Stock Market Sentiment and Mutual Fund Performance

Economic Forecasting Center Conference
February 19, 2003

Dr. Jason T. Greene
Associate Professor of Finance
J. Mack Robinson College of Business
Georgia State University
Fund Flows and the Market

Market Sentiment

Market Direction and Performance

Mutual Fund Flows

“price pressure”
Sentiment and the Market

Source: Yale School of Management Stock Market Confidence Indexes™
Mutual Funds and Sentiment

- Mutual fund investors can move easily among different asset classes
  - E.g., out of stock funds and into bond funds
- Flows into and out of mutual funds reflect investor sentiment
  - About the market and the performance of funds

- Mutual fund investors are fickle
- Fund companies cater to investors’ whims
Sentiment and Fund Flows

Source: Yale School of Management Stock Market Confidence Indexes™ and Investment Company Institute
Fund Flows and the Market

Source: Investment Company Institute
## Mutual Fund Outflows

<table>
<thead>
<tr>
<th>Month</th>
<th>$ Outflows</th>
<th>% of Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>July 2002</td>
<td>$52.6 billion</td>
<td>1.90%</td>
</tr>
<tr>
<td>September 2001</td>
<td>$30.0 billion</td>
<td>0.89%</td>
</tr>
<tr>
<td>March 2001</td>
<td>$20.7 billion</td>
<td>0.57%</td>
</tr>
<tr>
<td>June 2002</td>
<td>$18.1 billion</td>
<td>0.54%</td>
</tr>
<tr>
<td>September 2002</td>
<td>$16.1 billion</td>
<td>0.64%</td>
</tr>
<tr>
<td>August 1998</td>
<td>$11.6 billion</td>
<td>0.42%</td>
</tr>
<tr>
<td>October 1987</td>
<td>$7.5 billion</td>
<td>3.11%</td>
</tr>
</tbody>
</table>

Source: Investment Company Institute
Moving Out of Equity Funds

- Equity fund performance has led to outflows
  - Worst outflows in history of equity funds
- Nearly $100 billion flowed out of equity mutual funds in the last 7 months of 2002
  - Outflows in 6 of the last 7 months.
- Question: Where is the money going?
- Answer:
  - Bond Funds: +$80 billion
  - Money Market Funds: +$13 billion
Performance and Stability

- Investors seek better performance during a prolonged bear stock market
  - Bond Funds
- Investors seek stability in an unstable world
  - Money Market Funds

- The best of both worlds?
  - Stable Value Funds
Stable Value Funds

- Offer fixed net asset value (NAV)
  - Similar to Money Market Funds
- Offer intermediate-term yields
  - Better than Money Market yields
- Hold short- to intermediate-term instruments
  - Treasuries, government agency debt, GICs
  - Buy insurance contracts to guarantee the NAV

- New to the mutual fund world
  - Stable Value “funds” have been around for a while in the pension plan arena
Stable Value Funds – A Free Lunch?

- Yields are likely to be “sticky”
- Fund holds assets to maturity, earns their stated yields
  - Early liquidation of assets would result in a higher or lower yield that reflects the change in value of the assets
- This works very well in an environment of declining interest rates
- The sticky yields might make Stable Value Funds less attractive in an environment of rising interest rates
  - Other bond funds’ yields will increase
  - Investors will redeem, the fund must liquidate assets, …
    - Investors will redeem, only if allowed to do so
What the future holds…

- **Equity Funds**
  - Performance will rebound with the market…
    - Or, continue to languish with the market
  - As usual, mutual fund performance is likely to be somewhat below the market indexes, especially in a recovering market

- **Bond Funds**
  - As interest rates increase, performance will suffer
    - Long-term bond funds will suffer more

- **Money Market Funds**
  - Low yields for a while, but no risk

- **Stable Value Funds**
  - ...?