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Growth in Bond Mutual Funds: See the Whole Picture

BY SEAN COLLINS AND SHELLY ANTONIEWICZ

In the past decade, a number of regulators and academics have discussed concerns about the growth in the assets of bond mutual funds, as well as their increasing share of the bond market, especially the corporate bond market.¹ The concern is that bond fund investors, now playing a much larger role in the bond market, might massively redeem their fund investments during a market correction, potentially amplifying market stresses. These concerns resurfaced in light of the financial market turmoil related to COVID-19 in March 2020.



A Series on the Experiences of US Bond Mutual Funds During the COVID-19 Crisis

A closer look at the data, however, reveals aspects of the growth in bond funds that should help assuage such concerns:

- » Yes, assets in bond mutual funds have grown substantially. But bond mutual funds' share of total mutual fund assets has, if anything, fallen in the past decade.
- » Yes, bond funds' share of the corporate bond market has increased. But that may simply reflect a switch by households from holding bonds directly to holding them indirectly through mutual funds—the same trend we've seen for decades in bond and stock ownership.² In fact, the overall share of corporate bonds held by households and mutual funds is actually lower now than 10 years ago.
- » Yes, the corporate bond market itself has grown substantially in the past decade. But most of that growth was absorbed by insurance companies and overseas investors.

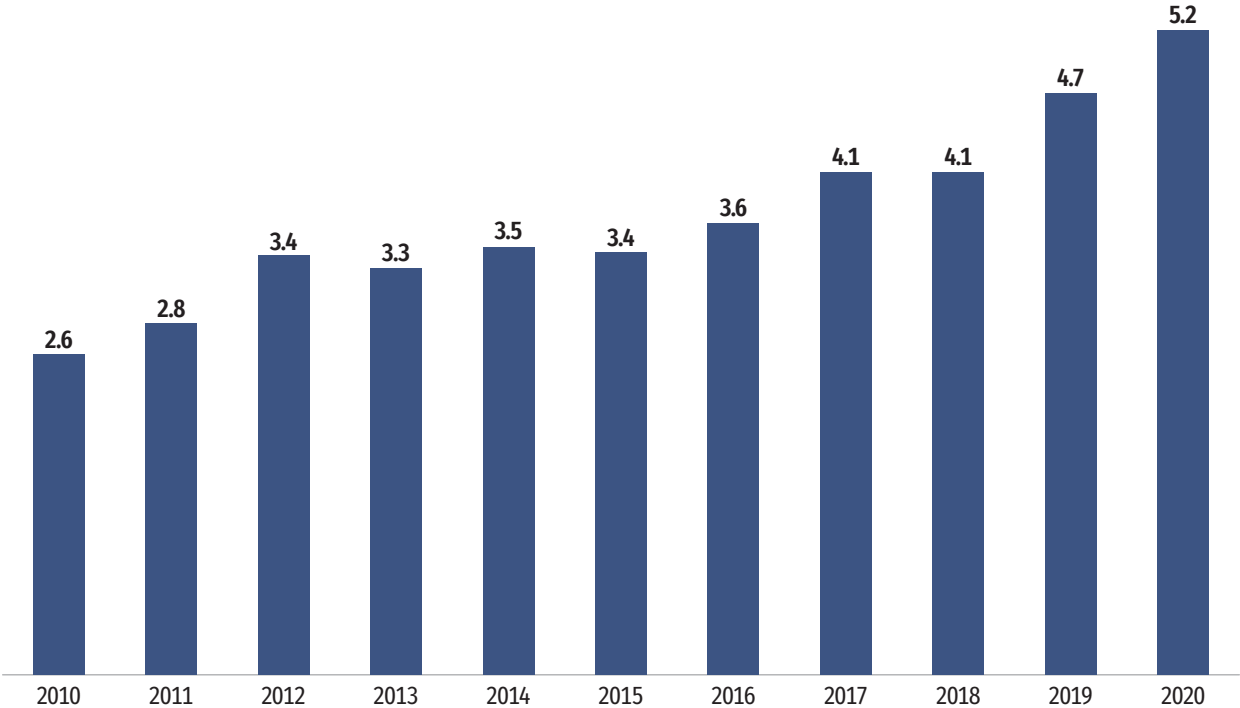
Taken together, these data send a clear message: yes, regulators need to take a holistic look at ownership of corporate bonds, not just funds' share of it.

In this ICI Viewpoints post, we will put the growth of bond mutual funds in context with other trends. In upcoming posts, we'll look at the forces powering that growth and the implications for financial stability.

Bond Mutual Funds Are Growing in Lockstep with Other Funds

Assets in bond funds have indeed grown substantially in dollar terms in the past decade. ICI data show that combined assets in all types of bond mutual funds doubled from \$2.6 trillion in 2010 to \$5.2 trillion in 2020 (Figure 1). This growth has been fueled both by net inflows from investors and by bond market returns.

FIGURE 1
Assets in Bond Mutual Funds
Trillions of dollars, year-end



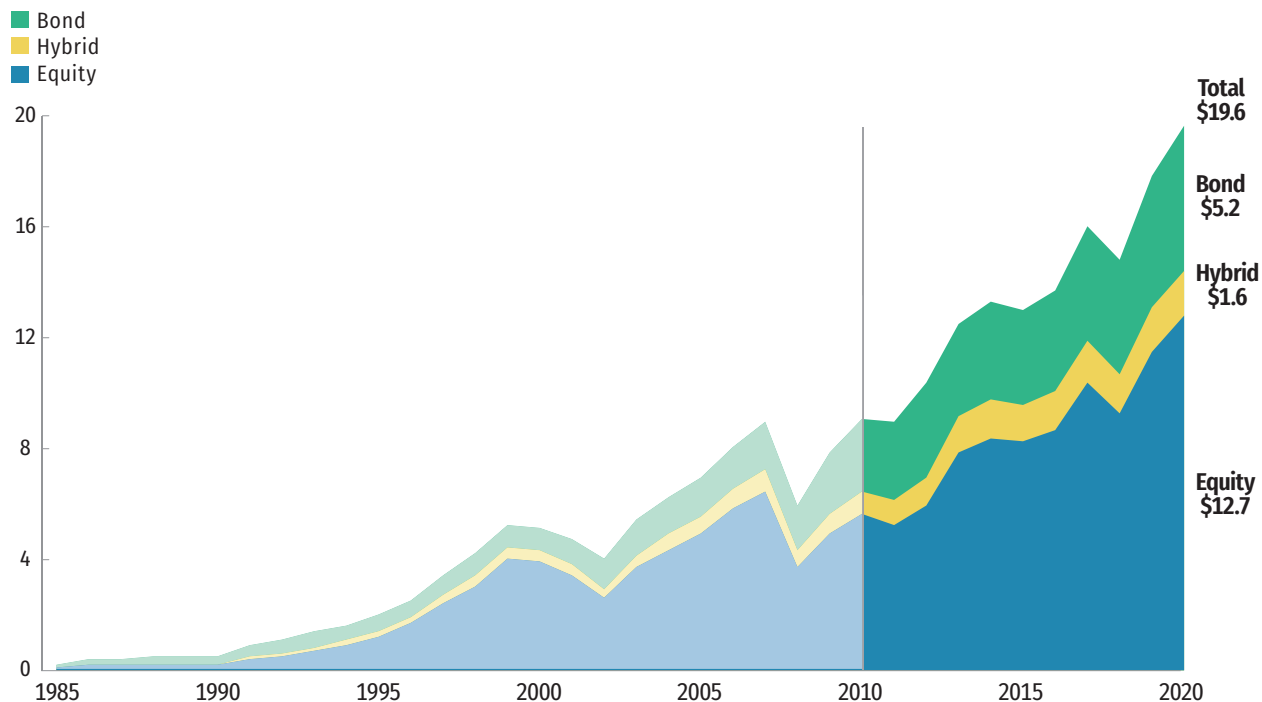
Source: Investment Company Institute and Morningstar

But this growth must be viewed in context. For example, as Figure 2 shows, over the past decade all long-term mutual fund assets have increased significantly—not just bond mutual funds, but also equity funds and hybrid funds. Despite the strong growth in the assets of bond mutual funds, their share of total mutual fund assets has been quite stable over the past decade—between 26 and 33 percent (Figure 3). Indeed, since 2013 the bond fund share has hovered at the low end of that range—26 to 28 percent.

FIGURE 2

Assets in Long-Term Mutual Funds by Broad Investment Objective

Trillions of dollars, year-end

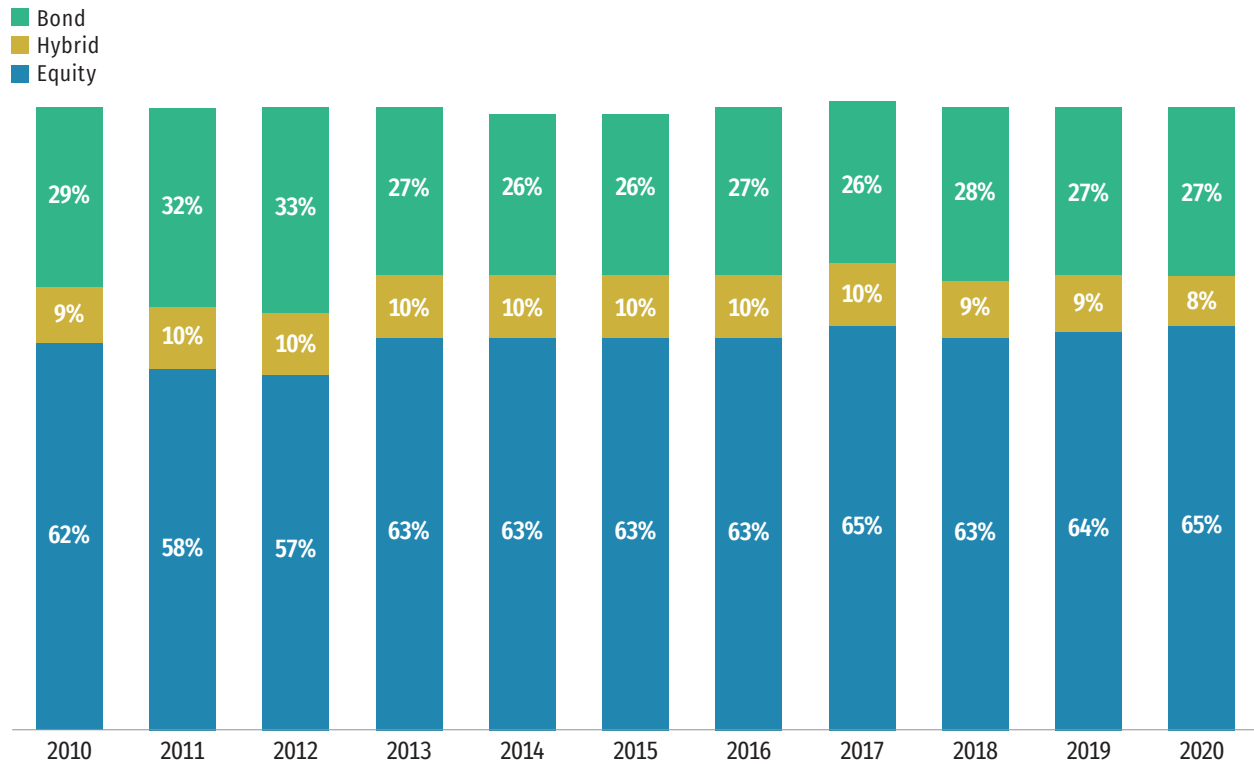


Source: Investment Company Institute

FIGURE 3

Assets in Long-Term Mutual Funds by Broad Investment Objective

Trillions of dollars, year-end



Source: Investment Company Institute

Corporate Bond Markets Are More Than Just Mutual Funds

Academics and regulators who worry about the growth of bond fund assets point to the fact that long-term mutual funds hold a rising share of the overall bond market. They're particularly concerned about "less-liquid" bonds—by which they mean corporate bonds. This growth, they argue, means that bond mutual funds could pose an increasing risk to the corporate bond market.

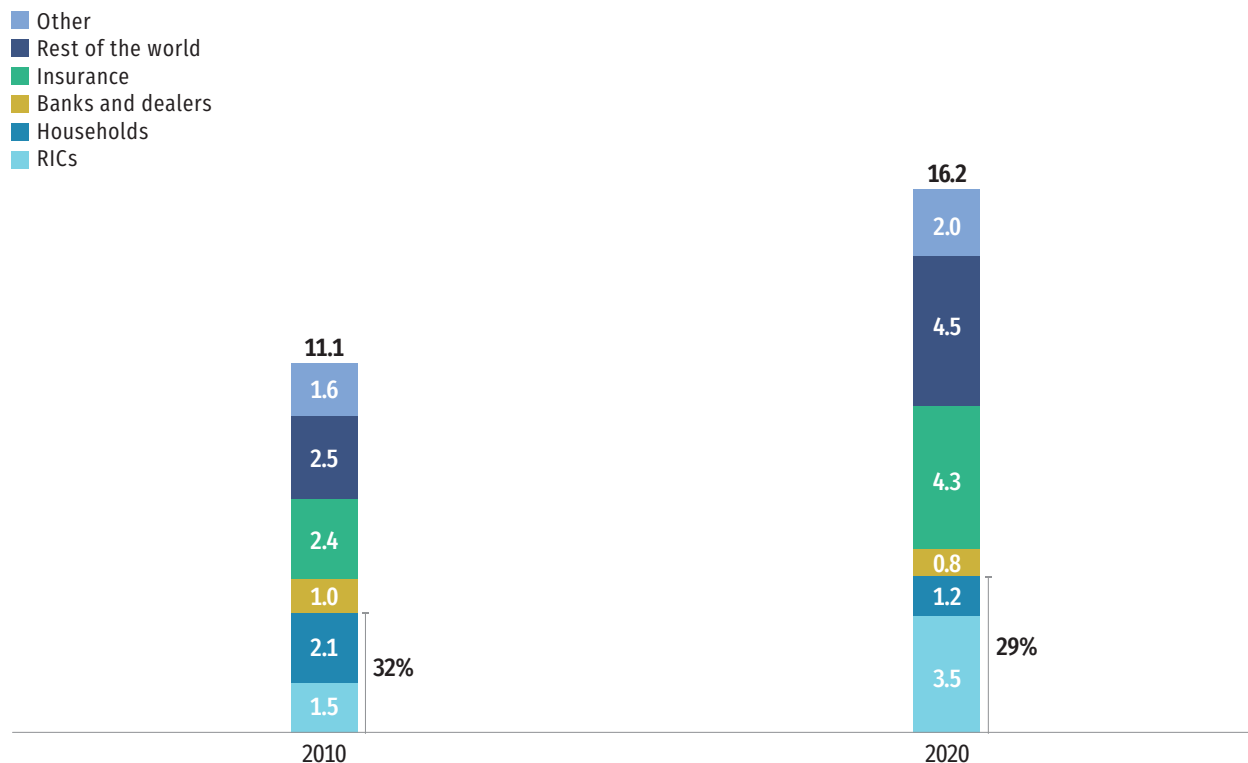
As ICI President and CEO Eric J. Pan noted in a recent speech, regulators and policymakers must "avoid looking at financial sectors in isolation from each other."³ Concerns about the rising share of corporate bonds held by funds fall prey to this: they reflect a partial analysis based only on funds' holdings. Expanding the analysis to include all other market participants changes the picture, and should help alleviate concerns about funds' holdings of corporate bonds.

It is certainly true that the share of the corporate bond market held by long-term mutual funds has increased in the past decade. As Figure 4 shows, the US corporate bond market grew from \$11.1 trillion at year-end 2010 to \$16.2 trillion at year-end 2020. Over the same period, the amount of corporate bonds held by registered investment companies (RICs)—which include long-term mutual funds, ETFs, and closed-end funds—rose from \$1.5 trillion to \$3.5 trillion. As a result, the share of the corporate bond market held by RICs rose from 14 percent in 2010 to 22 percent in 2020.

FIGURE 4

The Share of Corporate Bonds Held by RICs and Households Has Remained Stable

Value of corporate bonds outstanding, trillions of dollars, year-end



Note: Every category except rest of the world includes holdings of foreign issues by US residents; the banks and dealers category includes US-chartered depositories, foreign banking offices in the United States and banks in US-affiliated areas, and securities brokers and dealers. Components may not add to the totals because of rounding.

Source: Federal Reserve Board

But this may just reflect retail investors leaning toward indirect holdings of corporate bonds through RICs—rather than holding bonds directly—reflecting the greater cost-efficiency and better diversification that funds offer. As Figure 4 shows, the share of corporate bonds held directly by households fell over the past decade, from \$2.1 trillion in 2010 to \$1.2 trillion in 2020. As a result, the combined share of the corporate bond market held by households and RICs fell from 32 to 29 percent. Some might argue that the shift toward bond mutual funds creates the potential for a less stable demand for corporate bonds. But we know of no evidence proving that retail investors are more prone to sell when holding bonds indirectly through funds than when holding bonds directly.

Who Has Really Absorbed the Growth in Corporate Bonds: Insurance Companies and Overseas Investors

Another reason regulators can be more sanguine about growth in funds' holdings of corporate bonds is that the lion's share of the growth in the corporate bond market from 2010 to 2019 was absorbed by other investors, namely insurance companies and foreign investors.

As Figure 4 shows, the corporate bond sector grew by \$5.1 trillion from 2010 to 2019. The share held by households and RICs in combination grew \$1.1 trillion. Insurance companies and overseas investors ("rest of the world") accounted for a much larger share of the increase—\$3.9 trillion out of \$5.1 trillion. Consequently, their combined share of the corporate bond market rose from 44 percent in 2010 to 54 percent in 2020.

Regulators will need to examine whether these trends have improved or degraded the stability of the corporate bond market. For instance, it is unclear what impact the significant growth in the dollar holdings and increased market share of insurance companies and overseas investors has had on the stability of the demand for corporate bonds.

Given that retail investors' share of the corporate bond market (households plus RICs) has fallen, while insurers' and foreign investors' shares have risen, it's a bit puzzling that various commentators are so focused on bond mutual funds. When we explain why bond fund investors are increasing their holdings of corporate and other bonds—the subject of my next two ICI Viewpoints posts—that puzzlement will only grow

Other Posts in This Series

- » [Bond Mutual Fund Outflows: A Measured Investor Response to a Massive Shock](#)
- » [What's in a Name, Redux: For Bond Mutual Funds, "Corporate" Matters](#)

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NOTES

¹ See, for example, Tobias Adrian, Michael J. Fleming, Or Shachar, and Erik Vogt, "Redemption Risk of Bond Mutual Funds and Dealer Positioning," *Liberty Street Economics*, Federal Reserve Bank of New York, October 8, 2015; Financial Stability Oversight Council, "Update on Review of Asset Management Products and Activities," April 18, 2016; Itay Goldstein, Hao Jiang, and David T. Ng, "Investor Flows and Fragility in Corporate Bond Funds," *Journal of Financial Economics*, December 2017.

² See Brian K. Reid, "**The 1990s: A Decade of Expansion and Change in the U.S. Mutual Fund Industry**," *Investment Company Institute Perspective*, July 2000.

³ See Eric J. Pan, President and CEO, Investment Company Institute, "**Keynote Address**," 2021 Mutual Funds and Investment Management Conference, March 15, 2021.