

Morningstar U.S. Fund Flows: Fed Rate Cut Doesn't Spur Inflows

Long-term funds suffer \$16 billion in outflows during August.

Morningstar Research

August 2019

Data through Aug. 31, 2019
U.S. Mutual Funds and Exchange-
Traded Products

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Key Takeaways

- ▶ The Federal Reserve's July rate cut didn't seem to help investor confidence. Long-term open-end and exchange-traded funds had combined outflows of nearly \$16 billion in August, the greatest outflows since December 2018.
- ▶ Money market funds were a likely beneficiary with \$80 billion in inflows, the group's second-best month in 2019. Money market funds have collected nearly \$300 billion year to date, the best since 2009.
- ▶ Preliminary numbers show that passive U.S. equity assets passed active U.S. equity assets by about \$25 billion. This milestone has been a long time coming. Over the past 10 years, active U.S. equity funds have had \$1.3 trillion in outflows and their passive counterparts nearly \$1.4 trillion in inflows.
- ▶ Taxable-bond funds led the way with \$16.3 billion in inflows, but this was the group's second-lowest total of the year. Credit-oriented high-yield and bank-loan funds had about \$8.9 billion in combined outflows. Municipal-bond funds' inflows remained strong with \$9.1 billion.
- ▶ Commodities precious-metals funds had \$4.7 billion in inflows, the most since February 2016. This surge might reflect investor fears of potential inflation following the Fed cut.

Long-Term Outflows in a Rough Month for Active-Passive Funds Alike

The Fed cut rates a quarter point on July 31, 2019. Such cuts have sometimes increased investors' risk appetite, but that didn't happen in August. Investors pulled a combined \$15.9 billion from long-term open-end and exchange-traded funds for the month. Every major U.S. category group—except commodities—saw a decline in inflows or an increase in outflows compared with July. August's long-term outflows were the greatest since December 2018, when capital markets were enduring a nasty correction.

Money market funds were a likely beneficiary of these long-term outflows with \$80 billion in inflows, even though the Fed's rate cut will reduce the yield on such funds. This perhaps speaks to the level of investor trepidation. Nevertheless, August saw the group's second-greatest inflows in 2019. Money market funds have now collected \$298.3 billion for the year to date, the greatest sum since 2009 when investors were just beginning to recover from the credit crisis.

Exhibit 1 U.S. Category Flows

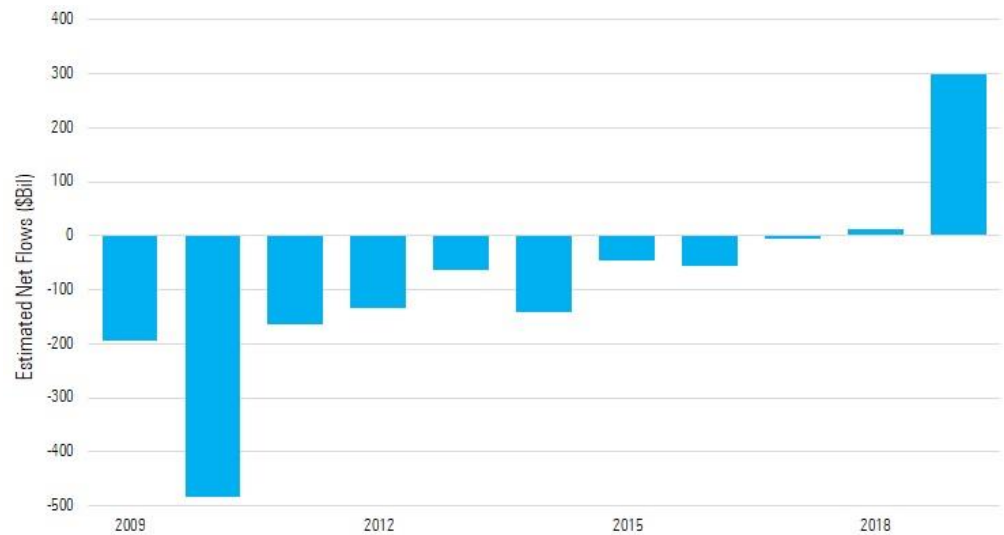
US Category Group	Estimated Net Flows (\$Mil)		Assets (\$Bil)
	Aug 2019	1 Year	
US Equity	(19,817)	29,340	8,517
Sector Equity	(10,051)	(60,723)	905
International Equity	(9,170)	(12,873)	3,047
Allocation	(2,297)	(63,804)	1,341
Taxable Bond	16,329	207,764	4,285
Municipal Bond	9,108	62,279	828
Alternative	(3,116)	(21,566)	192
Commodities	3,059	8,560	108
All Long Term	(15,956)	148,977	19,223
Money Market	79,993	450,753	3,353

Source: Morningstar Direct Asset Flows. Data as of Aug. 31, 2019.

Preliminary numbers show that passive U.S. equity assets passed active U.S. equity assets by about \$25 billion. (At the time of publication, we were still waiting for 70 or so funds, including all of Artisan's funds, to report their total net assets as of month-end.) If this result holds, passive share of U.S. equity open-end and ETF assets would be 50.15% versus 49.85% for active funds.

It's worth keeping in mind that mutual funds and ETFs are not representative of the broader U.S. equity market, but this is a milestone that has been a long time coming as the trend toward low-cost fund investing has gained momentum. Active U.S. equity funds have had outflows every year since 2006, with roughly equivalent inflows into passive funds during that time. Over the past 10 years, active U.S. equity funds have had \$1.3 trillion in outflows and their passive counterparts nearly \$1.4 trillion in inflows.

Still, 10 years ago, active U.S. equity funds had about 75% market share. And at that point we had recently entered one of the longest equity bull markets in U.S. history. If you had known this, would you have guessed that active U.S. equity funds were on track to lose \$1.3 trillion to outflows?

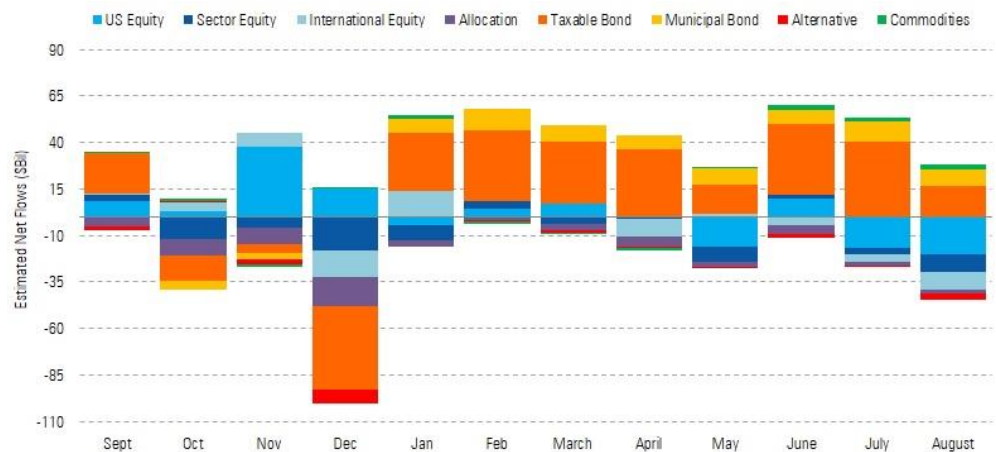
Exhibit 2 Money Market Flows, January Through August

Source: Morningstar Direct Asset Flows. Data as of Aug. 31, 2019.

August was a rough month, though, for both active and passive equity funds. Overall, U.S. equity funds had \$19.8 billion in outflows, the group's worst month since March 2018. Active outflows of \$18.9 billion were responsible for the bulk of this, but passive U.S. equity funds had nearly \$900 million in outflows. SPDR S&P 500 ETF SPY and iShares S&P 500 Index BSPIX had outflows of \$9.8 billion and \$4.4 billion, respectively. For active U.S. equity funds, such outflows are routine, but for passive funds, this was just the eighth month of outflows in the past five years. Interestingly, six of those months have come in 2018 and 2019.

The news has also been bad for sector-equity and international-equity funds. The past 12 months have easily been the worst for sector-equity funds in at least 10 years with \$60.7 billion in outflows. To put that in perspective, that's 6.3% of the group's starting asset base. In August, financials funds got hit the hardest among this group with \$4.2 billion in outflows, which isn't surprising given how the Fed rate cut mostly hurts banks, insurance companies, and other financial-services companies. For international-equity funds, outflows were \$9.2 billion, with the past 12 months also the worst for flows in a decade.

Moreover, the sector-equity pain was distributed pretty evenly between active and passive funds, as passive sector funds had \$5.3 billion in August outflows. For international-equity funds, passive funds fared even worse with \$7.4 billion in outflows versus just \$1.7 billion for their active counterparts. Most of the damage befell iShares MSCI Emerging Markets ETF EEM and iShares Core MSCI Emerging Markets ETF IEMG, which lost \$5.1 billion and \$2.1 billion, respectively, to outflows.

Exhibit 3 U.S. Category Groups' 12-Month Asset Flows

Source: Morningstar Direct Asset Flows. Data as of Aug. 31, 2019.

Taxable-bond funds led all category groups with \$16.3 billion in inflows. But this was their second-lowest haul in 2019. Furthermore, credit-oriented high-yield and bank-loan funds had about \$8.9 billion in combined outflows. Again, that's a curious result given the Fed's rate cut. On the other hand, intermediate core-plus bond funds, which tend to take on more credit risk than their intermediate-core cousins, led all taxable-bond categories with \$7.9 billion in inflows. Ultrashort-bond funds were the group's runner-up with \$4.9 billion in inflows. Meanwhile, municipal-bond funds continued enjoying strong inflows with \$9.1 billion. With \$70.7 billion collected for the year to date, 2019 remains on pace to be a record-setting year for municipal-bond inflows.

Exhibit 4 Three-Month Commodities Precious-Metals Flows

Source: Morningstar Direct Asset Flows. Data as of Aug. 31, 2019.

Commodities were the only U.S. category group that saw an increase in inflows from the previous month. Commodities precious-metals funds took in \$4.7 billion in inflows, the group's greatest since February 2016. SPDR Gold Shares GLD, which buys physical gold, was the big winner with \$3.0 billion in inflows. This surge might reflect investor fears of potential inflation following the Fed cut. During the past three months alone, the category has collected \$9.9 billion.

What's especially interesting is that this total far surpasses what the Morningstar Category collected in 2011 when gold prices hit a high of \$1,900 per ounce. Gold has rallied in 2019, but the price is currently around \$1,500 per ounce, nowhere near its previous high. In fact, the prior three-month high for inflows occurred through May 2010 when the group welcomed \$6.7 billion.

Exhibit 5 Estimated Net Flows (\$Mil) by Active/Passive U.S. Category Groups

US Category Group	Active			Passive		
	Aug 2019 (\$Mil)	1 Year (\$Mil)	Assets (\$Bil)	Aug 2019 (\$Mil)	1 Year (\$Mil)	Assets (\$Bil)
US Equity	(18,940)	(201,704)	4,246	(878)	(231,045)	4,271
Sector Equity	(4,790)	(33,346)	402	(5,260)	(27,377)	504
International Equity	(1,747)	(89,486)	1,780	(7,423)	76,613	1,266
Allocation	(2,620)	(68,703)	1,263	322	4,898	77
Taxable Bond	13,273	54,917	2,873	3,056	152,847	1,412
Municipal Bond	7,983	54,374	786	1,125	7,905	42
Alternative	(2,951)	(23,443)	141	(165)	1,877	51
Commodities	(1,464)	(1,076)	29	4,523	9,636	79
All Long Term	(11,256)	(308,466)	11,520	(4,700)	457,443	7,703

Source: Morningstar Direct Asset Flows. Data as of Aug. 31, 2019. Excludes money market funds.

Exhibit 6 Morningstar Categories With the Greatest Estimated Net Inflows and Outflows in August 2019 (\$Mil)

Morningstar Category	Estimated Net Flows (\$Mil)			1 Year	Assets \$Bil
	August				
	Active	Passive	Total		
Leaders					
Intermediate Core-Plus Bond	7,918	21	7,939	44,277	745,559
Foreign Large Blend	(1,146)	6,904	5,758	41,427	1,105
Ultrashort Bond	6,071	(1,203)	4,868	65,636	269
Commodities Precious Metals	0	4,702	4,702	11,889	72
Intermediate Government	629	3,355	3,984	27,651	172
Laggers					
Large Growth	(8,297)	(669)	(8,966)	(52,929)	1,778
Diversified Emerging Markets	409	(7,765)	(7,356)	16,424	536
High Yield Bond	(3,371)	(1,165)	(4,536)	(5,275)	296
Bank Loan	(4,230)	163	(4,393)	(45,647)	104
Financial	(280)	(3,944)	(4,224)	(19,760)	51

Source: Morningstar Direct Asset Flows. Data as of Aug. 31, 2019.

Fund Families

Exhibit 7 Estimated Net Flows (\$Mil) for the Top 10 U.S. Fund Families (by Assets)

Top 10 U.S. Fund Families (by Assets)	Estimated Net Flows (\$Mil)		August Total	1-Year Total	Assets (\$Bil)
	Active	Passive			
Vanguard	(454)	6,595	6,140	170,277	4,905
BlackRock/iShares	413	(7,840)	(7,427)	121,797	1,831
Fidelity Investments	(2,044)	6,343	4,299	86,152	1,662
American Funds	(301)	N/A	(301)	5,602	1,638
SPDR State Street Global Advisors	(236)	(10,479)	(10,714)	244	642
T. Rowe Price	(237)	(204)	(441)	(19,446)	631
Invesco	(3,303)	(85)	(3,388)	(35,320)	526
Dimensional Fund Advisors	128	(23)	105	7,549	412
PIMCO	825	(30)	795	1,500	384
Franklin Templeton	(2,060)	17	(2,042)	(25,583)	347

Source: Morningstar Direct Asset Flows. Data as of Aug. 31, 2019. Excludes money market funds.

Despite the rough month for U.S. equity funds, Vanguard Total Stock Market Index VTSMX still led all funds with \$6.3 billion in inflows. Sibling Vanguard Total International Stock Index VTIAAX followed with \$5.7 billion in inflows.

Exhibit 8 Funds With the Greatest Estimated Net Inflows and Outflows (\$Mil)

Fund Name	Estimated Net Flows (\$Mil)		Assets \$Bil
	Aug 2019	1 Year	
Leaders			
Vanguard Total Stock Market Index Fund	6,286	53,108	813
Vanguard Total Intl Stock Index Fund	5,737	33,701	374
SPDR Gold Shares	3,044	6,689	43
iShares Core S&P 500 ETF	2,630	15,620	182
Fidelity 500 Index Fund	2,593	30,693	203
Vanguard Total Bond Market Index Fund	2,469	20,996	241
iShares Edge MSCI Min Vol USA ETF	2,164	13,686	33
Vanguard 500 Index Fund	1,916	25,146	486
Fidelity Series Overseas Fund	1,773	3,489	3
PGIM Total Return Bond Fund	1,444	8,986	48
Laggers			
SPDR S&P 500 ETF	(9,821)	(13,022)	161
Vanguard Total Bond Market II Index Fund	(7,752)	3,238	183
iShares MSCI Emerging Markets ETF	(5,110)	(4,281)	25
iShares S&P 500 Index Fund	(4,369)	(3,373)	15
Vanguard Institutional Index Fund	(3,117)	(18,072)	225
Financial Select Sector SPDR Fund	(2,849)	(8,384)	21
iShares Core MSCI Emerging Markets ETF	(2,082)	7,850	53
iShares iBoxx HY Corporate Bond ETF	(1,980)	257	18
iShares Russell 2000 ETF	(1,781)	(1,385)	40
Fidelity Contrafund	(1,141)	(13,563)	118

Source: Morningstar Direct Asset Flows. Data as of Aug. 31, 2019.

Note: The figures in this report were compiled on Sept. 11, 2019, and reflect only the funds that had reported net assets by that date. As of this date, Artisan had not yet reported net assets for its funds. The figures in both the commentary and the extended tables are survivorship-bias-free. This report includes both mutual funds and exchange-traded funds, but not funds of funds unless specifically stated. It does not include collective investment trusts or separate accounts.

Important methodology note: Morningstar computes flows using the approach that is standard in the industry: Estimated net flow is the change in assets not explained by the performance of the fund. Our method assumes that flows occur uniformly over the course of the month. Adjustments for mergers are performed automatically. When liquidated funds are included, the final assets of the fund are counted as outflows. Reinvested dividends are not counted as inflows. We use fund-level reinvestment rates to improve accuracy in this respect. We make ad hoc adjustments for unusual corporate actions such as reverse share splits, and we overwrite our estimates with actual flows if managers are willing to provide the data to us.

Please click [here](#) for a full explanation of our methodology. ■■■



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