolio rollover is done only quarterly so the brokerage commissions are very low.

The main risks investors collide with investing in the NSEL 30 index fund and the way of avoiding or reducing them are discussed below.

Market risk. Stocks fluctuate in price, and their short-term volatility at times may be great. Since the fund invests in common stocks, the value of the fund's portfolio is affected by changes in the stock market. The fund's net asset value per share fluctuates as the value of the fund's portfolio of securities changes.

The fund reduces its exposure to market risk by diversifying its investments, that is, by spreading its assets across a wide selection of securities, industries and sectors (banking, electricity, transport, wearing apparel, food industries, etc.) [8]. It's important to remember that diversification won't protect the investor against overall market fluctuation; index funds that track the market will go up and down with the market they represent.

Investing for a long term greatly reduces the market risk. The short-term investment return may be inconsistent as prices of individual shares fluctuate. Nevertheless, the continuing recovery of Lithuanian economy should mean higher stock prices, and long-term investors who chose an index fund in Lithuania can reasonably expect to match the growing economy.

To minimize the market risk, the fund invests only in stocks of companies that are listed on the Lithuanian National Stock Exchange, that disclose information publicly and have a listing history on the Stock Exchange.

Specific investment risk. Any security from the fund's investment portfolio may lose its value because of temporary financial difficulties, market slump, bankruptcy or rehabilitation. Some securities which are traded on the Lithuanian securities market have a low liquidity. These securities may be included into the fund's investment portfolio. To reduce this risk, most of the fund's net assets are invested in the most liquid stocks of official list. The fund tries to avoid a negative short-term market decline by encouraging investing for longer terms.

Currency risk. The fund's capital is denominated in the Lithuanian currency and the fund invests only in stocks of Lithuanian companies; therefore, Lithuanian investors will not be affected by currency risk. Since the Lithuanian Litas is linked to the Euro (1 EUR = 3.4528 LTL), the Euro investors are likely not to be affected by currency risk. Foreign investors who invest in any currency other than Euros, however, may be affected by currency risk, because the value of investment portfolio may change relative to other currencies.

Fund's activity (liquidity) risk. There is a risk due to a low liquidity of the market, which would render impossible to sell the shares of the investment portfolio at the desirable time for the desirable price and to settle with shareholders redeeming the fund's shares in a timely manner. This risk is minimal, since a portion of funds in cash is always kept in the fund's account for redemption of the fund shares, besides the greater portion of the fund's net assets is invested in shares of high liquidity of the companies from the official and current lists of the National Stock Exchange.

The liquidity of the fund shares is especially high. Sales of shares of individual companies that are included into the fund's investment portfolio may be halted due to restructuring of those companies, capital changes, meetings of shareholders, etc. Additionally, some shares of individual companies may become illiquid due to the lack of demand; but all of this does not impede the fund's settlement with an investor redeeming the fund's shares.

The fund's shareholders can request the fund to redeem their shares from them at any time. The redeemed shares will be paid at the latest in 7 business days.

Influence of foreign investors. International financial capital functioning in Lithuania operates financial resources that are rather great for the Lithuanian market. This capital is mobile and vulnerable to market changes. That is why coming in or withdrawal from the market of one or several international financial investors may have a substantial influence on the situation in the shares market. Massive withdrawal of all foreign investors from the Lithuanian securities market is unlikely. At the moment there is a tendency of foreign investors to come into the Lithuanian market. In addition, the influence of foreign investors in the market is amortized by gradual appearance of local institutional investors, e.g. pension funds.

Inflation risk. A significant inflation of the national currency in Lithuania has not been a real threat for quite a long time (inflation was – 1.3% in 2003 [9]). As the Republic of Lithuania has become a member of the European Union, additional securities against inflation risk are regulations of the European Union for currencies and fiscal policies of member states.

Transaction parties and settlement risk. Any party functioning in the finance market faces the counterparty risk. Transactions of securities purchased by the fund are made through the National Stock Exchange of Lithuania (hereinafter referred to as NSEL) using a system that ensures a timely delivery of securities and money and the guaranteed fund of NSEL. Transfer of securities will be performed through the Central Depositary of Securities of Lithuania, i.e. the national system, used by all participants of the Lithuanian securities market.

Risk of changing legal environment. Recently legal rules regulating the securities market in the Republic of Lithuania have undergone dramatic changes. It caused certain inconveniences and additional expenses for participants of the securities market. The fact that recently there have been adopted the legal rules that completed formation of legal grounds for the securities market in the country allows for a radical improvement of the situation. At the moment, it can be claimed that the legal rules regulating the securities market of Lithuania are harmonized with the regulations of the European Union. Thus, it is quite plausible that there would be no radical changes in the legal rules regulating activities of the investment funds in the nearest future.

Hansa money market fund

The purpose of the fund is to ensure a stable growth of the fund's assets, a higher liquidity comparing to short-term deposits, seek for a higher return than the average return of the one month's fixed-term deposit in Litas in Lithuanian banks. The fund invests in liquid short-term, low-risk instruments in Lithuania and abroad. The investing currencies are Litas and Euro; the currency risk is fully insured if investing in other currencies [6].

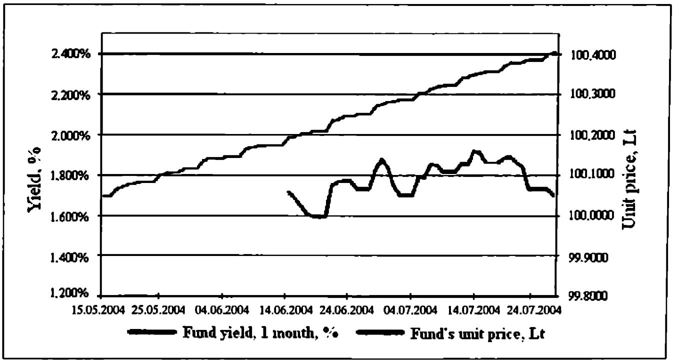


Fig. 13. Results of the Hansa money market fund activities

The fund's investing principles:

- it invests only in high-grade quality rating short-term securities (government, municipal, corporate bills and bonds) and short-term bank deposits;
- it invests only in securities and instruments of issuers of Lithuania, Latvia and countries which belong to the organisation of economical cooperation and development;
- the investments are diversified according to legal regulations.

The money market fund investments are very liquid. The fund's units are sold and redeemed for the price which is equal to the fund's net asset value per unit. The change of investment value of the fund portfolio and dividends is daily included into the value of investment unit.

The fund's unit price, net asset value, yield and change in the unit's value through different periods of time, as well as the main portfolio investments are provided daily in a report on the fund's website.

Conclusions

The basis of economical development and one of the most important factors conditioning the growth of the standard of living is an efficiently operating finance system. That is why it is important to improve the activity of the finance system by expanding the network of financial institutions and one of the largest financial intermediaries in the world – the investment fund.

Over the past decade, investment funds in Europe have gone from strength to strength, developing from a niche product into one of the most popular savings products on the market today. Statistics show that investors continue to favour investment funds as a product despite the environment which has witnessed a significant drop in their confidence in markets and various market-players. The advantages that they offer in terms of diversification, liquidity, costs, and real returns contribute to explaining their success as saving instruments. Those factors, together with the anticipated growth in private retirement savings in Europe and the growing importance European investors give to the risk-return frontier of their financial savings, should continue to give momentum to the European investment funds industry over the coming years.

The abundance of investment fund types and the variety of their structure can mislead even an experienced investor. Historical development has determined different preferences for savings in different countries with their legal and finance systems, that's why different investment habits and structures have been formed in different countries throughout the time. The heterogeneity of asset preferences reflects the degree of households' aversion to investment risks and the persistent cultural and historical differences that exist among countries, though a growing preference for equity funds is observed in all countries. The emergence of equity culture in Europe has been supported by:

- a desire on the part of European investors and households to improve the investment performance of their savings;
- the recognition by individual investors that equity funds provide them with an efficient, liquid and effective way to take the advantage of the generally higher returns offered by equities while avoiding excessively high levels of risks thanks to the asset diversification offered by equity funds;
- the need to increase long-term savings and financial security as a result of the pressures that the ageing population will have on public pension systems.

As the level of living and the average gross monthly earnings increase, the need for investing arises. The continued recovery of Lithuanian economy means higher stock prices, and the long-term investors that have chosen the investment funds in Lithuania can reasonably expect to match the growing economy. Lithuanian investment funds offer their investors the same advantages as do the funds of foreign countries. Though Lithuanian investment fund industry only marks its beginning, it reflects the main tendencies of the European market. According to the data of the Central Securities Depository of Lithuania, investments of individual investors to equities increased by 42% in the first quarter of 2004. On the other hand, it is quite comprehensible as the interest rates decreased significantly.

The fact that recently there have been adopted the legal rules that completed formation of legal grounds for the securities market in the country allows to expect a radical improvement of the situation. At the moment it can be claimed that legal rules regulating the securities market of Lithuania are harmonized with the regulations of the European Union. Thus, it is quite plausible that there would be no radical changes in the legal rules regulating the activities of investment funds in the nearest future.

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INVESTICINIŲ FONDŲ PLĖTROS TENDENCIJOS

L. Simanauskas, I. Kucko

Santrauka

Globalizacijos sąlygomis dinamiškai gausėjant teikiamų paslaugų ir plečiantis finansinių instrumentų spektrui, didėjant finansinių institucijų konkurencijai, vykstant jų jungimosi procesams, finansų sistemos plėtra, jos jautrumas vykstantiems pasaulinės finansų sistemos pokyčiams tampa aktuali problema Lietuvai, kur plėtojantis finansų sistemai ir didėjant vidutiniam mėnesiniam atlyginimui, atsiranda poreikis investuoti. Straipsnio tyrimo objektas – vienas iš finansų sistemos elementų, alternatyvus investavimo instrumentas – investicinis fondas. Sąvoka *investicinis fondas* čia vartojama kaip viešai siūlomo atvirojo fondo, investuojančio į perduodamus vertybinius popierius ir pinigų rinkos instrumentus, atitikmuo, kuris vadinamas „savitarpio fondu" (mutual fund) JAV ir UCITS (angl. Undertaking for Collective Investment in Transferable Securities) FEFSI pateikiamoje Europos investicinių fondų sektoriaus statistikoje. Investicinio fondo analogas Lietuvoje – investicinė kintamojo kapitalo bendrovė. Darbe Lietuvos investicinių fondų sektoriaus plėtros tendencijos nagrinėjamos remiantis Europos patyrimu, analizuojant plėtros istoriją ir veiksnius, taip pat aktyvų pasiskirstymą tarp skirtingų investicinių fondų rūšių.

Pastarąjį dešimtmetį investiciniai fondai Europoje nuolat stiprėjo. Praėjusio šimtmečio dešimtąjį dešimtmetį investicinių fondų sektorius buvo sparčiausiai auganti Europos šalių finansų sistemos dalis, jų valdomi aktyvai padidėjo nuo 500 mln. eurų dešimtmečio pradžioje iki 4,6 trln. eurų. 2003 m. rugsėjo pabaigoje. Investicinių fondų teikiami pranašumai: diversifikacija, likvidumas, kaina ir pelnas paaiškina jų, kaip taupymo instrumentų, sėkmę. Šie veiksniai, kartu su numatomu privačių pensinių santaupų augimu Europoje bei investuotojų teikiama svarba savo finansinių santaupų rizikos ir pelno santykiui ir toliau teiks inerciją

Europos investiciniams fondams. Straipsnyje šios augimo tendencijos nagrinėjamos įvairiomis kryptimis, lyginant su BVP, kitais instituciniais investuotojais, namų ūkiais. Daugelis individualių investuotojų Europoje investicinius fondus mano esant patrauklia finansinių aktyvų alternatyva, tačiau pirmenybė investiciniams fondams skirtingose Europos šalyse teikiama nevienodai, šis nevienalytiškumas rodo tiek kultūrinius ir istorinius Europos šalių skirtumus, ypač organizuojant pensijų sistemą, tiek ir atskirų investuotojų antipatiją investicinei rizikai. Trys šalys (Prancūzija, Liuksemburgas ir Vokietija) dominuoja sektoriuje, turi 59%, po jų Italija ir Jungtinė Karalystė, kartu sudarydamos 76% rinkos. Beveik visose šalyse nuolat stebimos akcijų fondų kilimo tendencijos, kurias remia:

- Europos investuotojų troškimas pagerinti santaupų investicinius rezultatus;
- Individualių investuotojų supratimas, kad akcijų fondai suteikia veiksmingą ir likvidų būdą pasinaudoti akcijų teikiamu didesniu pelnu, diversifikacijos dėka išvengiant pernelyg didelio rizikingumo;
- Poreikis padidinti ilgalaikes santaupas ir finansinį saugumą dėl spaudimo, kurį darys senstanti visuomenė valstybinei pensijų sistemai.

Nors Lietuvos investicinių fondų sektorius tik pradedamas plėtoti, tačiau išryškėjo bendros tendencijos: didėja tiek fondų skaičius, tiek ir investuoti aktyvai, jie dabar sudaro apie 26 mln. Lt, pakilę nuo 1mln. Lt 2000 metų pabaigoje. Investicinių fondų atsiradimas Lietuvos rinkoje ne tik didina jos likvidumą, bet ir suteikia individualiems investuotojams tuos pačius pranašumus, kuriais gali naudotis Europos šalių investuotojai.

Įteikta 2004 m. birželio mėn.