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ICI VIEWPOINTS

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2018 Investment Company Fact Book: Letter from the Chief Economist

By Sean Collins

A version of this letter by ICI Chief Economist Sean Collins was released in the Institute's 58th edition of the Investment Company Fact Book.

How do we see the world? Our eyes are flooded with light, bearing signals about the shape and movement of people and objects around us. But those signals don't make sense until they're processed through our eyes, our nerves, and our brains, where we apply accumulated knowledge and models of the world to turn patterns of light into the recognized image of a landmark or a friend's face.

Those of us who have worn glasses most of our lives know that one of the most crucial elements in this process is the right lens. A bad lens warps the light and distorts the signals—so our brains never have a chance to make sense of the patterns. The right lens sharpens the image and enhances our understanding.

This is a useful metaphor for the work that ICI Research does in providing informed analysis to guide public policy. Through our voluminous collections and surveys, we gather large amounts of data—signals about the behavior of funds, markets, and investors. But finding the patterns in these signals requires the right lens—accumulated knowledge provided by context, economic insights, and understanding of institutions.

The *Investment Company Fact Book* is one very visible result of this process and its many elements.

Data. The *Fact Book* provides objective data and information about investment companies and their investors—high-quality signals to send through the lens. Each chapter, as well as extensive data tables, was developed with great care by the research staff. All of the data in this book are available on ICI's website—in addition to data from the more than 300 statistical releases produced throughout the year under the direction of Judy Steenstra, ICI's senior director of statistical research.

The *Fact Book* also provides a wealth of information on investor characteristics. These are derived from unique databases and surveys—updated annually under the direction of Sarah Holden, ICI's senior director of retirement and investor research—that illuminate the success of the fund industry in helping investors save. In a recent *ICI Viewpoints*, Sarah and I used data drawn from chapters 7 and 8 to explain why mutual fund investors reacted rather calmly to the stock market turbulence in February 2018: investors save for long-term goals such as retirement, understand that funds involve risk/return trade-offs, and make financial plans (often with the help of a financial professional) that can help them weather market downturns.

Context. Chapters 2 and 3 in particular give us an example of focusing data through context. They offer informed analysis for how developments in markets affected flows to US mutual funds. Some have expressed concern that rapid growth in bond fund assets could destabilize fixed-income markets. As chapter 3 shows, bond funds have attracted more than $1.5 trillion in new money in the past decade. But even with that rapid growth, by year-end 2017, assets in funds accounted for only 20 percent of the US bond market (chapter 2). With this context, the concern over bond funds' rapid growth dissipates.

Institutional knowledge. Deep institutional knowledge—that is, an understanding of the institutions of funds, investors, and the financial and retirement markets—also is key to good vision. ICI Research spends a lot of time seeking to understand how investors and markets operate, which allows us to combine data with real world details. Chapter 4, as well as a recent a recent *ICI Viewpoints* by Shelly Antoniewicz, ICI's senior director of industry and financial analysis, offer good examples.

When stock market volatility spiked in early February 2018, some commentators pointed fingers at exchange-traded funds (ETFs). We explained that the vast majority of ETF trades occur between investors on the secondary market (i.e., the stock exchanges) and don't "touch" the stocks ETFs hold. Those stocks are affected only on the primary market—when there are net creations or redemptions of ETF shares. We showed that although ETF trading volumes did rise on the secondary market during the recent market turbulence, net redemptions of ETF shares were a tiny fraction of the value of company stocks traded.

Economic insights. The life-cycle consumption model—standard fare in undergraduate economics—is simple in concept: workers improve their welfare by smoothing consumption over their lifetimes. As my colleague Peter Brady has emphasized, the life-cycle model has vast implications for correctly interpreting data on households' preparedness for retirement. Because a worker's earnings typically increase early in life and then level off, the model suggests workers should delay saving for retirement until later in their career. In fact, as the model predicts, younger and lower-income workers are less likely to participate in employer-sponsored retirement plans.

But alarm over this pattern is misplaced: younger workers don't stay young, and many lower-income workers advance into better-paying jobs. As we show in chapter 8, by the time households approach retirement, 81 percent have accrued benefits in a defined benefit plan, accumulated assets in a defined contribution plan or individual retirement account, or both.

Global vision. Finally, to get a clear picture of the industry, we must sometimes broaden our field of vision. ICI has for years served on behalf of the International Investment Funds Association (IIFA) as a repository of data about the global funds market. Over the past decade, financial regulation has gone global in new and expansive ways that affect the fund industry. So, too, has the work of ICI, with the launch of ICI Global in 2011. As we continue to build our research and data in this area, the 2018 *Fact Book* introduces a new chapter—chapter 1—focusing on trends in the flows and assets of funds globally.

We hope you'll find this year's *Fact Book* an illuminating lens, both as a compendium of data and information, and ultimately as a store of knowledge. As a quote commonly attributed to (the famously bespectacled) Benjamin Franklin puts it, "An investment in knowledge pays the best interest."

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