Flight to passive funds continued in January: Morningstar

By Editorial Staff *Thu, Mar 1, 2018*

State Street enjoyed a second month of double-digit billion-dollar flows and almost caught up with Vanguard in terms of passive flows. Their flagship ETF, SPDR S&P 500 SPY, attracted the majority of the incoming money.

Investors started out the year by strongly declaring their preference for passive U.S. equity funds, which saw their largest monthly inflow since December 2016, according to "**Morningstar Direct Asset Flows Commentary: United States**," which was released this week.

"Far from running away from the U.S. stock market, investors were eager to embrace it and its stable returns—but in the form of low-cost offerings only, it seems. 'Returns,' in this context, only refers to January and does not include February's polar plunge, which saw the S&P 500 drop 7% through Feb. 12," the report said.

According to the report:

Taxable-bonds front received a total inflow of $47.0 billion, almost equally distributed between active and passive. After raising short-term interest rates three times in 2017, the Federal Reserve decided to leave them unchanged at its first 2018 meeting on Jan. 30, which was also Janet Yellen's last meeting as chairwoman.

International equity attracted $41.9 billion, with the majority of those flows going to passive funds.

Large blend was the overall top-flowing category in January despite a $7.3 billion outflow on the active side. Investors who switch to passive tend to prefer blend funds because they're a good middle-of-the-road option between growth and value. Diversified emerging markets and foreign large blend were also in the top five but, unlike large blend, with positive flows on both the active and passive side. So was intermediate-term bond.

The trend of transferring assets to lower-cost, passive vehicles is continuing to expand to asset classes other than U.S. equity, where it started. Judging by flows, investors have given up on active management for U.S. equity, still find some value in it for international equity, and consider it highly valuable for fixed income.

High-yield bonds experienced outflows for the fourth consecutive month. The Tax Cuts and Jobs Act may have prompted some of the outflows, because it is limiting the tax-deductible amount of interest expenses.

High-yield debt companies will be negatively affected by this new provision because their interest expenses are much higher, and not being able to write them off will adversely affect profitability.

On the active side, **American Funds** rallied in January with a $7.9 billion inflow (all its funds are active). The two funds with the largest inflows were American Funds Tax Exempt Bond AFTEX and American Funds

Europacific Growth AEPGX. Most of the top 10 companies enjoyed healthy flows in January. The few that did not do so well included Franklin Templeton and J.P. Morgan.

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