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Mutual Funds

Cogent Forecasts The Big Mutual Fund Chill

Study Predicts Major Shift in Assets to SMAs, ETFs by 2009

By John Morgan

Mutual funds may see a sharp drop in popularity in the coming years as investors start to explore newer products like separately managed accounts and exchange-traded funds.

Open-end mutual funds currently comprise the largest share of investment products, a 35% share of the market, according to the "Advisor Product Forecast" study by **Cogent Research**. But by 2009, that share could drop by 10% to 31% as advisers move their clients' assets to different products.

"I was surprised to see such a dramatic shift to newer products, said **Bruce Harrington**, managing director of Cogent. "Mutual funds represent such a huge piece of the product pie, that a 10% decrease in two years is substantial," he said. "Ten percent of $10 trillion is a big number. Even a 1% shift in the mutual fund category represents a significant shift in assets."

The Advisor Product Forecast is based on 1,266 online surveys of U.S.-based advisers who have an active book of business of at least $1 million and offer planning or investment advice to clients.

"We asked what products they're buying today and what products they'll be buying in 2009," Harrington said. "A lot of people are buying mutual funds today. Almost 50% of advisers are currently not selling ETFs, but of those who do, they plan to increase their use dramatically."

This is the first year Cogent has done the Advisor Product Forecast. Harrington said he didn't want to give away all the numbers for 2009, but it was clear from the study that the balance between different investment vehicles was "definitely shifting upwards and downwards."

SMAs currently make up 11% of the market, but they are projected to rise. ETFs make up 5% and will rise, but individual securities, which make up 24% of advisers' assets under management, are projected to drop. Closed-end funds are at 5% and are declining. Hedge funds make up 5% and are projected to remain at that level, and variable annuities comprise 7% and will also remain flat, he said.

'Rush of Sameness'

Mutual funds are likely to suffer a loss of market share if they continue to offer the same array of products and choices, said **Anu Heda**, a manager for **kasina**. "There is a rush of sameness when it comes to investment products," Heda said. "People are becoming more confused by the cluttered mutual fund landscape. Month after month, we are seeing hundreds of products coming to the market, but the underlying strategy is the same."

Heda said there are techniques asset managers can use to break from this cycle of "copy-cat products."

"There are 13,000 different kinds of mutual funds to choose from," said **Lynne Ford**, senior vice president and managing director of the retail retirement group at **Wachovia**, at a recent conference in New York. "Investors are feeling overwhelmed by too many choices. They want simplicity."

SMAs and ETFs are rising in popularity due to their tailored asset management features and their ability to allow investors to allocate their funds across different sectors and indexes. The main advantage SMAs have over mutual funds is the ability for an investor to have direct ownership of securities in a portfolio.

Advisers are beginning to explore these new investment vehicles in order to help them meet the needs of clients who clamor for new products, even though advisers said they find it challenging to explain to their clients what these new products do and how they differ from mutual funds.

"Advisers are the public face and personification of the asset management industry, and their roles evolve primarily in response to two issues: changes in the industry, as well as investor perceptions, attitudes and needs," Harrington said.

In addition to observing and evaluating trends in asset management products and accounts, he said advisers also have to determine how receptive a client is to new investment options and whether these new products are suitable for their needs.

Accentuate the Positive

"There are consistent themes that investment product manufacturers need to respect," Harrington said. "It's a simple tenet of marketing: A product must capitalize on its positive attributes and combat its negative ones."

The survey also measured loyalty to providers. Advisers said they were most loyal to heavy-hitters **American Funds** and **Franklin Templeton**, as well as **The Hartford**, **Russell** and **OppenheimerFunds**.

Financial services companies can improve their loyalty ratings by building upon their brand recognition, increasing innovation and communicating greater product differentiation, Harrington suggested.

Heda said he thinks the Cogent study is probably right on target. MME

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