

VIDEO

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Focus on Funds: IMF Paper Raises Concerns

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In the October 24, 2014, edition of Focus on Funds, Sean Collins, ICI's senior director of industry and financial analysis, outlines the concerns raised by the International Monetary Fund's Global Financial Stability Report.

Transcript

Stephanie Ortbals-Tibbs, Director, Media Relations: Welcome to Focus on Funds, the Investment Company Institute's weekly roundup of industry news, ICI activities, and research findings.

The International Monetary Fund recently issued a new paper which the asset management industry should pay attention to. ICI's research department has already taken a look, and I spoke with ICI Senior Economist Sean Collins.

Sean, this IMF paper has come out recently, and we immediately had concerns.

Sean Collins, ICI Senior Director of Industry and Financial Analysis: We have a number of methodological concerns. One of the high-level concerns that we have is that the report talks a lot about a notion that there will be vast outflows from mutual funds during some kind of financial market crisis, perhaps because investors panic. Especially with respect to bond funds, there will be heavy redemptions that will cause additional knock-on effects. There's a lot of evidence that suggests that investors do not react that way to financial market shocks.

U.S. Long-Term Funds Primarily Held by Households **Household and institutional ownership of U.S. long-term mutual funds**

Note: Data are for December 2013 and exclude assets in exchange-traded funds.

Source: Investment Company Institute

The investors in long-term mutual funds, about 95 percent of the assets, are retail

investors, who, for a number of reasons, do not react precipitously to financial market shocks. They tend to stay the course.

One reason is these are investors who are saving for the long term through retirement accounts. They may have a horizon of 10, 20, 30, 40, even 50 years, and that long horizon gives them the ability to look through financial market shocks.

Stephanie Ortvals-Tibbs: And in fact we saw evidence of that in 2008, a very difficult year, investors hung in there.

Sean Collins: Right, so 2008, the worst year of the financial market crisis—the stock market is down by about 50 percent at its worst, and redemptions from stock funds and bond funds were very muted.

Bond Investors' Response Was Muted Monthly, 2000-2013

1Net new cash flow to bond funds is plotted as a three-month moving average of net new cash flow as a percentage of previous month-end assets. Data exclude flows to high-yield bond funds. 2The total return on bonds is measured as the year-over-year percent change in the Citigroup Broad Investment Grade Bond Index.

Sources: Investment Company Institute and Citigroup

Stock funds, for example: redemptions totaled about 3 to 4 percent of assets. Bond funds, same thing.

Stephanie Ortvals-Tibbs: And again, we saw that around the tapering of the Fed's bond-buying program last summer.

Sean Collins: Yeah, interest rates went up very sharply over May and June on the order of about 100 basis points, which is about the largest increase we had seen since 1994.

In 2013, Bond Investors' Response Was Also Subdued Weekly; May 1, 2013-June 26, 2013

Sources: Investment Company Institute and IndexUniverse

And that was largely in response to the market's perception that the Fed was going to begin reeling back from its quantitative easing program. And so in some sense what the market was really concerned about was not investors in mutual funds selling, it was the fact there was going to be less purchasing by the Federal Reserve.

Which kind of raises an interesting issue, which is that over the next five to 10 years, it's conceivable that central banks around the world—the Federal Reserve, the ECB, and others—will in fact be the largest sellers of bonds, and that mutual funds—long-term bond funds—will be natural buyers of those bonds, rather than natural sellers.

Stephanie Ortvals-Tibbs: And so, we do see that we have a lot of data to offer, there's a lot of data out there that runs counter to what's in the paper. So what do you hope will happen next?

Sean Collins: Well, we certainly hope that the IMF and others like the IMF will reach out to ask for that data, and ask for advice and assistance on how to interpret that data in light of the structure of the industry, in light of the laws governing the industry. We're certainly happy to help. We stand ready to do that. And we believe that others—our members, regulators in the U.S.—would be happy to do that as well.

Stephanie Ortals-Tibbs: That's this week in funds. See you next week.

Additional Resources

- [ICI Viewpoints: The IMF Makes All of OFR's Mistakes—And More](#)
- [Financial Stability Resource Center](#)
- [Graphic: U.S. Long-Term Funds Primarily Held by Households \(pdf\)](#)
- [Graphic: Bond Investors' Response Was Muted \(pdf\)](#)
- [Graphic: In 2013, Bond Investors' Response Was Also Subdued \(pdf\)](#)

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