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# Fund Investors Will “Run”? Sorry, Charlie Brown

By Sean Collins and Sarah Holden

For decades, Charles Schulz kept us in suspense: surely this time, Lucy would let Charlie Brown kick the football. Nope. Every time, at the last second, she pulled the ball away—and Charlie Brown fell flat on his back.

We’ve seen the same gap between wish and fulfillment around market turmoil and mutual funds. For decades, commentators have predicted that investors in stock and bond funds, faced with market turmoil, would redeem en masse, perhaps adding to the market turmoil. Despite plenty of opportunities, that just hasn’t happened—but like Charlie Brown, the press and pundits don’t give up. *Next time*, they argue, fund shareholders will flee the market and redeem heavily. And Lucy will let Charlie Brown kick the football.

Stock market turmoil in February provides yet another example of this.

From November 2016 to January 2018, the stock market rose sharply, posting a total gain of 34 percent. Stock market volatility, as measured by the volatility index (VIX), remained quite subdued. In fact, it trended down a bit.

That changed in early February. Reflecting concerns that inflation could jump, perhaps leading to tighter-than-expected monetary policy, the stock market dropped sharply and volatility jumped. From February 1 to February 8, the S&P 500 index fell nearly 9 percent. The VIX nearly tripled, to a level not seen since August 2015. During the remainder of February, the stock market fluctuated.

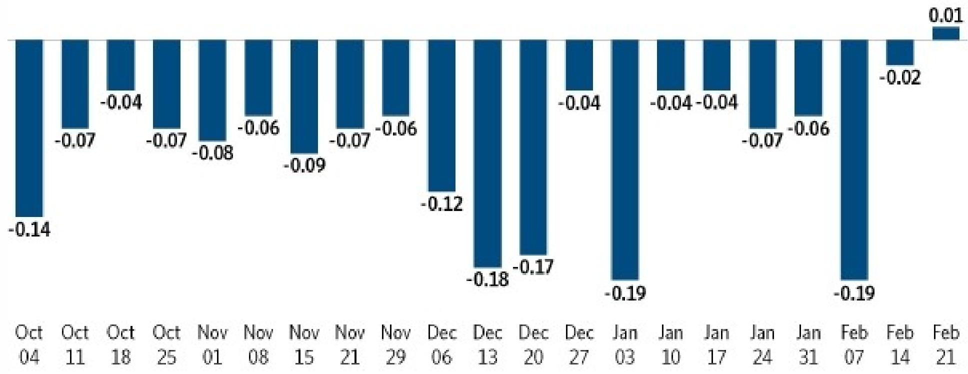
How did fund investors react? Last month, our colleague Shelly Antoniewicz reviewed the response of investors in exchange-traded funds (ETFs), and showed that it was quite muted.

What about investors in domestic equity mutual funds? Their response was even more subdued. During the week ended February 7, investors redeemed $15.2 billion on net from such funds, amounting to just 0.19 percent of their assets as of January 31 (see Figure 1, below). During the following week, investors in these funds redeemed another 0.02 percent. In short, despite the stock market’s “sound and fury,” mutual fund investors carried on about their business.

**FIGURE 1**

**Weekly Flows to Domestic Equity Mutual Funds**

***Percent of previous month-end assets****




*Previous month-end assets are based on the month prior to the Wednesday when the week ends.

Source: Investment Company Institute

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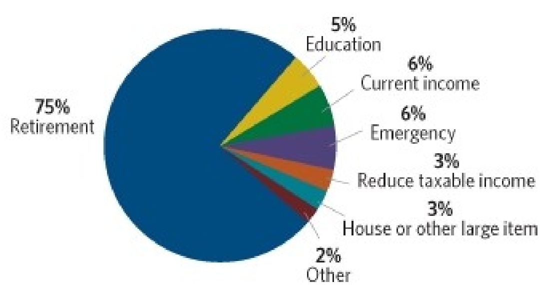
As ICI has frequently noted, this is pretty standard behavior for fund investors. We've nevertheless received a number of inquiries about why fund investors reacted so modestly in the face of considerable market turbulence. There are likely a range of factors.

First, fund investors are typically in it for the long term. In 2017, 92 percent of mutual fund–owning households cited saving for retirement as a reason they invest in funds. Fully 75 percent cited saving for retirement as their *primary* reason for investing (see Figure 2, below). Because these shareholders have investment horizons that can be years to decades long, they can stay the course when markets are unsettled.

**FIGURE 2**

**Primary Financial Goals Cited by Mutual Fund Investors**

***Percentage of US households owning mutual funds, 2017***




Source: Investment Company Institute

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Second, fund shareholders understand that investing poses a tradeoff between risks and returns. For example, 34 percent of mutual fund–owning households indicate a willingness to accept substantial or above-average investment risk. Another 46 percent state they are willing to accept average investment risk.

Third, many fund investors continue to purchase fund shares whether markets are rising or falling. Most notably, 401(k) plan investors frequently make additional fund purchases once or twice a month directly out of their paychecks. These plan participants tend to maintain their periodic 401(k) contributions through thick and thin. For example, an ICI survey of defined contribution (DC) plan recordkeepers found that during the financial crisis, 96 percent of 401(k) plan participants continued to contribute to their plans.

Fourth, investors make financial plans, often with the help of professional advisers. These plans may cover a range of considerations, such as asset allocation, saving for and investing in a home, job income, risk tolerance, and age—as well as the possibility that markets could drop. During February's market turmoil, several publications reported that financial advisers were allaying clients' concerns by reminding them that they have financial plans and that it makes sense to stick with those plans, even when markets are volatile.

Finally, many fund investors may have taken steps to limit their exposure to a market downturn before February 2018. No, fund investors were not especially prescient. But many investors—again, often with the help of an investment professional—periodically rebalance their portfolios to help mitigate investment risk. In a year when stock prices rise sharply, rebalancing can mean selling some stocks and buying some bonds.

In 2017, US stock market indexes rose 20 to 25 percent, far outperforming the US bond market, which returned about 4 percent over the year. Rather than simply directing their flows to the category with the highest returns, investors instead responded by *redeeming* $50 billion from domestic equity funds and *adding* a record $381 billion into bond funds. As a result, fund investors may have felt less need to react when the stock market fell in February 2018.

Doubtless, various other factors also contributed to fund shareholders' equable reaction to stock market volatility in February. Whatever the underlying causes, February events provide yet another illustration that the hypothesis that fund investors "run"—or redeem en masse in response to unsettled markets—simply doesn't fit the facts.

Granted, despite all evidence to the contrary, one can never rule out the possibility of such an event. And Lucy just might let Charlie Brown kick that football.

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