
by Brian Reid and Kimberlee Millar

SUMMARY

U.S. and world financial markets produced a mixed environment for mutual funds and their shareholders in 1999. In the U.S., technology and communications stocks performed well. However, other sectors of the U.S. stock market posted losses, and more than half of all stocks experienced price decreases for the year. Furthermore, rising interest rates led to one of the largest annual declines in bond prices in 30 years. Outside the U.S., many foreign stock markets registered strong gains, particularly those in Asia.

In this setting, mutual fund assets increased 24 percent to $6.843 trillion. About one-quarter of the growth was attributable to net new investments by mutual fund shareholders, which totaled $364 billion; most of the remainder came from investment performance. Net flows rose for equity funds in 1999 compared with 1998, but declined for other major investment objectives.

This issue of Perspective reviews mutual fund asset growth and net flows in 1999. Highlights of the review include the following.

Equity Funds

- Equity mutual fund assets increased 36 percent in 1999 to $4.039 trillion. Fund performance accounted for about 80 percent of the growth.
- Net new cash flow to equity funds rose 19 percent to $188 billion. Domestic equity funds accounted for most of the net flow.
- Among domestic equity funds, those with relatively large investments in technology stocks captured a disproportionate share of the net flow. In addition, the inflow to index funds continued to rise.
- New sales of all equity funds increased to $918 billion in 1999. As a percentage of average assets, new sales were unchanged at 26 percent, after declining during the previous two years. Redemptions rose to $743 billion or 21 percent of average assets from 20 percent in 1998.
- The monthly pattern of net new cash flow to equity funds suggests that fund investors did not redeem or curtail fund investments in anticipation of potential Y2K problems.

Bond Funds

- Assets in bond funds fell 3 percent in 1999 to $808 billion. The decline was attributable to rising interest rates, which lowered bond fund returns. Net new cash flow declined to $5 billion in 1999, down from $75 billion in 1998.
- Mutual fund complexes continued to consolidate government and municipal bond funds in 1999. Investor demand for these funds has been
weak since the mid-1990s, leading many complexes to merge or liquidate their smaller funds.

**Hybrid Funds**

- Assets in hybrid funds—those investing in a mix of stocks and bonds—rose 5 percent to $384 billion.
- The modest growth resulted from a combination of fund performance, which was held down by the decline in bond prices, and a net outflow of $12 billion.

**Money Market Funds**

- Assets in money market funds rose 19 percent in 1999 to $1.612 trillion. Net new cash flow of $194 billion was the second highest annual flow on record.
- Net flow to retail money funds was $82 billion, second only to the record $131 billion in 1998. Inflows slowed from their 1998 pace during the first half of 1999 as yields on retail money funds fell relative to rates on bank and thrift deposits. The slowdown may also have reflected a decline in household demand for liquidity.
- Net flows to retail money funds were not appreciably stronger than usual near yearend, providing further evidence that individuals’ reaction to potential Y2K problems was muted.
- Institutional money funds experienced a record net inflow of $112 billion in 1999. Some of the pickup reflected an absence of a seasonal outflow that often occurs during the second half of December.

**MUTUAL FUND ASSETS AND FLOWS**

Total mutual fund assets increased 24 percent in 1999 to $6.843 trillion (Figure 1). Investment performance, largely from rising stock prices, accounted for about two-thirds of the asset growth. Net new cash flow of $364 billion accounted for 28 percent of the increase in assets, with the remainder of the growth attributable to new funds.

Net new cash flow to equity funds rose, generally reflecting strength in the major stock price indexes. Bond funds posted a net outflow, as rising interest rates deterred investors. Hybrid funds, which invest in both stocks and bonds, also were adversely affected by rising interest rates, posting a net outflow for the year. Finally, the flow of new cash to money funds declined from the record high in 1998 but nonetheless was substantial.

**FIGURE 1**

*Net New Cash Flow to Mutual Funds, 1985-1999*  
(billions of dollars)

<table>
<thead>
<tr>
<th>Year</th>
<th>Equity</th>
<th>Bond</th>
<th>Hybrid</th>
<th>Money Market</th>
<th>Total</th>
<th>Total Mutual Fund Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>1985</td>
<td>8</td>
<td>63</td>
<td>2</td>
<td>–5</td>
<td>68</td>
<td>495</td>
</tr>
<tr>
<td>1986</td>
<td>22</td>
<td>103</td>
<td>6</td>
<td>34</td>
<td>164</td>
<td>716</td>
</tr>
<tr>
<td>1987</td>
<td>19</td>
<td>7</td>
<td>4</td>
<td>10</td>
<td>40</td>
<td>769</td>
</tr>
<tr>
<td>1988</td>
<td>–16</td>
<td>–4</td>
<td>–3</td>
<td>0</td>
<td>–23</td>
<td>809</td>
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<tr>
<td>1989</td>
<td>6</td>
<td>–1</td>
<td>4</td>
<td>64</td>
<td>73</td>
<td>981</td>
</tr>
<tr>
<td>1990</td>
<td>13</td>
<td>6</td>
<td>2</td>
<td>23</td>
<td>44</td>
<td>1,065</td>
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<td>59</td>
<td>8</td>
<td>5</td>
<td>112</td>
<td>1,393</td>
</tr>
<tr>
<td>1992</td>
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<td>71</td>
<td>22</td>
<td>–16</td>
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<tr>
<td>1993</td>
<td>129</td>
<td>73</td>
<td>39</td>
<td>–14</td>
<td>228</td>
<td>2,070</td>
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<tr>
<td>1994</td>
<td>119</td>
<td>–65</td>
<td>21</td>
<td>9</td>
<td>84</td>
<td>2,155</td>
</tr>
<tr>
<td>1995</td>
<td>128</td>
<td>–11</td>
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<td>89</td>
<td>212</td>
<td>2,812</td>
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<tr>
<td>1996</td>
<td>217</td>
<td>3</td>
<td>12</td>
<td>89</td>
<td>321</td>
<td>3,526</td>
</tr>
<tr>
<td>1997</td>
<td>227</td>
<td>28</td>
<td>16</td>
<td>102</td>
<td>374</td>
<td>4,468</td>
</tr>
<tr>
<td>1998</td>
<td>157</td>
<td>75</td>
<td>10</td>
<td>235</td>
<td>477</td>
<td>5,525</td>
</tr>
<tr>
<td>1999</td>
<td>188</td>
<td>–5</td>
<td>–12</td>
<td>194</td>
<td>364</td>
<td>6,843</td>
</tr>
</tbody>
</table>

Source: Investment Company Institute

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2 Asset and flow data for 1999 are preliminary and are subject to revision.
EQUITY FUNDS


The increase in net flow to equity funds, coming primarily from higher net purchases of equity funds by households, contrasted with their continued selling, on balance, of direct stock holdings. As has been the case since 1994, households sold more of direct holdings of stocks last year than they indirectly acquired through mutual funds. The net sale of equity over the past six years has occurred even though the number of households owning stocks directly or indirectly increased by more than 20 percent to 49 million in early 1999. Despite the net sale of stocks by households, rising equity prices pushed the dollar value of total household equity holdings to $10.8 trillion or about 34 percent of household financial assets at the end of the third quarter of 1999.

Domestic Equity Funds

Net new cash flow to domestic equity funds rose to $177 billion in 1999 from $150 billion in 1998 (Figure 2). Net flows began the year at a subdued pace, averaging $12 billion per month in the first quarter, the lowest level in a first quarter since 1995. Net flows picked up in the spring and averaged $15 billion per month over the last nine months of the year. Overall, the net flow in 1999 to domestic equity funds was second only to the record net flow in 1997.

Even though domestic equity funds collectively experienced an increase in net new cash flow in 1999, net flows across individual domestic equity funds were more concentrated than normal. The 10 percent of domestic funds with the largest inflows had a total net new cash flow of $286 billion

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2 The Flow of Funds Accounts of the United States: Flows and Outstandings Third Quarter 1999 (December 15, 1999), Board of Governors of the Federal Reserve System, Washington, DC indicate that residents of foreign countries and state and local government pension plans were net buyers of equities during the 1990s.

3 Domestic equity funds consist of aggressive growth, growth, sector, income, and growth and income funds. At yearend 1999, there were 3008 domestic equity funds in the ICI database with $3.455 trillion in assets.

4 Net flow to domestic equity funds averaged $6.8 billion per month in the first quarter of 1995.
in 1999, meaning that the remaining 90 percent combined for a net outflow of $109 billion. The ratio of the net flow of the top 10 percent to the total net flow for all domestic equity funds was 1.62, the highest level since 1990 (Figure 3). By comparison, the ratio ranged between 0.83 and 1.25 between 1991 and 1998.

Reflecting the greater concentration of net flows, the percentage of domestic equity funds posting a net inflow declined to 58 percent in 1999 from 65 percent in 1998 (Figure 4). The percentage in 1999 was the lowest since 1990, when only 55 percent experienced a net inflow. Between 1991 and 1998, the percentage of domestic funds with a net inflow fluctuated between 63 percent and 74 percent.

The increased concentration in net flows to domestic equity funds partly reflected strength in prices of technology stocks. These stocks posted gains in 1999 that greatly exceeded the market as a whole. Indeed, 56 percent of all stocks listed on U.S. exchanges declined last year, whereas the technology-laden Nasdaq 100 index more than doubled in 1999 and the Nasdaq index rose 86 percent. The S&P 500 index and the Russell 2000, which have smaller technology components, rose 20 percent.

The average return on domestic equity funds exceeded the return on the S&P 500 index, but a disproportionate share of the net flows went to funds benefiting from relatively large investments in technology stocks. For example, in a sample of 1,520 domestic stock funds, the 10 percent with the highest net new cash flows had about 30 percent of their assets in technology stocks,

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7 The ratio in 1990 was elevated in part because the net flow to domestic equity funds was only $6 billion.
8 Associated Press
9 Lipper—Equity Fund Performance Analysis, Fourth Quarter 1999, REUTERS SA
roughly double that of the 10 percent with the lowest net flows (Figure 5).\textsuperscript{11} Investor preference for funds with significant exposure to the technology sector similarly was reflected in net new cash flows by investment objective. Capital appreciation funds\textsuperscript{12} nearly doubled their net flow in 1999 to $160 billion from $83 billion in 1998. In contrast, the net flow to funds with a total return\textsuperscript{13} objective fell to $16 billion in 1999 from $67 billion in 1998.

Domestic equity index funds also continued to attract investor interest in 1999.\textsuperscript{14} Net new cash flow to these funds was $53 billion, up from $38 billion in 1998 (Figure 6). During the last five years, index funds, particularly S&amp;P 500 index funds, gained in popularity, rising from 2 percent of all net new cash flow to domestic funds in 1994 to 30 percent in 1999. Over this period, the large capitalization stocks generally outperformed smaller capitalization stocks. As a result, index funds, which tend to hold large capitalization stocks, generally outperformed many small-stock and actively managed funds, which invest more heavily in medium and small capitalization stocks.\textsuperscript{15}

**International and Global Equity Funds**

Assets of international/global equity funds increased 49 percent to $584 billion in 1999.\textsuperscript{16} Investment performance was responsible for virtually all of the growth in assets, as net new cash totaled $11 billion.

### Figure 5

**Average Share of Equity Fund Portfolios Invested in Technology Stocks, by Total Net New Cash Flow** (percent)

<table>
<thead>
<tr>
<th>Decile Based Upon Net New Cash Flow</th>
<th>15</th>
<th>17</th>
<th>17</th>
<th>16</th>
<th>17</th>
<th>19</th>
<th>22</th>
<th>24</th>
<th>29</th>
<th>32</th>
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<tr>
<td>1</td>
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<td>3</td>
<td>4</td>
<td>5</td>
<td>6</td>
<td>7</td>
<td>8</td>
<td>9</td>
<td>10</td>
<td></td>
</tr>
</tbody>
</table>

\textsuperscript{1}The first decile contains the 152 funds with the smallest net new cash flows. The second decile contains the 152 with the next smallest net new cash flows. The remaining deciles are similarly defined.

Sources: Morningstar, Inc. and Investment Company Institute

### Figure 6

**Net New Cash Flow and Assets of Domestic Equity Index Funds, 1990-1999** (billions of dollars)

<table>
<thead>
<tr>
<th>Year</th>
<th>Net Flow</th>
<th>Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>1991</td>
<td>2</td>
<td>7</td>
</tr>
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<td>1995</td>
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<td>1996</td>
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<td>60</td>
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<tr>
<td>1997</td>
<td>24</td>
<td>141</td>
</tr>
<tr>
<td>1998</td>
<td>38</td>
<td>230</td>
</tr>
<tr>
<td>1999</td>
<td>53</td>
<td>338</td>
</tr>
</tbody>
</table>

Source: Investment Company Institute

\textsuperscript{11} Fund investments in various sectors were estimated using data from ICI and Morningstar, Inc. Morningstar has data on equity fund investments by industry sector. These funds could be matched with 1520 domestic equity funds in the ICI database. These funds represent 51 percent of domestic equity funds in the ICI database, accounting for 77 percent of assets and 60 percent of net new cash flow. These funds were first ranked by net flows and then placed into deciles. The first decile contained the 152 funds with the lowest net flows; the second decile contained the 152 funds with the next lowest net flows; and so on for the remaining deciles.

\textsuperscript{12} Capital appreciation funds consist of aggressive growth, growth, and sector funds.

\textsuperscript{13} Total return funds consist of income and growth and income funds.

\textsuperscript{14} The ICI database contained 117 domestic equity index funds at yearend 1999. About 60 percent of them were in the growth and income category.

\textsuperscript{15} Index funds made up nearly 10 percent of domestic equity fund assets last year, compared with 2 percent in 1990.

\textsuperscript{16} International and global equity funds consist of emerging market, global, international, and regional equity funds. At yearend 1999, the ICI database contained 956 of these funds.
The annual return on international/global equity funds was 43 percent according to Lipper—Equity Fund Performance Analysis, Fourth Quarter 1999, REUTERS SA.

The relatively low level of net flow to international/global funds occurred even though most foreign stock markets posted sizable gains, as did world equity funds generally.17 The sluggish pace of inflows to these funds was a continuation of a trend that began in October 1997 with the economic and financial crises in many emerging market countries. The reluctance of U.S. fund owners to invest in foreign-related funds was reinforced with the decline in foreign stock prices in late summer of 1998. For the twelve-month period beginning in August 1998 and ending in July 1999, international/global funds posted net outflows in ten of the twelve months, and the cumulative outflow over the entire period was $19 billion. During the last five months of 1999, however, net inflows resumed, with investors adding, on balance, $18 billion to these funds.

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The annual return on international/global equity funds was 43 percent according to Lipper—Equity Fund Performance Analysis, Fourth Quarter 1999, REUTERS SA.
New Sales and Redemptions of Equity Fund Shares

New sales of all equity fund shares rose 31 percent in 1999 to a record $918 billion (Figure 7). New sales exclude sales arising from the reinvestment of dividends and capital gains distributions and the exchanges from other funds within a fund family. New sales were 26 percent of average assets, unchanged from 1998 after declining during the previous two years.\(^{18}\) Share redemptions, other than those through exchanges, also rose to $743 billion in 1999. In contrast to new sales, redemptions as a percent of equity fund assets rose to 21 percent from 20 percent in 1998.\(^{19}\)

During the last two years, the redemption rate moved somewhat above the range of rates that prevailed from 1990 to 1997. To some extent, the increase may have reflected investor caution following the sell-off in equity markets worldwide in August 1998. On a monthly basis, the rate of redemptions increased in that month and rose higher in December 1998 (Figure 8).\(^{20}\) The redemption rate began to work its way downward in the spring, and remained at a lower level until rising at the end of the year.

Net New Cash Flows and Y2K Concerns

The monthly pattern of net new cash flows to equity funds suggests that fund investors did not redeem or curtail fund investments in anticipation of potential disruptions in equity markets associated with Y2K computer software problems. Net new cash flows actually strengthened during the last three months of the year when concerns about Y2K issues likely would have been the most evident (Figure 9). In fact, the net flow of $64 billion in the fourth quarter was the largest quarterly flow in 1999 and the highest since the third quarter of 1997. The increase in cash flow in the fourth quarter reflected higher new sales of shares, which ran counter to the typical seasonal slowdown in sales. In the fourth quarter, investors generally postponed share purchases in advance of capital gains distributions that occur in November and December to avoid paying taxes on those distributions.

BOND FUNDS

Assets in bond funds fell 3 percent in 1999 to $808 billion.\(^{21}\) The decline was attributable to rising interest rates and falling bond prices. Intermediate- and long-term interest rates, which had reached 30-year lows in the fall of 1998, rose throughout 1999. The yield on the 10-year Treasury note, for example, gained 1\(\frac{1}{2}\) percentage points during the year and its price dropped 13 percent.\(^{22}\) This marked the largest one-year drop in Treasury prices since 1994.

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\(^{14}\) New sales as a percentage of average assets is the sum of new sales for the year divided by the average of current and prior yearend assets.

\(^{15}\) Redemptions as a percent of average assets is the sum of redemptions for the year divided by the average of current and prior yearend assets.

\(^{20}\) Monthly redemption rates are computed by dividing total redemptions for the month by assets at the end of the previous month.

\(^{21}\) Bond funds consist of taxable (corporate, high-yield, world, and government) and municipal bond funds. At yearend 1999, there were 2266 bond funds in the ICI database.

\(^{22}\) Computed from the Merrill Lynch Price Index for the 10-year Treasury note.
In this environment, the average return was 1.0 percent on taxable bond funds and –3.8 percent on tax-exempt bond funds.\textsuperscript{23} Net new cash flow to bond funds, which typically declines when interest rates rise, fell to –$5 billion in 1999 from $75 billion in 1998. Net flow began the year at a strong pace, totaling $19 billion during the first quarter (Figure 10). As interest rates rose, monthly net flows turned negative and cumulated to –$24 billion over the last three quarters. The level of net outflows increased in the last quarter, as many investors likely sold funds for tax purposes, as they did in 1994 when many bond funds also posted losses for the year.

**Taxable Bond Funds**

Assets of taxable bond funds rose 1 percent to $537 billion in 1999. Net new cash flow fell to $7 billion in 1999 from $59 billion in 1998, reflecting both a decline in new sales and a pickup in redemptions. Monthly new sales (including exchange sales) averaged 3.4 percent of previous month-end assets, compared with 3.9 percent in 1998. The average rate of monthly redemptions (including exchange redemptions) rose to 3.3 percent in 1999 from 2.9 percent in 1998. The combination of lower sales and higher redemptions was consistent with the patterns and magnitudes exhibited during other periods of rising interest rates over the past 25 years.\textsuperscript{24}

**Municipal Bond Funds**

Assets of municipal bond funds fell 9 percent to $272 billion from $299 billion in 1998, the first annual decline since 1994. About two-thirds of the decline was attributable to fund performance, with the remainder resulting from a $12 billion net outflow. As with taxable bond funds, new sales declined and redemptions rose. New sales slowed to an average monthly rate of 2.1 percent of previous month-end assets in 1999 from 2.3 percent in 1998, while the redemption rate rose to 2.5 percent from 1.9 percent.

**Consolidation of Bond Funds**

Since 1995, mutual fund complexes have gradually consolidated municipal and government bond funds. In 1999, the number of municipal bond funds declined for the fifth consecutive year to 888 from 900 in 1998, and the number of government bond funds dropped to 379 from 395 (Figure 11). The number of municipal bond funds peaked at 1,012 in 1994, while the peak in government funds also occurred in 1994 at 442. The reduction in the number of municipal and government bond funds occurred at a time when investor demand for these funds appears...
to have remained fairly flat, after growing rapidly between 1990 and 1993. 26

The merged or liquidated funds tended to be small. In 1999, 39 municipal bond funds were merged or liquidated, with average assets of $60 million 27 compared with average assets of $306 million for the surviving funds. 28 The 30 government bond funds that were merged or liquidated in 1999 had average assets of $94 million, 29 compared with $367 million for the surviving funds. 30

HYBRID FUNDS
Assets in hybrid funds—those investing in both stocks and bonds—rose 5 percent in 1999 to $384 billion. 31 The modest asset growth resulted from fund performance, which was held down by the decline in bond prices, and from a net outflow of $12 billion, the first annual outflow since 1988 (Figure 12). Net new cash flow turned negative after the stock market sell-off in the summer of 1998 and remained negative throughout most of 1999.

The decline in net flow reflected an increase in redemptions rather than a slowdown in new sales, which remained about unchanged in 1999. Redemptions rose to $72 billion in 1999 from $55 billion in 1998. As a percentage of assets, they rose to 21 percent from 19 percent in 1998.

26 Since 1994, net new cash flows to government bond funds were negative in every year except 1998, with net outflows averaging $6.60 billion each year compared with average annual net inflow of $6.15 billion between 1990 and 1993. Similarly, annual net outflows from municipal bond funds averaged about $4 billion each year since 1994, compared with average annual net inflow of $24 billion between 1990 and 1993.

27 The median asset level of the merged or liquidated municipal bond funds was $22 million.

28 In 1999, 31 of the 39 merged or liquidated municipal bond funds were single-state funds.

29 The median asset level of the merged or liquidated government bond funds was $35 million.

30 Fund mergers, acquisitions, and other reorganization transactions involve a number of legal, compliance, and operational issues. In a fund acquisition, for example, a new advisory contract must be approved by a majority of the independent directors of the target fund’s board, as well as its shareholders. In fulfilling this obligation and their broader responsibility to safeguard the rights and interests of the fund’s shareholders, the independent directors must determine, among other things, that the transaction is in the best interests of the shareholders.

31 Hybrid funds consist of asset allocation, balanced, flexible portfolio, and income-mixed funds. At yearend 1999, there were 533 hybrid funds in the ICI database.
Inflows to retail money funds in January and February 1999 were $6 billion more than the same period in 1998, $24 billion more than in 1997, and $17 billion more than in 1996.

Outflows from retail money funds during these four months in 1999 were $13.9 billion. In 1993, there were outflows of $16.6 billion during this period.

MONEY MARKET FUNDS
Assets of money market funds rose 19 percent in 1999 to $1.612 trillion. Net new cash flow was $194 billion, down from the record $235 billion in 1998. Nonetheless, the net flow in 1999 was the second highest on record. The slowdown in net flow occurred entirely at retail money funds, which are primarily held by individuals. In contrast, institutional funds—held primarily by businesses, pension funds, financial institutions, and governments—posted a record inflow in 1999.

Retail Funds
Retail money funds posted an increase in assets of 15 percent in 1999, rising from $835 billion in 1998 to $964 billion in 1999. Asset growth slowed from the 26 percent pace in 1998, largely because net inflow declined to $82 billion in 1999 from $131 billion in 1998 (Figure 13). Inflows to retail funds typically slow when yields on retail money funds fall relative to rates on bank and thrift deposits, as occurred during the first part of 1999. Monthly net flows did not increase appreciably until the second half of the year when the yield advantage of money funds widened significantly.

The slowdown in net new cash flow to retail money funds also may have reflected a decline in household demand for liquidity. Net inflows strengthened noticeably after the stock market sell-off in the summer of 1998 and remained strong through February 1999.32 As the U.S. stock market recovered from a drop in February 1999, net flows to retail money funds declined. In fact, from March through June the net flow to retail funds was at the lowest level during that four-month period since 1993.33

Inflows to retail money funds did not increase appreciably near yearend, providing further evidence that individuals’ reaction to potential Y2K problems was muted. Monthly inflows averaged $9 billion during the last quarter of 1999, somewhat higher than for the same period in 1996 and 1997 and less than in 1998.

Institutional Funds
Assets in institutional money funds rose 26 percent in 1999 to $648 billion. Net new cash flow rose to a record $112 billion, surpassing 1998’s net flow of $104 billion by 7 percent. The increase in assets in 1999 extended the rapid growth that began in 1994. This growth partly reflected a shift by corporate cash

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32 Inflows to retail money funds in January and February 1999 were $6 billion more than the same period in 1998, $24 billion more than in 1997, and $17 billion more than in 1996.

33 Outflows from retail money funds during these four months in 1999 were $13.9 billion. In 1993, there were outflows of $16.6 billion during this period.
managers to money funds from other liquid assets (Figure 14).

The stronger net flows to institutional money funds last year also reflected a build up in balances at yearend. Institutional money funds typically experience a drop in assets over the last half of December, partly resulting from quarterly corporate tax payments in mid-December. In addition, money market rates often rise relative to money fund yields at yearend, causing some institutional cash managers to shift from money funds into money market instruments. This seasonal pattern, however, did not materialize in 1999, as assets of institutional funds increased $17 billion over the last two weeks in December. In contrast, between 1996 and 1998, assets of institutional funds declined $22 billion, on average, over the second half of December.

Institutional investors may have added to balances at money funds because of uncertainties surrounding the potential for computer problems at the turn of the year. The absence of outflows also reflected steps taken by the Federal Reserve to keep overnight interest rates from rising at yearend. As a result, overnight interest rates were below yields on many institutional money funds during the last week of December, giving institutional investors an incentive to maintain balances in money funds rather than directly holding money market instruments.

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34 Institutional money fund managers prepare for such outflows by increasing their holdings of overnight securities relative to longer maturity instruments. As a result, the average maturity of institutional money fund portfolios declines in December. For example, from 1996 to 1998, the average maturity fell by 3 days over the last three weeks of December. In 1999, the average maturity fell by 7 days, indicating that institutional money funds increased their holdings of overnight securities more than usual. Data obtained from IBC’s Money Fund Report, IBC Financial Data, Inc.

35 The Federal Reserve took a number of steps to keep overnight interest rates from rising near yearend. A discussion of these actions can be found in “Domestic Open Market Operations During 1999” Federal Reserve Bank of New York, Markets Group, pp. 27-35.
Back issues of *Perspective*, written by Institute staff, leading scholars, and other contributors, address public policy issues of importance to mutual funds and their shareholders. Contact the Institute's Public Information Department at 202/326-5945 for more information. All issues of *Perspective* are also available on the Institute's website; for an online index of issues, see http://www.ici.org/economy/perspective.html.

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