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Investigations upon the correlations between the efficiency of investment strategies and the market performances of the Romanian financial investment companies

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Abstract

Defining, implementing and monitoring investment strategies are sensitive coordinates for solid corporate governance within investment entities and may significantly influence the investors' perception regarding the financial performances. We based our research on the assumption that efficient investment strategies has major impact upon the net asset value (NAV) reported by Financial Investment Companies, and implicitly upon the stock price. The paper is focused on identifying a certain pattern in the portfolio structures of these entities and measuring some possible correlations with the market performance. For the purpose of this paper, we examine the trading discount or premium determined as price to net asset value per unit (NAVU) ratio in order to measure investors' perception regarding the asset management performance, defined as market performance. Nevertheless, we consider that our research find its utility also for financial audit missions conducted for investment entities, whenever significant misstatement risk is assessed as part of planning the missions. Therefore, we consider that our correlation testing may be efficiently used as analytical procedures when gathering sufficient knowledge about the entities and the asset management industry.

Keywords: investment strategy, financial performances, net asset value discount, Financial Investment Companies, financial instruments, correlation measurement.

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1. Literature Review and Problem Formulation

Financial Investment Companies are investment entities operating as major institutional investors on the Romanian capital market. Their main area of business regards acquisitions and sales of traded financial instruments, as well as purchasing control or influence interests in non-listed companies for the purpose of developing adequate corporate governance to enhance the business practices. Based on a prudent portfolio diversification, this special category of Romanian institutional investors is permanently seeking to achieve maximum efficiency of their investments. Therefore, these entities must constantly answer challenges in matter of designing and implementing investment strategies and models to assess financial instruments designed to assure optimal adjustment of the structure and the size of their portfolios. The investment process can be reflected in a synthetic manner by reference to the following steps:

(a) Defining investment objectives. Setting targets for the investment process is based on the risk-return correlation associated with each investment option. Basically, institutional investors are considering at least two major objectives: the "expected return" and the degree of "risk aversion", on the assumption that in the absence of realistic determinations related to investment objectives, the actual assessment of the capital allocation process within the investment strategy is very difficult to quantify. The investment objectives which support the asset management process within the Financial Investment Companies, essentially aim to :

- *Maximize dividends earned from issuers in the portfolio*. The logical consequence requires the need for selecting issuers with a high potential of sharing dividends. Without the ability to exercise control or significant influence, a stake in an issuer that does not pay dividends is deprived of economic substance in situations other than alienation at a price higher than the purchase.
- *Maximize capital gains from disposal of investments.* This objective requires either a short-term trading strategy with highly speculative features or a strategy of business purchases and sales over a period longer than one year. The former strategy involves accurate fundamental and technical analysis reports, as well as careful market surveillance, while the later is typical for private equity investments.
- *Maximize interest income* generated from interest-bearing financial instruments (corporate and municipal bonds, treasury notes) or other money market instruments. From this perspective, the prevailing consideration is that investments must simultaneously meet reasonable profitability and liquidity characteristics, correlated with adequate solvency of the issuer.

(b) Identifying constraints. The major constraint is related to the liquidity of capital investments, and therefore the investment strategy is aimed at establishing a minimum level of liquidity in the portfolio, supported by an appropriate policy of asset allocation. From this perspective, the institutional investors are required to:

- *Determine the category of financial assets* comprising the portfolio (money market instruments, fixed income assets, shares, units of investment funds, derivatives, real estate) correlated with the regulated investment policy and subject to prudential supervision;
- *Assess the capital market prospects*, using specific instruments and methods of technical and fundamental analysis;
- *Generate the efficient frontier of portfolios* that provide maximum return at a given level of risk. This undertaken is ultimately designed to achieve optimal combination for the purpose of harmonizing investors' objectives and the constraints involved.

(c) Reducing the constraints' effect. Management strategies based on the efficient frontier theory are developed to swift the global portfolio from the inefficient zone by maximizing the expected return at a given level of risk or by minimizing the investment risk at a certain level of expected return.

Strategic management techniques implemented in the asset management industry are focused on maximizing corporate value by minimizing the risk of significant variations from the expected performance. Manate *et al.*, 2006 pointed out some specific coordinates of this process with regard to Financial Investment Companies:

- *Establishing the expected performance* (benchmark) represents the starting point in creating the