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Advisors pivot from high-cost to low-cost active funds

By Editorial Staff *Thu, Aug 3, 2017*

'Fund manufacturers without a low-cost solution are, at best, being ignored and at worst, getting trampled,' said Jeff Tjornehoj, Broadridge's director of fiduciary and compliance research, in a release.

In a sign that the fiduciary rule is discouraging commission-based mutual fund sales, advisors at independent broker-dealers and wirehouses have shifted assets out of high-priced actively-managed “load” funds and into low-fee or institutionally-priced versions of active funds.

Active funds enjoyed a net inflow in the first half of 2017, but most of the net flow stemmed from the conversion of load funds into low-fee and institutional-priced share classes, according to the Fund Distribution Intelligence service of Broadridge Financial Solutions.

As of June 30, advisors at independent broker dealers invested a net $150 billion into the low-fee classes of active funds, while advisors at wirehouses added a net $40 billion. Most of that money came from liquidations of A, B and C-shares of load funds, which shrank by $122 billion at independent broker-dealers and by $37 billion at wirehouses.

The shift hurts purveyors of active funds. (In a sign of the times, Fidelity, whose wheelhouse was traditionally active funds, said Monday that it would reduce total fees on 14 of its 20 stock and bond index funds to 0.099%, effective August 1, the better to compete with Vanguard.)

“Fund manufacturers without a low-cost solution are, at best, being ignored and at worst, getting trampled,” said Jeff Tjornehoj, Broadridge’s director of fiduciary and compliance research, in a release. “While equity mutual funds have collective outflows of $69 billion, those with an expense ratio of just 20 basis points or less have inflows of $93 billion.

“The battle ahead is about how fund sponsors will accept a fraction of what they historically collected. Even channels that traditionally supported premium-priced products, such as wirehouses and broker dealers, have shifted strategies based on fees.”

“We expect to see the move to lower fee share classes continue throughout 2017 as the majority of advisors move to a fee-based practice and the broker-dealer home office realigns the mix of share classes offered to meet both client demand and regulatory requirements related to the DOL fiduciary rule,” said Frank Polefrone, senior vice president of Broadridge’s data and analytics business, in a release.

Advisors continue to invest client assets into passively managed ETFs and index funds at an increased rate, the release said. The net new asset flows into institutional shares of actively managed funds, Polefrone added, demonstrated that “price and performance are the driving factors in advisor fund selection.”

A shift to lower-fee products

Virtually all net new assets in the first half of 2017 flowed to lower fee products – ETFs, index funds, and institutionally priced actively managed funds. AUM increased by $566 billion, or 5.5%. Of that, about $433 billion went into lower fee passive products and ETFs and the remaining $133 billion flowed to lower fee institutional share classes of actively managed products.

Across all channels—independent broker-dealers, wirehouses and RIAs—actively managed funds experienced net inflows of $87 billion while passive funds gained $48 billion. Net new assets into actively managed funds from all retail channels – independent broker dealer, wirehouse, RIA and online retail – were up $87 billion versus $48 billion for passively managed funds.

The fastest-growing channel on a percentage basis for the first half of 2017 was the direct online channel, led by Vanguard and Schwab. Net new flows of mutual funds increased by $67 billion, or 22%, with more than half of net new assets ($36 billion) going into actively managed funds.

In the first half of 2017, overall assets for ETFs increased by 11.6% to $3.1 trillion. The largest increase of ETF assets in the first half of 2017 occurred in the RIA channel, with net new assets of $78 billion, up 11.4%. The RIA channel remains the largest channel for ETFs, with over $800 billion invested in ETFs.