THE ROLE OF MUTUAL FUNDS IN U.S. ECONOMY

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Abstract:
The main aim of this article is to present the correlations between different macroeconomic indicators and the dynamics of mutual funds in U.S. The direct relationship between inflation rate and net subscription of stock funds in the US market is validated. On the other hand, a lower interest rate in US means investing people's savings in monetary and bond funds. We have also shown an indirect link between interest rate and bond funds. We couldn't highlight the direct link between global funds and its balance of payments and the country's GDP. The weak correlation between balance of payments and global funds is due to the fact that in the current account balance are included other financial flows that are much larger and with a greater influence on it, such as imports and exports. Also, the weak correlation between the net assets of global funds and the evolution of GDP is due to influence of other factors that leads to the decision of investing internationally. We have also shown the importance of investment funds by increasing what they hold in total savings of the population. This increase is explained both by placing the weight of massive cash of traders in investment funds and by the existence of a higher utility of personal savings invested in investment funds aimed at saving for retirement. Also we briefly highlighted the role of investment companies in the State unemployment rate.

Keywords: financial markets, intestment funds, inflation rate, stocks, bonds, interest rate, monetary assets

JEL Classification: E44; G12; G14; G15; G21

I. INTRODUCTION

Internationally, the importance of investment funds in the financial markets differs from one state to another, depending on how the sector is developed. So, in the developed states of the world such as USA, Great Britain, France, Japan, the role of investment funds in the financial system is much more pronounced than in some less developed countries. Imposing presence of the funds, however, depends not only on the size and economic development of the country, but also by internal regulations, tax benefits, industry experience and economic situation (eg Ireland, Luxembourg).

One of the main role of investment funds is the protection of people's savings against inflation. So, while the shares and other variable income securities increase their value once the general price index development, are among the few profitable ways of investing in conditions of rising inflation. A moderate increase in inflation leads also to upward trend of stock mutual funds, an increase of preference of placing people's savings in such portfolios in the hope of obtaining a higher gain.

On the other hand, a lower inflation rate usually means a lower interest rate, and hence investing people's savings in funds that invest in fixed income assets. So, for example in the conditions in which the U.S. Government has kept and still maintain a zero interest rate, during the recession, has been observed that both the net assets and net subscriptions showed a favorable trend in bond and monetary funds. With the uncertainty characterizing financial markets, these two categories of funds were a viable alternative, particularly in the short term, for the investors not only from U.S. but also in the most of the countries.

Shares have traditionally been associated with an "asset class that cover inflation". So, recent studies such as those made by MSCIBarra and Dexia Asset Management (2010) are showing the existence of a direct relationship between moderate inflation (up to 4%) under a stable economic framework. After this limit, the stocks begin to struggle, due to economic imbalances.

Also, direct linkages exist and in the case of other macroeconomic indicators like: between investment funds and GDP, between investment funds and balance of payments, between investment funds and people's savings.

To demonstrate the correlation between the items mentioned will take the U.S. example, as its accounts almost half of the world market for investment funds.

II. THE POSITION OF INVESTMENT FUNDS IN THE U.S. MACROECONOMIC CONTEXT

The data used for demonstrate our hypothesis are: 1999-2010 for the correlation between inflation rate and stock funds, 2002-2010 for the correlation between current account balance and net subscription of global funds, 2001-2010 for the correlation between GDP and net subscription of global funds and for the correlation between population's savings and net assets of investment funds. The data are taken from the following websites: www.ici.org, www.inflationdata.com, www.bea.gov.

1. This study starts with the correlation between the inflation rate and the investment funds in general and especially about the stock investment funds. Everywhere around the world the financial markets are facing the negative effects produced by the financial crisis, which led in 2008 to the increase of the inflation rate in the many countries.

Traditionally the stocks have been looked upon as an "asset category that is not affected by the inflation". But the recent economic studies proved otherwise. In the condition of a stable economic framework they showed the existence of a direct relationship between a moderate inflation – up to 4% – and the stocks. If this threshold is exceeded the letter start to struggle because of economic imbalances. It is obvious that in an inflationary environment the fixed income bonds and the monetary assents will not have a very high yield. In these conditions the only alternative for the investors are the stocks whose net subscriptions had increased in the same proportion as the inflation rate. This trend can be also observed by analyzing the chart.

The analysis of the correlation between the annual inflation rate and the stock fund assets is not as relevant because of the fact that the letters are also influenced by the results of the previous investments. The years 2003, 2008 and 2009 are the only exceptions from the analyzed time period.

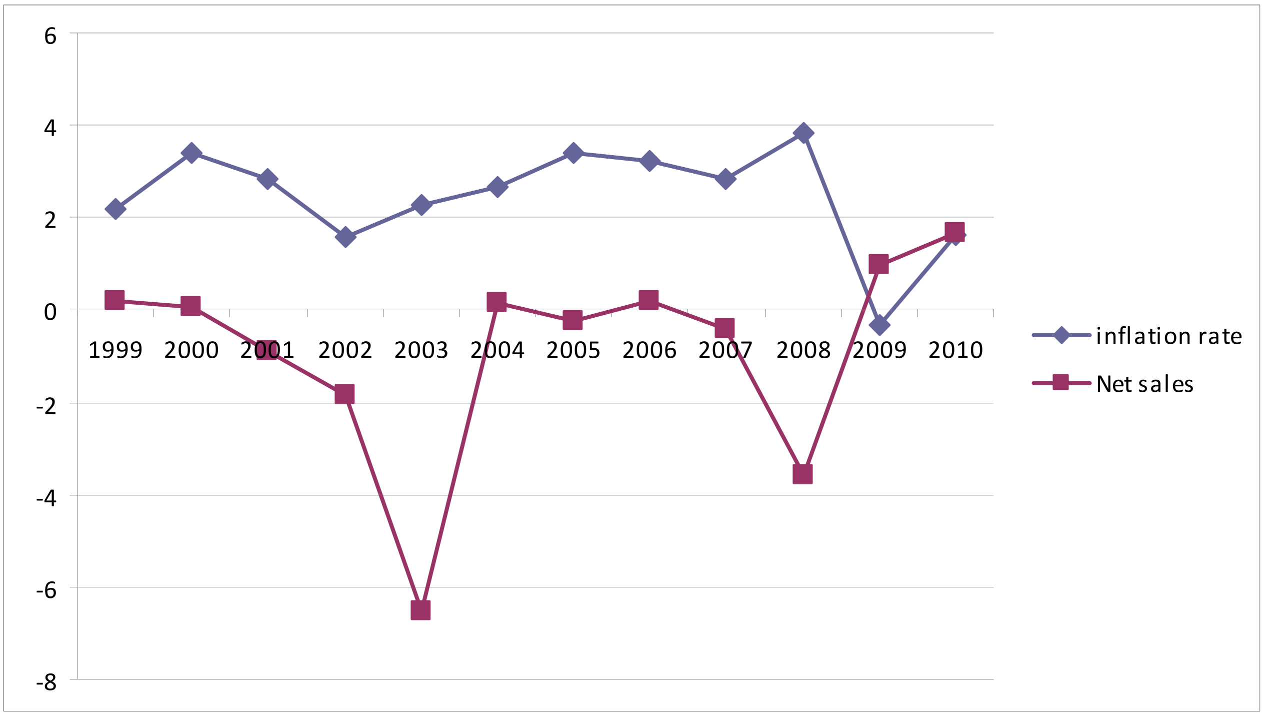


Figure no. 1. Inflation and net subscriptions of U.S. equity funds, 1999-2010 (%)

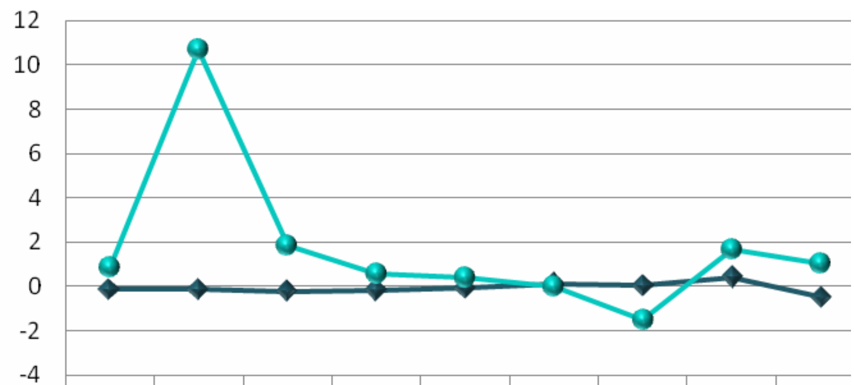
Source of data: www.ici.org , www.inflationdata.com

In 2003, on the US market, the absence of correlation between these two indicators can be explained by the fact that approximately 77% of the total net inflows were global stock funds, given that the U.S. inflation is an internal factor while the global funds are a factor of the foreign capital markets. In 2008, because of the global financial crisis, there were massive withdrawals of funds at both the national and global ones. This was the result of the decline in stock prices. In spite of the fact that the annual inflation rate had increased, the net subscriptions drastically declined. The same mismatch is observed in the following years but the other way around. The inflation rate decreased while net subscriptions rose. This happened mainly due to global funds which registered inflows worth 31 billion USD.

So, in certain periods, the equity and the hybrid funds are designed to cover household savings against inflation, being among the few profitable ways of investing in conditions of rising inflation.

2. In terms of U.S. bond funds, they had an oscillating trend, especially in the last three years. This was due to the change of the market interest rate. Traditionally, the bond's coupon rate – which is fixed – becomes more or less attractive depending on the market interest rate. So, in terms of a benchmark interest rate higher than the coupon rate, bonds will be sold below VAN (discount) and vice versa. So, in 2008, due to the increase of the benchmark interest rate past the coupon rate on long term corporate bonds, the bond funds net subscriptions (net new cash flow) declined by 70% (from 108,768 million USD to 27,574million USD). The amount of redemptions greatly increased (682,553 million USD) in comparison with the increase in subscriptions (710,127 million USD). The situation improved in 2009 and continued in 2010, the net new cash flow increasing 12 times compared to previous year (375,526 million USD). The total value of subscriptions increased by over 40% (1,010,761 billion USD) while redemptions decreased (635,263 million USD) compared to previous. The causes of that increase were the decreasing of the annual average interest rate from 1.6% in 2008 to 0,3% in 2009 but also the lower risk tolerance of the investors which made them choose the bond funds instead.

3. Influencing the balance of payments in U.S. by investment funds is achieved through global funds. Therefore, global investment funds activity is reflected at the macroeconomic level in the current account of balance of payments. It is understood that among global funds and the balance of payments current account exists an inverse relationship, meaning that investing in global funds involves transfers of money abroad, which inversely affects the current account. Evolution of the two indicators is presented in the following chart.



	2002	2003	2004	2005	2006	2007	2008	2009	2010
evolution of current account balance	-0,14	-0,14	-0,21	-0,17	-0,07	0,1	0,03	0,41	-0,49
evolution of net subscriptions	0,88	10,66	1,83	0,55	0,4	-0,01	-1,49	1,69	1,02

Figure no. 2. The evolution of current account balance and net subscriptions of U.S. Global Funds (2002-2010)

Source: www.ici.org, www.bea.gov

From figure no. 2 we can see a weak correlation between the two indicators have been analyzed, and this is due primarily to the fact that in the current account balance are included other financial flows that are much larger and with a greater influence on it, such as imports and exports. Current account curve is too flat in comparison to net subscriptions, but we can see an inverse correlation between 2004 and 2008, meaning that the lower value of net subscriptions in the overall funding leading to a smaller amount of current account balance. On the background of outflows slowdown, this is due to the decrease in stock prices in international markets, changes in the dollar during this period and increased redemptions in 2008 because of global financial crisis.

4. U.S. investment funds contribute to GDP, to the development of the country's economic performance. Thus, a directly proportional relationship on financial markets is between evolution of GDP and assets, in this case referring to the current U.S. global investment funds and GDP registered in the U.S.

In Figure nr.3 we can see a weak correlation between the net assets of global funds and the evolution of GDP (current prices) due to influence of other factors that leads to the decision of investing internationally. These can include the growing up sophisticated requirements to diversify the portfolio, the external market conditions, within the meaning of higher growth rates in emerging markets, estimates on the profitability, the growth of information access through these funds at a low cost and aging population. However, it is apparent that the growth trend of U.S. economy by the year 2007 (in particular the accelerated growth in the range 2002-2004) led to the decision of investing abroad, mainly in emerging markets in Europe and Asia (rhythm rapid growth in 2003-2006).

Figure no. 3. The evolution of GDP and global fund's net assets from U.S. (2001-2010)
Source: www.bea.gov, www.ici.org

It may also be noted that an accelerated growth of GDP in the U.S. also leads to a downturn in global net asset value, due to lower stock prices on international markets (provided that they hold the largest share of total fund assets overall). This decrease can be demonstrated by the fact that the growth trend in the economy led to the appreciation of the dollar in foreign markets - especially in the years 2003-2005 (due to limitations of funds for export) so that the market value of shares held in other states, denominated in dollars fell. This trend has been somewhat stopped by the global increase in yields between 2003-Q3 2007, an increase in the MSCI stock index average of 20% per year, the largest growth was in emerging markets. Since Q4 2007 until semester 2 of 2009, net assets of global funds and U.S. GDP experienced a drop sharp on the backdrop of global economic crisis, which led to the printing of uncertainties in the international markets, and thus the foreign shares lower yield. Since mid 2009 and till 2010,on the recovery of financial markets background, MSCI index has risen by about 79%, which led to the growth of the first indicator (due to weaker GDP), the largest share being held by Asian equity investments .

5. To analyze the impact of investment funds on population, we continue to analyze the evolution of net subscriptions of investment funds and the value of U.S. population's savings between 2001 and 2010.

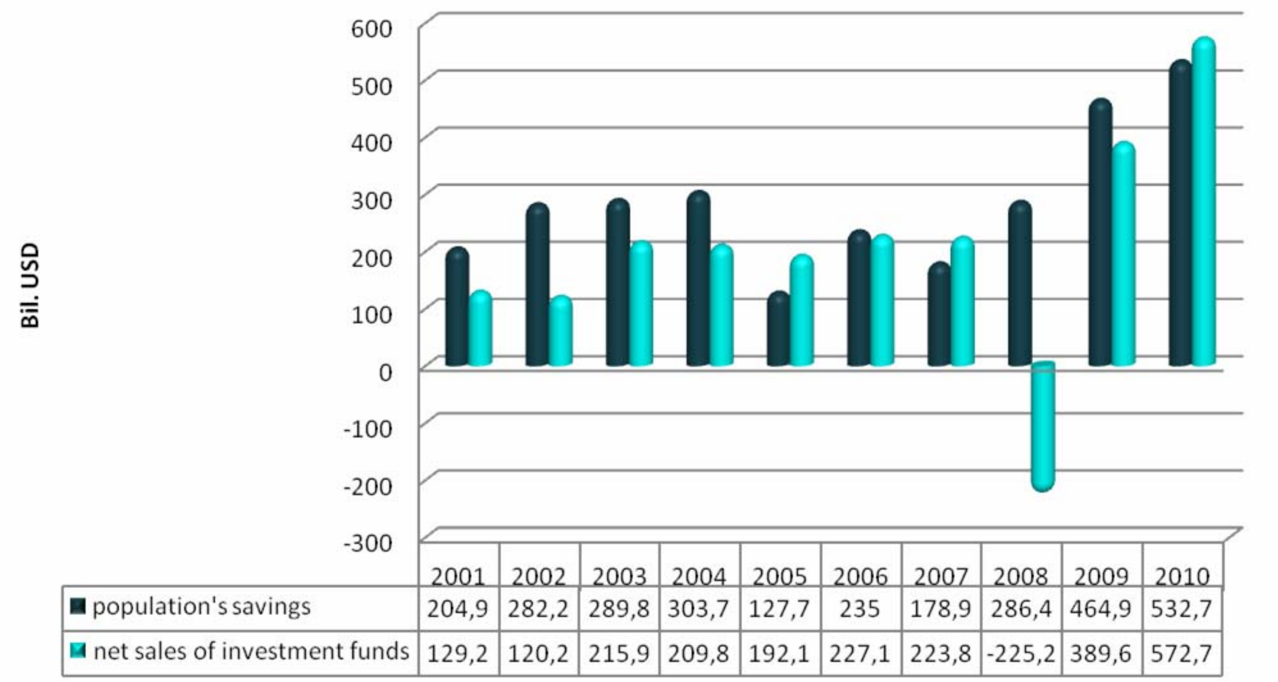


Figure no. 4. The evolution of population's savings and net subscriptions of U.S. investment funds (2001-2010)

Source: www.bea.gov, www.ici.org

From figure no. 4 we see that by the year 2005 the investments in investment funds have an increased share in total savings of the population, but lower than that. This increase is explained both by placing the weight of massive cash of traders in investment funds (especially in shares) and by the existence of a higher utility of personal savings invested in investment funds aimed at saving for retirement (most investing for this purpose).

But the situation reversed in 2005 and 2007, when net subscriptions have surpassed the growth of personal savings decrease, with 85.65 bil. and respectively 76 bil. USD. This is due to the contribution of increasing cash inflows of investment funds, too (which decreased by 10% in 2005 and a minor increase of 12% and 6% in 2006 and 2007), but mainly due to reductions in the savings rate of the American population. During these three years it has been recorded the lowest values of this indicator in the past 70 years. This status means that the American people spent more than he won, which is possible through excessive growth of loans taken by them. Thus, the following year because of economic recession, the savings have increased (increased market interest rate), but the redemption also had increased, and as shown in the figure nr. 4, the investment fund industry has made massive withdrawals of money (225,209 USD). Most repurchases were made in the domestic equity portfolios, followed by the international ones. Within the bond funds, they were much more stable because of the long-term instruments that pay a fixed income. We can also see a return to the situation before the recession in 2009 that continued in 2010, in which both, the level of savings has increased by 60% over the previous year, and the net underwriting investment funds increased almost three times compared to the previous year.

6. Also, the role of investment companies in the economy can be justified by the fact that it gives people jobs, so a development of this industry implicitly leads to a reduction in State unemployment rate. For example, the United States, in 2007 the estimated number of employees in this industry was 168,000 and in 2008 it dropped to 157,000 due to lower overall costs to the firm substantial decrease in revenues during this period under unemployment rate increased from 5% to 7.4% over the same period.

III. CONCLUSIONS

The U.S. investment funds market is important because it accounts for almost half the global market share of net assets. In the analysis of U.S. investment funds market, direct correlations between inflation and stock funds on the one hand, and indirect linkages between interest rate and bond funds are recorded in almost all the years analyzed (exceptions in 2003, 2008 and 2009 in inflation-stock funds relationship). A moderate increase in inflation in US, leads to upward trend of stock mutual funds, an increase of people's preference of placing their savings in such portfolios in the hope of obtaining a higher gain. Also, a lower inflation rate in US, usually means a lower interest rate, and hence investing people's savings in funds that invest in fixed income assets (monetary and bond funds).

We couldn't show a link between current account balance and global investment funds due to the lower volume of global funds. Also the lower volume of net sales of global funds hasn't highlighted the direct link with the country's GDP. We have shown the importance of investment funds by increasing what they hold in total savings of the population, and by the fact that there exist direct linkages in almost all the periods. This increase is explained both by placing the weight of massive cash of traders in investment funds and by the existence of a higher utility of personal savings invested in investment funds aimed at saving for retirement. Also we briefly highlighted the role of investment companies in the State unemployment rate.

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