

ICI VIEWPOINTS

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Revisiting the Age-Old Active Versus Passive Debate

By Brian Reid

The *New York Times* recently published an [article](#) examining investor behavior in the context of an old debate: actively managed funds versus passive funds (such as index funds). When reading stories like this, it is important to keep a couple of key points in mind.

Investor Demand for Index Funds Is a Long-Term Trend

During the last 15 years investors have shifted more of their investments into passive products. Today, for example, 23 percent of all equity mutual fund and ETF assets are invested in index funds, compared to 10 percent in 1995.

However, this development is no “fall from grace” for active management, as the *Times* story suggests. To the contrary, index funds have been part of the fund landscape for decades, and they have long attracted investors wanting a low-cost option for investing in the market. In recent years, investor demand for these funds has expanded beyond broad-based domestic equity funds to fixed-income and international funds.

Moreover, growth in index funds does not signal the end of active management. Many investors who use index funds also invest in actively managed funds. In addition, even among those investors and financial advisors who exclusively use index funds, many “actively manage” their portfolios over time by increasing or decreasing the allocation to fixed-income funds and by adjusting the share of their portfolios allocated to particular market sectors or certain countries and economic regions.

Overall, Stock Fund Investors Have Seen Gains in the Past 10 Years

The *Times* story puts heavy emphasis on recent investor movement out of stock funds. But consider the aggregate numbers during the past 10 years. ICI data shows that the assets in stock funds grew from \$4.042 trillion in December 1999 to \$5.667 trillion in December 2010. Net new cash flow into stock funds from December 1999 to December 2010 was \$775 billion. Hence, after fees and expenses, stock funds produced a gain of about \$850 billion back to investors during this period. For domestic equity funds, the gain was \$453 billion after fees and expenses. These gains occurred even though the U.S. stock market endured its worst back-to-back bear markets since the Great Depression.

For more on the big trends in fund investing, you can find good perspective in our annual [Investment Company Fact Book](#), which we will update in the next few weeks. Or check out [my video series](#) that discusses trends in mutual fund investing. For weekly and monthly information on flows, consult our [statistics page](#).

Brian Reid was Chief Economist of the Investment Company Institute.