Fund flows turn negative in February: Morningstar

By Editorial Staff *Thu, Mar 29, 2018*

If one still had any lingering doubt about how bad last month actually was in terms of flows, one only had to look at Vanguard: almost $33 billion in January, barely $12 billion in February, writes Morningstar senior analyst Alina Lamy.

Overall, this February seems to have been a record of lows, with investors shaken by the wild swings in the market and keeping their distance. January's flows across all category groups totaled $128.1 billion. In contrast, February's total amounted to a negative $7.7 billion.

If one still had any lingering doubt about how bad last month actually was in terms of flows, one only had to look at Vanguard: almost $33 billion in January, barely $12 billion in February. If the reigning provider saw such a drop, just imagine what everyone else must have endured.

February was a roller-coaster month for the U.S. stock market, with all major indexes plummeting, then floating back up, then dropping again to end the month in negative territory. This volatility was reflected in the flows, with investors running away from U.S. equity—not only from active funds but from passive ones as well.

Redemptions of $8.4 billion from passive U.S. equity marked the first monthly outflow for the category since April 2015.

Although international markets suffered in tandem with the U.S. market last month, the international-equity category group didn't stop growing in February. Instead, it dethroned taxable bond, which had enjoyed the largest flows for quite a while, and led with a $22.8 billion inflow overall, most of it to passive funds.

Inflation and interest-rate concerns caused taxable-bond flows to diminish last month to only $5.2 billion. It was the smallest inflow for taxable bond since November 2016.

Large blend landed on the bottom-flowing list last month, after having been among the top-flowing Morningstar Categories despite outflows on the active side. The category is usually the beneficiary of passive flows because investors who index tend to prefer large-blend (as opposed to growth- or value-specialized) funds. With overall passive flows into U.S. equity taking a dive in February, large blend was the hardest hit.

Foreign large blend and diversified emerging markets remained in the top five as investors continued to focus on international equity. Intermediate-term bond continued to be the most popular option in the taxable-bond category.

Interestingly, the flows driven by February's market shock didn't seem to discriminate as much between active and passive. All top five categories experienced inflows on both the active and passive side, and all categories with the largest outflows (except large growth) experienced the same pattern.

It seems investors are much more meticulous about active versus passive when it comes to depositing their money than withdrawing it. Susceptible categories experienced redemptions on both sides, and for one month it seems the "outflows from active, inflows to passive" pattern was, if not broken, at least disrupted.

High-yield bond experienced outflows for the fifth 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 now much higher, and not being able to write them off will adversely affect profitability.

On the active side, American Funds managed to stay positive with a $2.2 billion inflow (all its funds are active). The two funds with the largest inflows were American Funds EuroPacific Growth AEPGX and American Funds American Balanced ABALX.

On the other hand, Fidelity, T. Rowe Price, and Franklin Templeton continued to suffer outflows from their active funds. After two months of double-digit billion-dollar flows, State Street experienced an extreme $25.3 billion outflow driven by its flagship exchange-traded fund, SPDR S&P 500 SPY.