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From December Outflows to January Inflows: Seasonal Factors in Mutual Fund Flows

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As US and global stock markets churned in December, the press took note of ICI's reports on outflows from US long-term mutual funds and drew a hasty conclusion: individual fund investors were fleeing from market turmoil. In response, ICI pointed out that these flows, while large in dollar terms, made up a tiny fraction of fund assets and could not be interpreted as a mass flight from the market. December's outflow of \$183 billion totaled about 1 percent of the \$15.7 trillion in assets in long-term mutual funds (stock, bond, and hybrid funds) at the end of November. The reason for this muted response is simple investor behavior: most mutual fund shareholders are investing for long-term goals, and don't react strongly to short-term market swings.

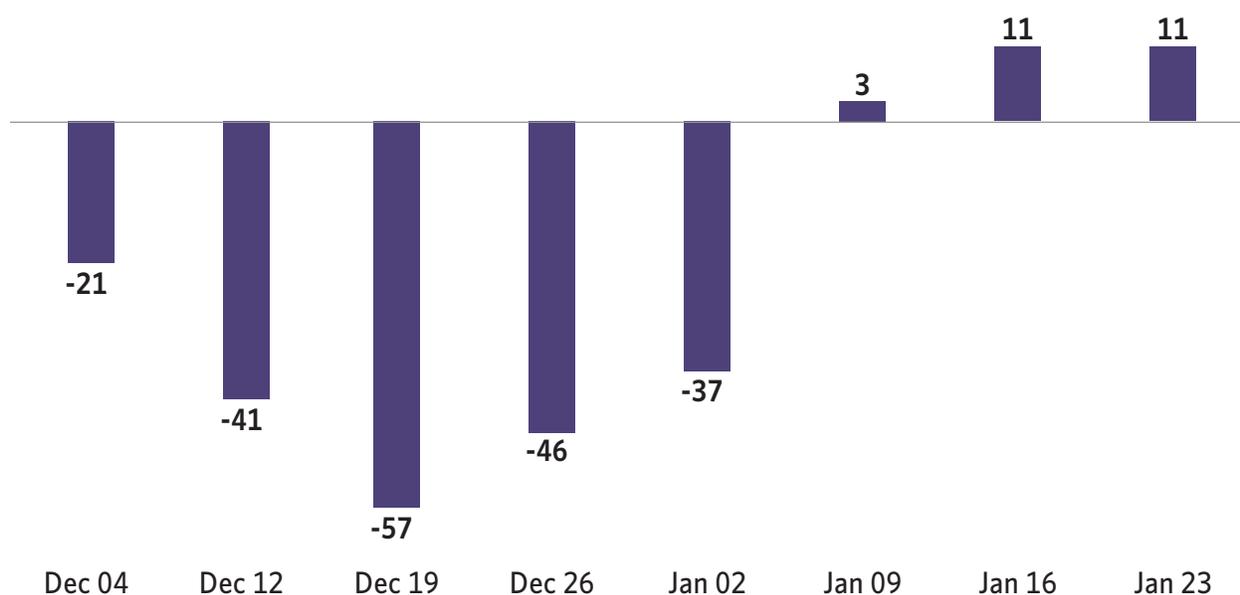
Weighing flows against total assets is the first step to putting fund flows in context. A second factor to be considered is the calendar. It turns out that mutual fund flows have a distinct seasonal pattern, with stronger inflows early in the year giving way to weaker inflows or outflows during the second half.

The reason again is investor behavior. Early in the year, investors are putting year-end bonuses to work or making tax-deductible contributions to their individual retirement accounts (IRAs), or both. But in December, we generally see outflows as investors hasten to meet year-end deadlines. Some outflows are due to "tax loss harvesting"—when investors sell funds in which they have capital losses and use those realized losses to reduce their taxes by offsetting income distributions or capital gains from other funds or securities. Other investors may redeem to complete their annual required minimum distributions (RMDs) from IRAs. We could also see increased outflows because of investors who delay investing in mutual funds to avoid paying taxes on capital gains that funds distribute (capital gains distributions from funds tend to be concentrated in November and December). In all of these cases, tax deadlines—April 15 to fund IRAs and December 31 to realize gains and losses or avoid tax penalties associated with RMDs—contribute to strong seasonal effects.

As shown in Figure 1, those seasonal effects have been in play recently. ICI's weekly estimates of long-term mutual fund flows show outflows during December 2018 and inflows for the first few weeks of January 2019. Although market volatility in December likely played a role in some investors' decisions to redeem moderately from long-term mutual funds, the calendar and the tax code also contributed.

Figure 1: Estimated Flows of Long-Term Mutual Funds

Billions of dollars, weeks ended December 4, 2018, to January 23, 2019



Source: Investment Company Institute

How Big Are Seasonal Factors in Mutual Fund Flows?

These regularly recurring investment decisions by fund investors at the beginning and end of a calendar year have a noticeable impact on mutual fund flows during those months. Using statistical techniques, we can estimate what are called “seasonal factors” for each month of the year. These seasonal factors, shown by the bars in Figure 2, are estimates of the dollar amount of mutual fund flows in each month that would be expected to be regularly more than (positive value) or less than (negative value) the average monthly mutual fund flows. The estimates are based on the historical pattern of monthly flows in long-term mutual funds (excluding money market funds) over the past 10 years.

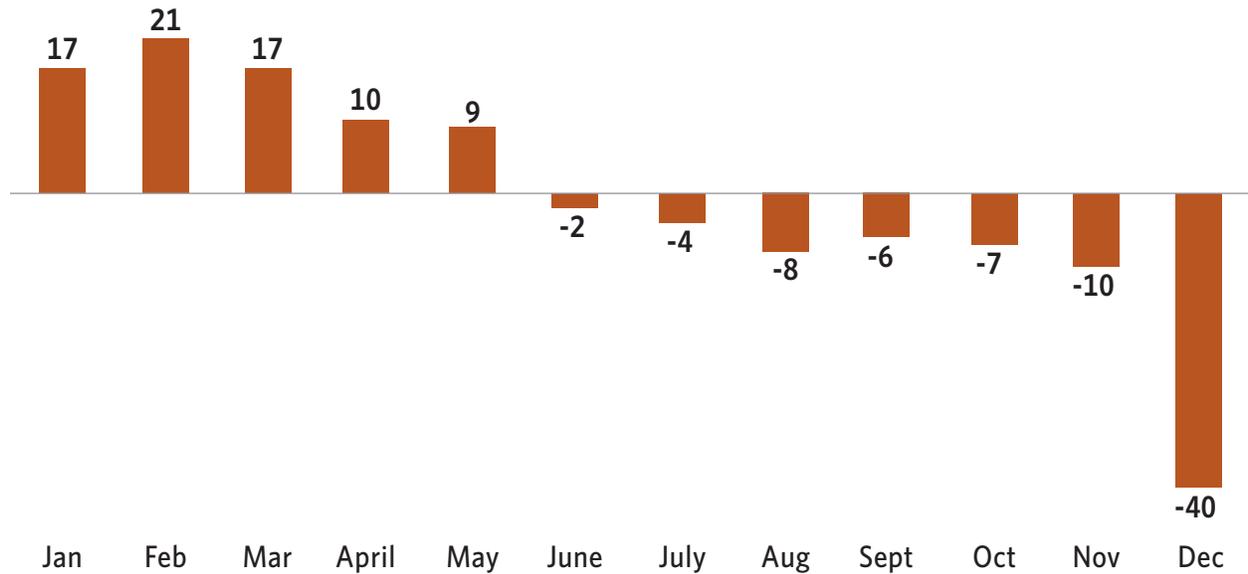
As Figure 2 shows, flows to long-term mutual funds tend to be higher than average in the first part of the year and lower than average at the end of the year. This pattern is consistent across different types of mutual funds, such as domestic equity, world equity, bond, and hybrid. Overall, flows to mutual funds are regularly boosted by \$17 billion in January and \$21 billion in February. In contrast, flows to mutual funds are regularly dampened by \$40 billion in December—by far the largest seasonal factor.

While many government agencies routinely adjust their statistical reports for seasonal effects, ICI does not seasonally adjust any of its reported fund data. The process is complex, and few users of ICI data are looking for seasonal adjustments. Still, it’s important to keep the impact of the calendar in mind when interpreting fund flows—particularly in times of market stress.

How much of this past December's flows could be attributed to these average seasonal effects? According to our monthly estimate, long-term mutual funds had \$183 billion in outflows in December. Based on average seasonal movements over the last 10 years, at least 22 percent (\$40 billion out of \$183 billion) of those outflows resulted from investor behavior similar to what we've seen in previous Decembers over the past 10 years.

Figure 2: Seasonal Factors for Monthly Long-Term Mutual Fund Flows*

Billions of dollars



* Each bar represents the average of the month's seasonal factors estimated over the period from January 2009 to December 2018 using the X-13 ARIMA statistical technique.
Source: ICI calculations

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