

## ICI VIEWPOINTS

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## A Changing Landscape for the Fund Industry—and Fund Investors

By Rob Elson

Continue to expect change in the investment landscape, with the Federal Reserve, the Millennial generation, and technological evolution all playing major roles. So said industry experts on the “Investment Strategies and Insights” panel at ICI’s General Membership Meeting, held last week in Washington, DC.

Tyler Mathisen, co-anchor of CNBC’s *Power Lunch* and *Nightly Business Report*, moderated the two-person panel, which included Krishna Memani, chief investment officer at OppenheimerFunds, and Liz Ann Sonders, senior vice president and chief investment strategist at Charles Schwab & Co.

### The Fed’s Path Forward

Big news from the day before—the release of the minutes from the most recent Federal Open Market Committee (FOMC) meeting—framed the early part of the discussion. The minutes “evidenced a heavy implication that an interest rate hike is a live option for the next [FOMC] meeting in June,” Mathisen remarked, asking the two executives about their expectations for the Fed’s course.

Memani agreed, but added that what he expects the Fed to do doesn’t line up with what he thinks the Fed *should* do. “The minutes made clear that June is very much alive [for a rate hike]. Having said that, my personal view is that the room for the Fed to tighten is not there yet. I believe that the Fed should be very careful with tightening.

“We are still dealing with a deleveraging world,” he stressed. “It’s going in cycles—moving from the United States, to Europe, to emerging markets. And if the Fed tightens before that process has concluded, there will be severe problems, not unlike those we saw in February. If the U.S. economy is doing well, and we tighten policy when everyone else is easing it, we are effectively transferring U.S. growth onto others, and that’s not good for our economy.”

The possibility of an imminent rate hike had come as a surprise to many, considering Federal Reserve Board Chair Janet Yellen’s dovish speech in March. “If you listened to Chair Yellen’s speech—if you had read the statement after the last meeting—it felt very different in tone from what we saw in those minutes yesterday,” Mathisen noted. “Does the Fed have a messaging problem?”

Not quite, according to Sonders. “The Fed is trying to get ahold of its messaging. The market [has been] guiding [the Fed’s] decision-making more than it would like.” But that doesn’t mean that the Fed is solely looking at the stock markets to help determine monetary policy, she said. It’s looking at financial conditions more broadly. For example, “financial conditions tightened in August, and the Fed backed away [from a rate hike] in September; financial conditions loosened in December, and the Fed was then able to tighten rates.”

### The Millennial Factor

But will investors be well-positioned for a rate hike? Mathisen, noting the billions of dollars recently flooding into bond funds and out of stock funds, questioned whether investors might be “doing the wrong thing at the wrong time,” given that interest rates are likely to continue to rise.

“This is not a new story—this is a seven-year story,” Sonders responded. “I think that [the 2007–2009 financial crisis] scarred a generation of investors,” she said, referring to Millennials, “and I’m not so sure we’ll ever get them back again. The investing public is still scared—they want safety and income without the risk” of investing in equities.

But even greater risks might lie in striving for safety—and missing out on potential returns. “The challenge for our industry is extraordinary,” Memani warned. The industry, he said, needs to explain to investors that completely avoiding risk actually is equivalent to “taking a significant amount of risk.”

Millennials appear to be more skeptical and distrustful of financial services firms than older generations, according to Mathisen. “If you look at the data,” Memani added, “it smells and tastes like that is the case—and it definitely is a problem.”

“Millennials don’t have a lot of money at the moment,” he continued, “but they’re going to inherit the world. A lot of the assets that we manage as an industry will transition to them. And if we do not address their concerns—their apprehensions—in a systematic and very energetic way, we’re going to have a problem as a business.”

The same goes for recruiting young investment management talent, Sonders added, acknowledging that working on Wall Street doesn’t have the same cachet that it did when she was growing up. “We as an industry have to adapt to the desires of Millennials,” she insisted. “We have to express that this is a viable industry—and an interesting one.”

## Trends in Fund Products

Turning to trends in fund products, Mathisen began by looking at target date funds. In theory, these funds make sense, he said. The risk in their portfolios should decrease as the investor gets closer to retirement—but sometimes, market conditions might call for a change in strategy.

“Target date funds are not perfect,” Memani agreed. “In my opinion, an actively managed multi-asset fund is much better. But they’re a tougher sell to someone who doesn’t want to get involved in equities.” Target date funds, he says, help people dip their toes into risk that they might not otherwise take.

The near future of fund products, the panelists said, lies with alternative investment funds, or any product that can bring alternative investment classes to retail investors at affordable prices.

“To some degree, we’re already seeing this” through exchange-traded funds (ETFs), Sonders noted. “I think we will see more access to venture capital and private equity through vehicles that allow smaller investors, maybe in a pooled way, to get that exposure.”

## How “Disruptable” Is Your Business?

With fund products rapidly evolving, it should be no surprise that the industry as a whole—including financial advice—is also ripe for evolution. Near the end of the session, Mathisen asked the executives, “How ‘disruptable’ is your business—right here, right now?”

“In today’s world, no business is an island,” Memani replied. “If we assume that we are not disruptable, we are deluding ourselves.” The question is really more about the pace of disruption, he said, rather than whether it will actually happen. “We have to participate in that—we have to engage in that. And that’s not just from the standpoint of engaging customers—it’s from the standpoint of the way we manufacture returns as well.” Sonders agreed, bringing the conversation back to Millennials once again. It’s they, she said, who will drive the disruption of the mutual fund industry.

“The marriage of robot and human” has tripled productivity in some industries, with strong results for bottom lines, Sonders explained, citing a *Wall Street Journal* report. “I think we’re going to see that in financial services—certainly in advice. Still, I don’t think we’re going to eliminate the human out of the equation any time soon.” Then she added, with a smile, “but I’m human, so I’m biased.”

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