



## Letter to the Editor

January 22, 2013

*The following is in response to Paul Franchi's article, [Demographics and the Decline of Equity Mutual Funds](#), which appeared last week:*

Dear Editor,

I am interested to know whether Mr. Franchi included in his analysis of net-new money into equity mutual funds the rise in popularity of equity ETFs. I suspect he did not. I am interested in how including a shift by equity fund investors from traditional mutual funds to ETFs might affect his hypothesis about the decline of equity mutual funds.

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*Paul Franchi replies:*

*The overall trend is unaffected by incorporating ETFs, but there are some challenges in incorporating the data. For example, foreign individuals and institutions can and do buy ETFs. ETFs are used by institutions who manage mutual funds (which would introduce double counting). Here is very interesting [article](#) on who owns ETFs.*

*I was determined to keep the analysis pure to mutual funds and I excluded ETFs, unit trusts and closed-end funds. But there is definitely a trend to lower-margin products as a result of the move to fee-based planning, which I will be covering in part 3.*

*Below are data that I used for Exhibit 14 and the appendix (the "Ned Davis" Charts), including the following extremely conservative assumptions:*

- 1. There is absolutely no double counting, i.e., no mutual funds hold ETFs. This is false, and if I had to guess probably more than 50% of the ETF issuance in 2007-2008 was from institutional managers. They sold these off in 2009 in the secondary market which is why I would estimate that the issuance of ETFs for 2009 was so low because of plenty of supply from existing holders.*
- 2. 100% of ETFs are owned by US investors (also false).*
- 3. 100% of ETF holders would consider owning a mutual fund – also false, as noted in the Forbes article. CALPERs (who invests via separate accounts) owns 71% of the outstanding shares of the S&P Emerging Market Small Cap EWX -*



*Net flows in/out of US equity funds used for exhibit 14 and the appendix:*

*2006 - Mutual Funds \$+10.9 Bn US Equity ETF Issuance Bn \$31  
2007 - Mutual Funds \$ (46) Bn US Equity ETF Issuance Bn \$79  
2008 - Mutual Funds \$(147) Bn US Equity ETF Issuance Bn \$+118  
2009 - Mutual Funds \$(39) US Equity ETF Issuance + \$2 Bn  
2010 - Mutual Funds \$(97) Bn US Equity ETF Issuance + 38 Bn  
2011 - Mutual Funds \$(133) Bn US Equity ETF Issuance +45 Bn*

*Stress testing my core thesis using (as depicted in exhibit 14 and the appendix) with unrealistically high data points for ETFs still results in outflows for mutual funds for the above key years.*

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