

VIDEO

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ICI Chief Economist Discusses Recent Mutual Fund Trends on Bloomberg Radio's Hays Advantage

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ICI Chief Economist Brian Reid discussed recent ICI research and mutual fund trends with Kathleen Hays and Peggy Collins in a July 11, 2014, podcast on Bloomberg Radio's "The Hays Advantage."

- [Audio Recording of Brian Reid \(mp3\)](#)

Transcript

Kathleen Hays: Time for personal finance. Peggy Collins is back—Bloomberg News personal finance expert—and she's got a special guest.

Peggy Collins: I do. Thanks for having me as always, Kathleen. Today I've brought on Brian Reid, who is chief economist at the Investment Company Institute. And one of the reasons is because the ICI, as it goes by its name, has the closest eyes on mutual fund industry. And, of course, you know I'm always talking about retail investors and what they're doing in terms of their stock, bond, and muni bond portfolios, and the ICI has data that's just come out that Brian's compiled looking at trends for the first six months of the year, really. Brian, thanks so much for joining us today.

Brian Reid: Thanks for having me in, Peggy.

Peggy Collins: So one of the things I wanted to start off with is: we saw so much activity last year, stocks had an incredible run last year and we saw some huge outflows out of bond funds. Let's start with stocks: what have you seen so far in terms of investor appetite for stocks in the first six months of the year?

Brian Reid: Investors continue to be quite attracted to the international sector. So, we hear about some of the changes that are going on in the markets in Europe and the like, and yet investor flows into international equity funds and even international bond funds have been strong this year. Last year, we had \$142 billion dollars come into international equity funds and this year it's a little bit slower pace at about \$40 billion but still strong demand there.

In addition to that, we've seen some inflows into domestic equity but not at a very big pace.

Peggy Collins: Yeah, I've been surprised, Brian, and I don't know if you have as well, Kathleen, but I've been watching the numbers of the last several months, and I've seen some consistent outflows out of domestic stock funds even though we've had continued strength in the stock market and better unemployment figures. What do you think of some of those outflows from domestic stock funds? What's driving that?

Brian Reid: So there are a couple of things. First of all, the domestic stock market fund flows don't capture ETFs, and we know we've had ongoing demand for ETFs in the domestic space, and even flows there have been a little weaker this year than last year. They also don't capture other types of products that are more common to be found in, let's say, a 401(k) plan; these are things like separate accounts or collective investment trusts. They have the look and the feel of a mutual fund, but they're actually not a mutual fund. So, as we see some of the larger plans moving away from mutual funds and into these other types of products, that accounts for some of this as well.

Kathleen Hays: So, I just have to come back to this question: supposedly investors were so loaded up on bonds, we were supposed to get the great rotation, and we did see some move out of bonds to a certain extent, but to see money coming out of stocks—in fact Peggy and I were talking about this yesterday in anticipation of talking to you—I mean, are people so smart that they're saying, "Ok, big move up in stocks in the U.S., people are calling for a market correction, I'll pull some of my money out of stock funds for a little while"? Most people do not trade that actively.

Brian Reid: That's right, they don't trade that actively and so we have to be a little careful when we think about what are these flows telling us. There are some of these long-term trends that are in place: this greater demand for global stock investing; other types of products that are not traditional mutual funds. We did see some money coming out of bond funds, there was some of this talk last year about the great rotation. It's almost imperceptible when you look at the total flows over the last five or six years. And we've had money coming back into bond funds this year.

Kathleen Hays: Give us some of the volume numbers, what is the amount of money right now sitting in U.S. equity stock funds, U.S. bond funds, when you're looking at some of the overseas, more global funds. What kind of billions or trillions are we looking at?

Brian Reid: Well, for instance, for bond funds, we're talking about roughly \$3.5 trillion sitting in bond funds both domestic as well as global...that [includes] muni bond funds as well. Overall, if you look at ETFs and mutual funds together, nearly \$17 trillion Americans have invested in mutual funds and ETFs and [that includes] closed-end funds. It's one of the most significant ways investors come into the market and access the market. If we were talking about this 30 or 40 years ago, it was buying individual stocks and bonds. Now they're buying mutual funds and ETFs, and that is the way they enter in and out of the market.

Peggy Collins: About how much of those assets in mutual funds is being held in retirement accounts, like IRAs, 401(k)s, which have become such a big part of this market?

Brian Reid: So, nearly two-thirds of equity fund assets are sitting in some kind of a retirement account, either a 401(k) or an IRA. Little bit less for bonds fund, about half, but it's still a significant component: we have nearly a trillion dollars in bond funds that are sitting in retirement accounts and those are all in taxable bond funds, obviously.

Peggy Collins: We saw a lot of outflows from bond funds in May and June last year when the Fed first indicated that it was going to taper. But we've actually seen money go back into bond funds this year. What have you seen in terms of the amount going back into bond funds in the first six months of the year?

Brian Reid: We've seen strong demand coming back in. What this tells me is that there are really two fundamental drivers here for bond funds. Number one, it's the short-term cyclical—when interest rates rise, we tend to see, for a period of time, money coming out. Bond returns are going to fall because the prices are falling. But once those prices stop falling, and the coupon begins to kick back in again, then the returns go back up and we see money coming in. But I think even more important is the long-term demographics that are driving this market. So, individuals hold about \$5 trillion in directly held bonds, and another \$3.5 that are sitting in bond funds. And we'd had another \$2 trillion come into bond funds, really since the mid-2000s. Demographics. Aging Baby Boomers. They have a lot of money in 401(k)s and IRAs. When they get ready to retire they want to allocate a portion of that—not all of it—but a portion of that into fixed income. So this has provided a long-term secular underlying demand for bond funds.

Kathleen Hays: When you say direct ownership of bonds, those are mostly munis that people own directly or are there more people who are finding ways to buy corporates, high-yield, etc.?

Brian Reid: There's a combination, including Treasuries, which you can get through Treasury Direct, for instance, but a lot of the munis are held directly. They tend to be older Americans who are looking for tax-exempt income. So the Americans who own tax-exempt bond funds and tax-exempt bonds just tend to be older and somewhat higher income as well.

Peggy Collins: I've heard from a lot of wealth managers I've talked to this year that taxes are a huge issue. People have really swallowed the increases at the high end of the scale, both on a state level and on a national and federal level, and that that has made munis that much more attractive. Is that reflected in what you're seeing in terms of fund flows to munis this year?

Brian Reid: I think what's happening in the muni space is somewhat driven by the headlines. We had Detroit filing for bankruptcy last year, we had the issues around Puerto Rico and some of their challenges. I think this tends to cause some investors to step back, and so we had about 10 percent of the money come out of muni bond funds last year. But we've seen a turnaround, we've seen money come back in. It hasn't fully recovered from last year's outflows, we've seen about \$10 billion come in, but once again they're returning back into the market.

Kathleen Hays: Are you able to break any of this down according to income levels, because of course, we would assume that the more affluent Americans are the ones who are able to put more money into funds. A lot of people have been stretched. It's tough to find the money to pay the bills let alone even save, although many of them would like to. Do you get any sense of that from the data the Investment Company Institute gathers?

Brian Reid: So one of the things that we do know is that mutual funds and ETFs generally are held by about half of American households. These tend to be middle income and upper middle income, and as you point to, a lower-income household who's working minimum wage or multiple jobs—they're having a hard time just putting food on the table and paying

the rent. So they're not accumulating typically as many assets. But what we do find is that ownership in mutual funds as well as 401(k)s and IRAs is highly correlated with age as well. So younger investors, they may be getting their first job, they may be paying off student loans, but as they begin to age they get into that job, they put that money into a 401(k), they're much more likely to become a fund investor. And also, we know that income is also highly correlated with age: as you get older and become more established in your career, people's incomes go up and so they're going to become fund investors as well.

Peggy Collins: On that point about younger investors, and a lot of people have questioned whether the financial crisis that we had in 2008 or 2009, would really keep Millennials, the younger generation, from investing in stocks because that was their first real exposure to it. What have you seen with that?

Brian Reid: You know, interestingly, we have seen just the opposite. The reason is, for young Millennials coming in, or younger investors generally, one of the first places they're introduced to the stock market is through their 401(k). And with the advent of target date funds and auto-enrollment, so you come in, your first day on the job, you don't have to decide whether you want to be in the 401(k). Many firms are saying, we're going to automatically enroll you. If you don't want to be in you can opt out, but you're going to have to sign a piece of paper to opt out. Then they put you, if they automatically enroll you, in the default, which is this target date fund. Most target date funds for younger investors tend to...have a pretty high equity concentration, somewhere around 80 percent on average. So, we have seen, actually since 2007, is a decreasing percentage of younger investors in 401(k)s without any equity and an increase in the amount of equity they're holding because they're being automatically enrolled in these target date funds and they're getting equity exposure.

Peggy Collins: Yeah, some of the target date funds that I see actually have as much as 90 percent in stocks for your first 10, 15, or even 20 years that you're invested in them.

Brian Reid: Yes, and these target date funds are becoming more and more common as part of that overall automatic enrollment process.

Kathleen Hays: Alright, well Brian Reid, thank you so much for joining us.

Brian Reid: Thank you very much.

Additional Resources

- Monthly [Trends in Mutual Fund Investing](#) Statistics
- [The Great Rotation: Are We There Yet?](#)

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