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Q How did the year 2012 go for Mutual Fund Sector?

A As the market correction continued, I think 2012 was a good year for value oriented mutual funds like the ones we manage. The year created some attractive investment opportunities for us. However, all fund managers do not follow the same approach and you may have noticed that many funds have lost huge amounts of money in the last couple of years.

Due to prevailing gloom in the capital market, fund managers were unable to raise new funds. Majority of the asset management companies (AMCs) are incurring losses as they do not have significant amount of money under management. So overall it was not a great year for the mutual fund industry.

Q To what extent did the sector perform in context of your expectation level? What strategy did you follow in 2012?

A The sector did not meet expectation in 2012 but we are happy with the performance of our funds. As value investors we try to invest in securities we consider undervalued and hold them for relatively longer periods.

Q What were the positivities in the capital market that you observed in 2012?

A I think in 2012 the BSEC showed its commitment for reforms. They have taken some initiatives to bring changes to some regulations. The agenda of demutualization of stock exchanges seems to be on track. Also the government has taken some initiatives to empower BSEC.

Q What positivities do you expect in 2013 in the context of the whole capital market?

A The current BSEC leadership is working for long-term betterment of the capital market and I expect them to continue their good work in 2013.

Q "BSEC's mid- and long-term strategies are wonderful. The main problem is that they don't have capacity to implement those. Whatever capacities it has is mostly being used in trying to manage market movements." You mentioned of some challenges when we interviewed you in our last year-end issue- deterioration of external environment and proposed BSEC initiatives might not be implemented that you expected to occur in 2012. How well were those challenges dealt with?

A I think the BSEC has realized that managing the day-to-day movements of the market is not their job. Now they seem to be more focused on their real job and are getting good support from the development partners. However, their capacity, especially at the desk level, is an issue. They need to have a pay structure that can attract professionally qualified people like CFAs, CAs and CMAs at mid level positions. They need to deal with the breaches of securities laws, especially those related to misrepresentation of the financial performance and financial positions of the listed companies, insider trading and market manipulation.

Q How much transformation took place over the span of last year in terms of trading nature of our majority investors? Are they still sticking to the nature of following the herd and trading without doing much background check of the company?

A There has not been any significant change in investors' behavior. Herd mentality persists. Most investors are focused on short-term returns. Value investors are rare.

Q "Another challenge of the mutual fund sector is the lengthy registration process. It should take merely days, not months, to finish up with the whole registration process which is not happening," Islam said passively. "Also, there is no role for a custodian. Worldwide only three parties- asset management companies, trustees, and investors are involved in a mutual fund," to this Islam added, "I defy the distinction of sponsors. I don't understand the role of sponsors in a mutual fund. Why should they be separately considered than the general investors? I really don't get it."--- as a year has passed, do you see any improvement in your stated lingering scenario? What is your outlook for Mutual Fund for the coming year 2013?

A I think that the length of registration process is less an issue now. This is primarily due to fall in number of applications for new funds after the bursting of the mutual fund bubble. Only few years ago mutual funds traded at insane prices such as at 600% premium to NAV. That created a gold rush for new AMC licenses and there was a sort of competition among banks in terms of the size of the mutual funds they were sponsoring.

The regulations of mutual funds have still roles for sponsor and custodian. As I told you last year mutual funds do not need sponsor and the role of custodian can be eliminated by slight enhancements of roles of the fund manager and the trustee.

The biggest problem of mutual fund industry in Bangladesh is

lack of long-term investors. Investment horizons are pretty short here. Also the market is not fundamentally driven. Investors love the gimmicks such as bonus shares and stock splits. They like to see 'sensational' declarations from companies and mutual funds but do not want to research on the substance of the declarations. They hardly look at the performance of the funds (primarily the net asset value and the growth of net asset value) and the credentials and ethical standards of the fund managers. And unfortunately, some mutual fund managers try to exploit the ignorance of the investors and focus on delivering sensations, not substance.

Q Recently, the BSEC have come up with a guideline which will allow the stock dividends/ right shares to be given by the Mutual Funds. What is your view regarding this move by the regulator?

A Personally, I don't like the idea because our investors still believe that stock dividend should have implications on share/unit price more than anything else. If the objective of allowing mutual funds to issue stock dividends/right shares is to make the funds appealing to the investors, I think it is unethical. It is a sin to exploit the ignorance of naïve people.

Q It has been observed recently that price to NAV ratio of Mutual Fund industry is 1, whereas just six months ago it was 0.8. How do you view this change?

A A mutual fund should trade at a price close to its NAV (i.e., price to NAV ratio of 1.0). If NAV goes down, price should go down. If NAV goes up, price should go up. Wild swings in mutual fund prices, if not linked with swings of NAVs, reflect ignorance of investors.

As you noted, the price to NAV ratio of mutual fund industry is currently close to 1.0. I think that is logical. But there is a wide variation of this ratio among the funds. Some funds are trading at multiples close to 2.0 and others at multiples close to 0.7. That does not make sense to me.

Q What are the attributes which an investor should consider when paying a premium price for a Mutual Fund?

A Investors should never pay significant premium to NAV for a mutual fund. Perhaps the credentials and track record of fund managers may warrant a very thin premium.

Q Given the current scenario, what will be your suggestion for the investors who are willing put their money in the mutual fund sector in the coming year?

A If investors believe in the integrity and credentials of fund managers, they may consider investing in the fund. However, as I mentioned earlier they should try not to pay any premium over NAV of the fund. And they must avoid getting confused between NAV of a fund and its face. My advice to the investors is – understand mutual fund before investing in it. Also the investors need to be fully confident about ethical and professional standard of the fund manager.

Q It is often observed that the regulator takes incentives which are of short terms. What could be the probable reasons which are holding back the regulators from taking farsighted decisions regarding strengthening the industry? What changes do

you expect to take place in this industry in 2013 (both from the regulators' end and from the mutual funds' end?)

A In the past we have noticed nervousness of politicians afflicting the regulators. But I think now they have started taking farsighted decisions. I think regulators will continue their good work and most of the mutual fund managers will support them.

Q Do you think that our mutual fund managers have lack of professionalism to outperform?

A Some fund managers may lack professionalism and long-term orientation. Fund managers' main roles are asset allocation and security selection. That's how they should try to maximize risk adjusted returns for their investors. Instead some fund managers try to convince investors that market price of closed-end units would trade at premiums to NAV and they would make windfall gains from it. I think an ethical fund manager should never do that.

Q "In the meantime when cynicism has already engulfed the environment and Mr. Islam was boldly asked "why are you still here and managing funds if you are so frustrated with the country?" He smiled and replied everything is not so bad and the long term outlook of the country is positive. He promised a more detailed answer in the next year-end issue." Your ending note in the last year had a trailing remark where you mentioned a long term potential outlook of the country. Could you please elaborate on that note?

A I think Bangladesh is a high-risk-high-return proposition for any investor. The long-term story looks attractive because of its attractive demography, great location and continuous improvements in social indicators. But the country has fundamental problems as well. We need huge improvements in rule of law, governance and infrastructure.

Though the capital market in general, and the fund management industry in particular, is small in Bangladesh it is an interesting place for value investors. The market is still pretty inefficient and it is relatively easy to differentiate between undervalued and overvalued assets. Managing money is far more challenging in developed financial market. Those markets are far more efficient and generating alpha is very difficult.

Q What's your capital market expectation for 2013?

A Currently, most of the market participants see a lot of dusts in the political atmosphere. Until the dusts settle they are expected to remain bearish. More importantly, the risk free rate is still very high. Some saving certificates offer effective annual rate in excess of 13.5%. Obviously expected return from risky assets such as stock should be much higher than that. I am not sure if the fundamentals of many listed companies are attractive enough to draw investors who have expected returns much higher than 13.5% per annum.

Interview is taken by Md. Ashaduzzaman Riadh and Tanzina Ahmed Choudhury. All views and opinions expressed here are solely of the interviewed persons and neither represent the views of LankaBangla Securities Ltd. nor those of any of its associated institutions.

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