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‘One Size Fits All’ Doesn’t Fit Today’s Fund Investors

By Brian Reid

David F. Swensen is the chief investment officer of Yale University and a noted author of investment advice for the public. In books and articles over the last decade, he’s focused much of his attention on mutual funds. Yet he consistently ignores or is unaware of basic facts about how mutual funds operate, how investors seek and use funds, and how individuals manage their portfolios—gaps on full display in his latest [commentary in the New York Times](#) last weekend.

Swensen urges the Securities and Exchange Commission (SEC) to require every actively managed mutual fund to compare its results to “an index-fund alternative.” But every mutual fund has been required to benchmark its performance to an index since 1999.

What about disclosing fees? That goes back even further. Funds have reported their fees for decades, and have published prominently displayed fee tables with a wealth of cost information since 1988.

And the SEC “should hold the mutual fund industry to a ‘fiduciary standard,’ one that puts clients’ interests first”? Of course, the Investment Advisers Act of 1940 has held mutual fund advisers to exactly that fiduciary standard for the last seven decades, and the [fund industry supports](#) extending just as strong a fiduciary standard to broker-dealers as well.

Ignoring these inconvenient facts allows Swensen to present a distorted picture of the mutual fund industry in support of a radical proposal that would herd investors into a one-size-fits-all portfolio.

The heart of his argument is that the mutual fund industry somehow colludes with individuals’ brokers and investment advisers to induce investors to “churn” their funds, driving cash toward the highest-cost funds.

How well is this alleged scheme working? Not at all, if the data on net new cash flow to stock funds is any indication. From 2000 through 2010, 82 percent of that new cash went to stock funds whose expense ratios were in the lowest quartile. Even among actively managed funds, 74 percent of net new cash went to the 25 percent of funds with the lowest expenses. Those figures suggest that the mutual fund industry is far more competitive—and that investors and their advisers are a lot more thoughtful and fee-conscious—than Swensen appears to believe.

Swensen’s proposed solution is no more informed about investing reality. First, he urges individual investors to ditch their financial advisers, because they offer little more than “sales pitches.” Then, he urges the SEC to bend its full regulatory and enforcement powers to force investors toward “a well-diversified portfolio of low-cost index funds.”

Here, Swensen ignores the fact that investors rely upon their financial advisers for...well, advice. In our surveys, 90 percent of fund shareholders with ongoing adviser relations told us they’ve sought out their adviser in the previous 12 months—for counsel on taxes, retirement and college savings, estate planning, providing for elderly family members, and other financial issues. And, of course, investing. Many of these investors, working with their advisers, do use index strategies. Assets of index and exchange-traded funds have grown 2.4 times faster than those of active funds in the last decade.

But here are some more facts Swensen has overlooked: someone has to design that “well-diversified portfolio” he applauds, and that portfolio has to be flexible enough to meet different investors’ needs. Without the personalized advice that he disparages, who is going to dictate the perfect portfolio?

Investors value personal advice, and they don't want a one-size-fits-all portfolio. Nine out of 10 households with defined contribution or individual retirement accounts [reject the idea](#) that the government "should not allow individuals to make their own investment decisions." They're no more likely to turn over their non-retirement funds to a government-endorsed investment plan.

Criticizing mutual funds, brokers, and investment advisers is a well-worn path to book sales and media popularity. But even successful asset managers need to follow the facts—and not be led astray by their hubris.

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