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Active asset managers knocked by shift to passive strategies

Robin Wigglesworth and Stephen Foley in New York

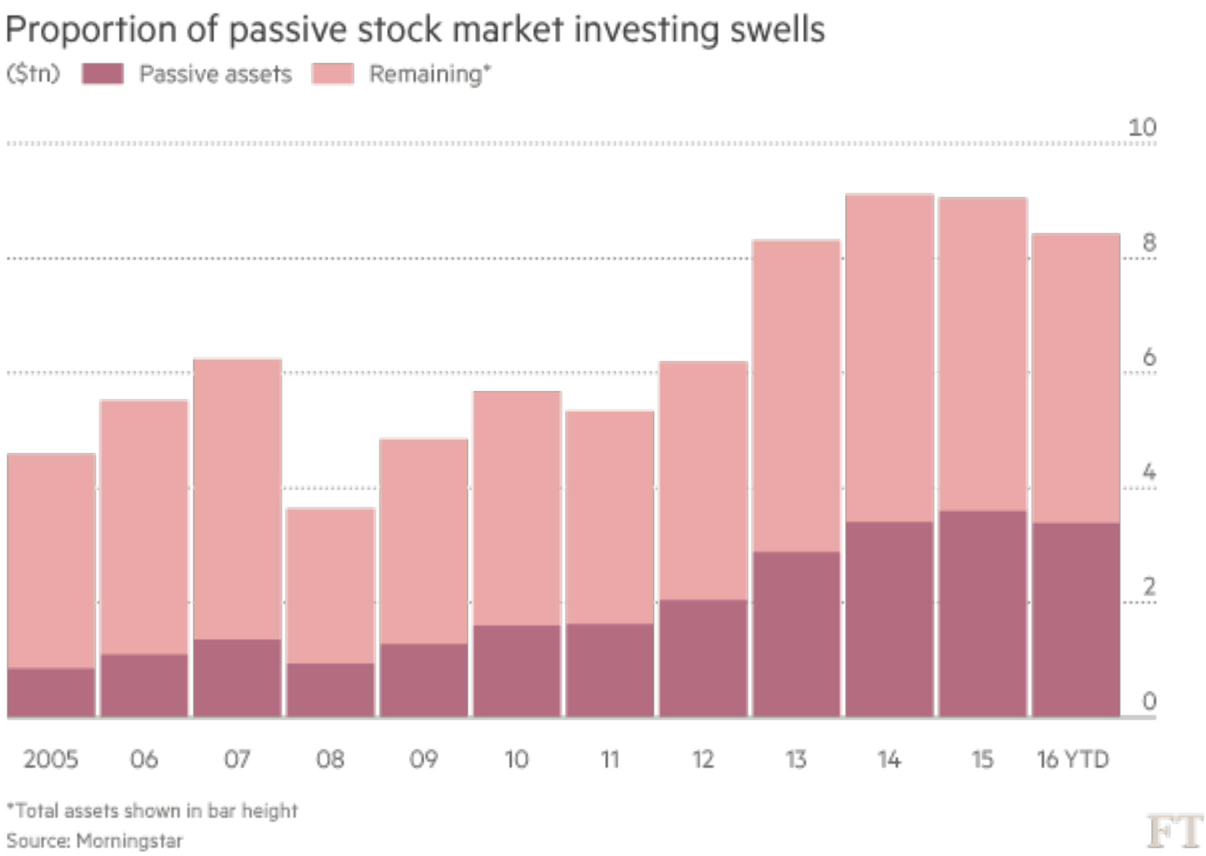
The deteriorating ability of money managers to beat their indices has led to investors accelerating a shift towards passive strategies such as exchange traded funds, adding to the pressure on actively managed funds to justify their fees.

Equity funds that are actively managed have suffered net outflows of $34.9bn globally this year but stock market ETFs have taken in another $7.6bn, according to research company EPFR, despite the turbulent performance of markets.

Last year, ETFs attracted nearly $200bn while actively managed equity funds lost $124bn.

“It doesn’t surprise me that we’re getting this continuous move towards passive investment," said Mohamed El-Erian, chief economic adviser to Allianz. "Active funds have disappointed investors, and in a low-return environment costs become more important."

The shift is most pronounced in stocks. This year the assets of passive US equity vehicles crossed the 40 per cent mark of total US equity fund assets, up from 18.8 per cent a decade ago, according to Morningstar, a data provider.



But the trend is also accelerating in bonds. Actively managed fixed income funds globally have lost almost $16bn in 2016, but bond ETFs have absorbed nearly $41bn of investor inflows this year, according to EPFR.

More than a quarter of all US bond fund assets are now in passive vehicles, according to Morningstar, up from less than 10 per cent a decade ago.

Morningstar dubbed this "flowmageddon" in its latest newsletter, writing that "something big is happening" to the investment management industry: "ETFs have gained the upper hand in the active/passive debate".

The trend has been under way for years but the continued — and worsening — ability of asset managers to consistently beat their indices is expected to accelerate the move.

Just 19 per cent of US mutual funds that invest in "large-cap" companies outperformed the S&P 500 in the first three months of 2016, according to Bank of America Merrill Lynch, the lowest quarterly hit rate since its data began in 1998.

Only 6 per cent of "growth" funds managed to beat their index, the worst rate since at least

1991.

As a result of the shift towards cheaper funds, the shares of US-listed asset managers have dropped nearly 8 per cent this year, compared with the S&P 500's 0.6 per cent gain, and overall have sagged by more than a fifth since the 2015 peak.

Active managers will have to respond to the changing landscape by cutting costs and making staff run larger portfolios, according to Tim Guinness, chief investment officer of Guinness Asset Manager and manager of the Guinness Global Money Managers Fund, an investment fund focused on the industry.

The result could be "paymageddon" for active managers, he said.

"We see ETFs and passives taking market share for a few more years, and in due course I would expect active funds to get cheaper and cheaper to compete. The days of great prosperity for active fund management may be behind us."

Investment group executives are aware of the dangers and are scrambling to respond by cutting fees and unveiling their own passive investment vehicles.

"This isn't a potential threat to mutual funds, it is already here," Joe Sullivan, chief executive of Legg Mason, told the Financial Times earlier this year.

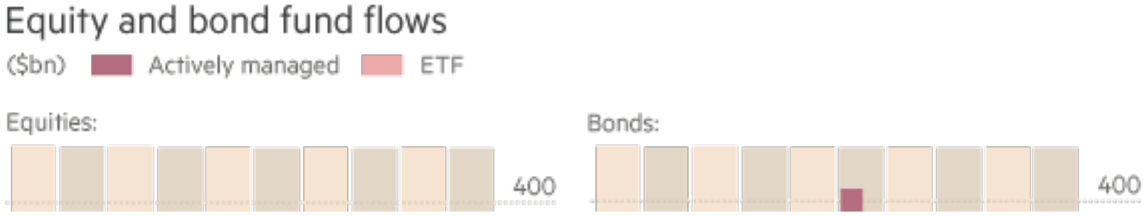
Like many other large, traditional asset managers, Legg Mason has launched a series of next-generation ETFs to adapt. "Investor preferences ebb and flow, but as an asset manager if you can't tap into that you put your business at great risk."

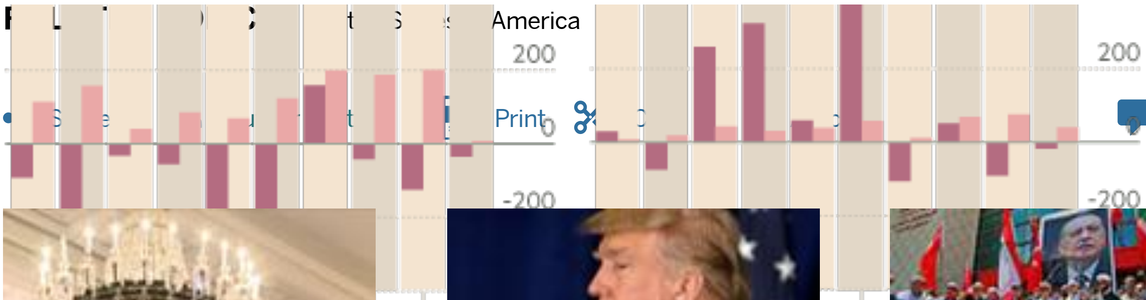
Fidelity and Capital Group, the largest US asset management groups, known for their stockpicking funds, have ploughed more money into marketing the benefits of active management over the past year.

Capital Group has funded studies to show that particular kinds of fund families can be relied on to outperform over the long run.

Fidelity revealed in its most recent annual report that its return to asset growth last year was the result of new passive products.

"Fidelity's consistently strong investment performance has shown that there is long-term value in active management," wrote Charles Morrison, the asset management division president. "That said, sometimes perception can overshadow reality."





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