

Mutual bonds deceive investors with 'window dressing' scams

by Anna Rivilis

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Professor Matthew R. Morey of the Lubin School of Business along with Professor Edward S. O'Neal of Wake Forest University in North Carolina made national news when they published their study addressing the problem of window dressing behavior in mutual funds - primarily in bond funds, the group of bonds that makes up over a third of all mutual funds in the United States.

"A typical window dressing scenario entails fund managers replacing poor performing securities with top performers at the end of reporting periods," said Morey

Window dressing is not a new trend and has been one of the biggest concerns of investors and the finance industry as a whole. According to the researchers, other studies regarding window dressing behavior have been published but often provide conflicting results. Their goal in this study was to clearly showcase patterns of window dressing behavior in order to make investors more aware of it.

Morey began his research last year when he investigated the ratings provided by Morningstar and Value Line of mutual funds and showed that the ratings were barely able to forecast any winning funds. He then extended his research further and joined O'Neal in showing how window dressing primarily occurs in bond funds.

According to Dr. John Teall, a Lubin finance professor, all papers regarding window dressing clearly imply that professionally managed funds sell losers at the end of reporting periods; but the real question remains whether these bonds are victims of window dressing scams or are simply sold for the purpose of gaining tax efficiency.

Although there have been several concerns voiced by the U.S. Securities and Exchange Commission (SEC) against window dressing, there has not been a single case brought against a U.S. mutual fund questioning its falsification. It is hard to regulate window dressing because it is extremely difficult to distinguish window dressing from tax efficiency purposes.

"This lack of action is not surprising given the difficulty in identifying portfolio activities that are solely cosmetic in nature," said Morey

Since it is very difficult to determine window dressing, investors are still led to believe that bonds are a safe investment.

"One way investors can protect themselves is by having as much information as possible, and avoid companies that sell losers but do not produce any tax efficiency," said Teall.

To learn more about window dressing or read the completed research visit http://appserv.pace.edu/emplibary/Window_Dressing.pdf.

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