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Passive versus Active Report (P.A.R.)

Key evidence about the competition between passive and active management

Abstract

This report describes the competitive landscape for passively and actively managed funds over the last ten years in Canada and the United States. In the first six months of 2016, Canadian passive funds increased their market share from 11.9% to 12.9% on the back of a positive flow of over \$7 billion. In contrast, Canadian active funds attracted only \$1 billion. Over the same period, U.S. passive funds increased their market share from 30% to 32%. This year to date (YTD), U.S. passive funds have attracted \$177 billion, versus outflows of \$107 billion for active funds. Since 2007–2008, Canadian passive funds have increased their market share from 4.1% to 12.9% and have attracted \$55 billion in net new money, compared to \$34 billion for active funds. Since 2006–2007, U.S. passive funds have increased their market share from 16% to 32% and have attracted a \$2.5 trillion net money flow, compared to \$954 billion for active funds.

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This report was written by Raymond Kerzérho, PWL Capital Inc. and Claire Churchill-Smith PWL Capital Inc. The ideas, opinions, and recommendations contained in this document are those of the authors and do not necessarily represent the views of PWL Capital Inc.

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Introduction

This report describes the competitive landscape for passively and actively managed funds over the last ten years in Canada and the United States. We document the assets under management, market shares and flow of funds for mutual funds and ETFs in aggregate.

1. Methodology

All the data in this report is provided by Morningstar Direct, and accounts for **all mutual funds and exchange-traded funds combined**, in Canada (dating back to 2007) and the United States (dating back to 2006). The data excludes all money-market funds because they are not at the core of the competition between active and passive funds. Funds of funds are also excluded to avoid the double-counting of assets. In order to mitigate the survivorship bias of our study, the data includes funds that disappeared during the period being considered.

Our study focuses on funds categorized by Morningstar as “passively managed, long-term.” This definition of a “passive” fund includes index funds but excludes sector, leveraged and inverse ETFs, which are considered closer in characterization to active funds due to their investment approach. Consequently, we include the latter three sub-categories among active funds.

In contrast, Morningstar categorizes funds from Dimensional Fund Advisors as “passively managed, long-term.” These funds are more similar to the passive philosophy of investment, despite not being index funds. Therefore, this fund sub-group was included in the passive category. Lastly, the Canadian mutual fund data excludes segregated funds sold by life insurance companies.

2. Canadian Market 2007–2016

2.1 Market Share

TABLE 1: ASSETS UNDER MANAGEMENT IN CANADA (CAD BILLIONS)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016 YTD	2007–2016 GROWTH RATE
ACTIVE	440	316	388	427	457	497	509	570	633	639	45%
PASSIVE	19	17	30	37	42	54	64	75	86	95	403%

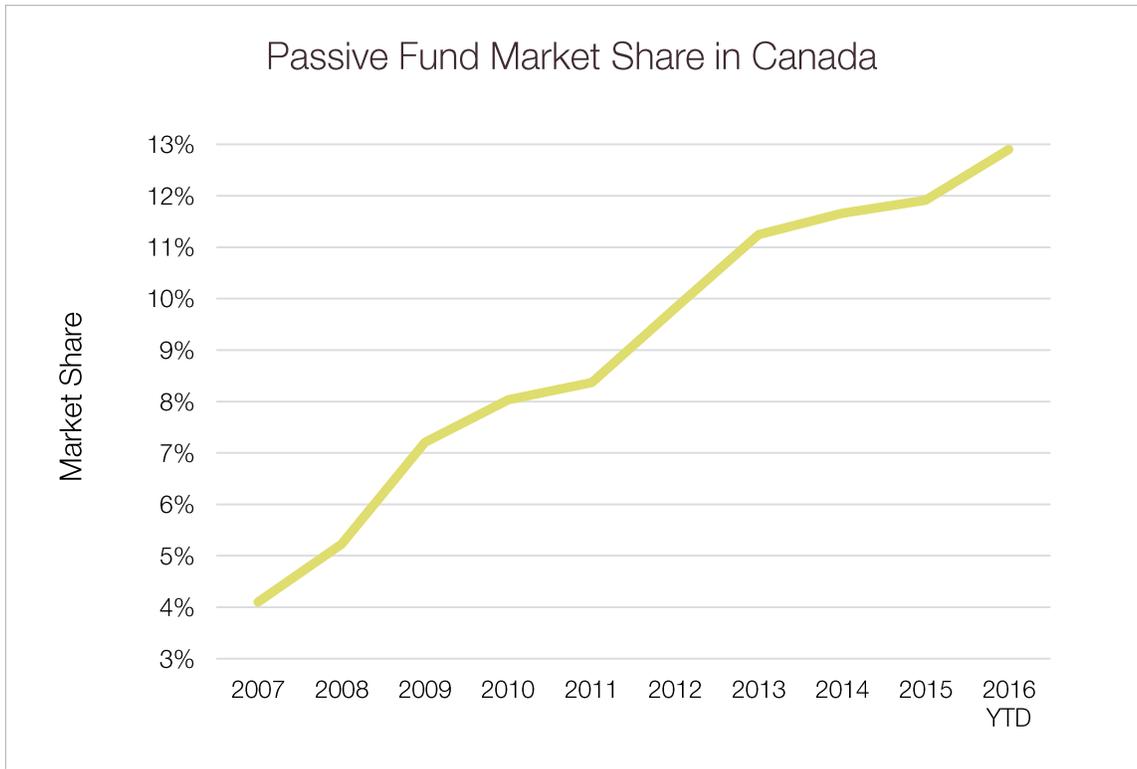
Source: Morningstar Direct

TABLE 2: MARKET SHARE—CANADA

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016 YTD
ACTIVE	95.9%	94.8%	92.8%	92.0%	91.6%	90.2%	88.8%	88.3%	88.1%	87.1%
PASSIVE	4.1%	5.2%	7.2%	8.0%	8.4%	9.8%	11.2%	11.7%	11.9%	12.9%

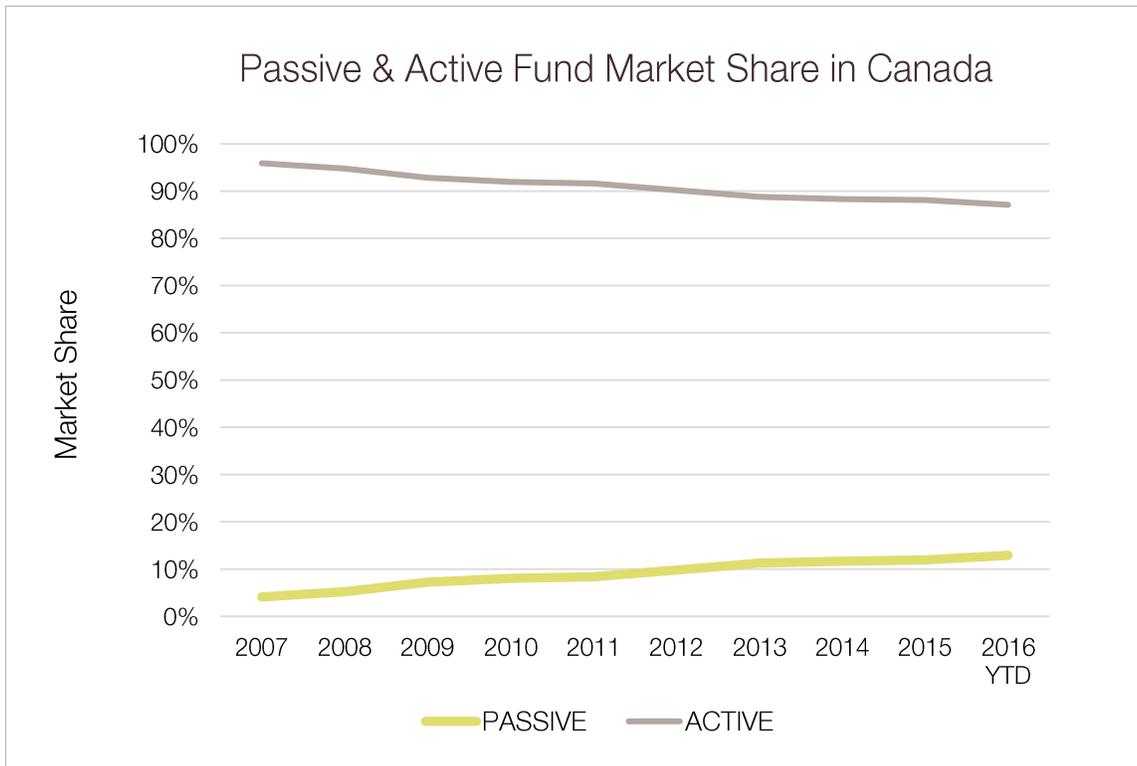
Source: Morningstar Direct

CHART 1



Source: Morningstar Direct

CHART 2



Source: Morningstar Direct

In the first six months of 2016, the market share of passive funds increased by a full percentage point, from 11.9% to 12.9%. The market share data for Canada displays a positive trend in terms of passively managed funds taking an increasing percentage of the market, from a meager 4.1% in 2007 to 12.9% in 2016 YTD. Consequently, the market share of actively managed funds has fallen from 95.9% of the market in 2007 to 87.1% as of 2016 YTD.

The Canadian data shows not only a clear upward trend in passive fund market share, but also a strong growth rate of funds between the years of 2007 and 2016 YTD. Passive funds experienced an impressive 403% growth rate during this period, compared to 45% for active funds. In other words, passive funds grew nine times faster than active funds during the 2007–2016 period. However, in dollar terms, actively managed funds grew by \$199 billion, compared to a gain of \$76 billion for passively managed funds. These impressive gains in active assets under management are mostly due to having the market gains on a larger asset base, as passive funds attracted more new money in the last 9½ years than did active funds (details in Section 2.2).

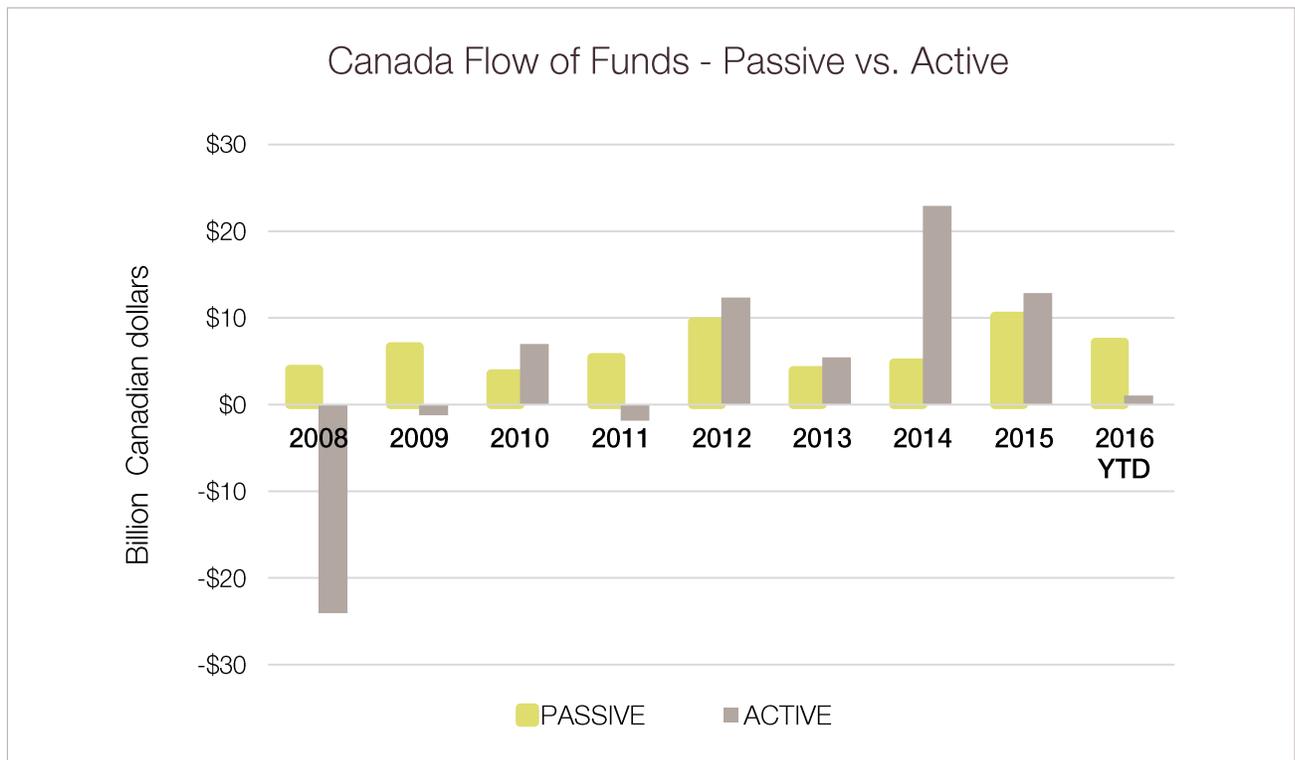
2.2 Flow of Funds

TABLE 3: CANADIAN FLOW OF FUNDS INTO ACTIVE AND PASSIVE FUNDS (CAD BILLIONS)

	2008	2009	2010	2011	2012	2013	2014	2015	2016 YTD
ACTIVE	-24.1	-1.2	7.0	-1.9	12.3	5.5	22.9	12.9	1.0
PASSIVE	4.0	6.6	3.5	5.4	9.5	3.9	4.8	10.2	7.2

Source: Morningstar Direct

CHART 3



Source: Morningstar Direct

Chart 3 shows the flow of money into active and passive Canadian funds between the years 2008 and 2016. Although the amount flowing into passive is less than the amount going into active in the years 2010, 2012, 2014 and 2015, the flow into passive funds is positive every year. For 2008 to 2016 YTD, the flow of funds into active funds is highly volatile, and within this time period, the total amount invested falls short of the investment into passive funds: \$34.4 billion compared to \$55.2 billion. Currently, in 2016, passive funds have collected \$7.3 billion, compared to only \$1 billion for active funds.

3. U.S. Market 2006–2016

3.1 Market Share

TABLE 4: ASSETS UNDER MANAGEMENT IN THE U.S. (USD TRILLIONS)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016 YTD	2006-2016 GROWTH RATE
ACTIVE	6.5	7.2	4.6	6.2	7.2	7.1	8.1	9.6	10.1	9.7	9.8	51%
PASSIVE	1.2	1.5	1.1	1.6	2.0	2.1	2.6	3.4	4.0	4.3	4.6	280%

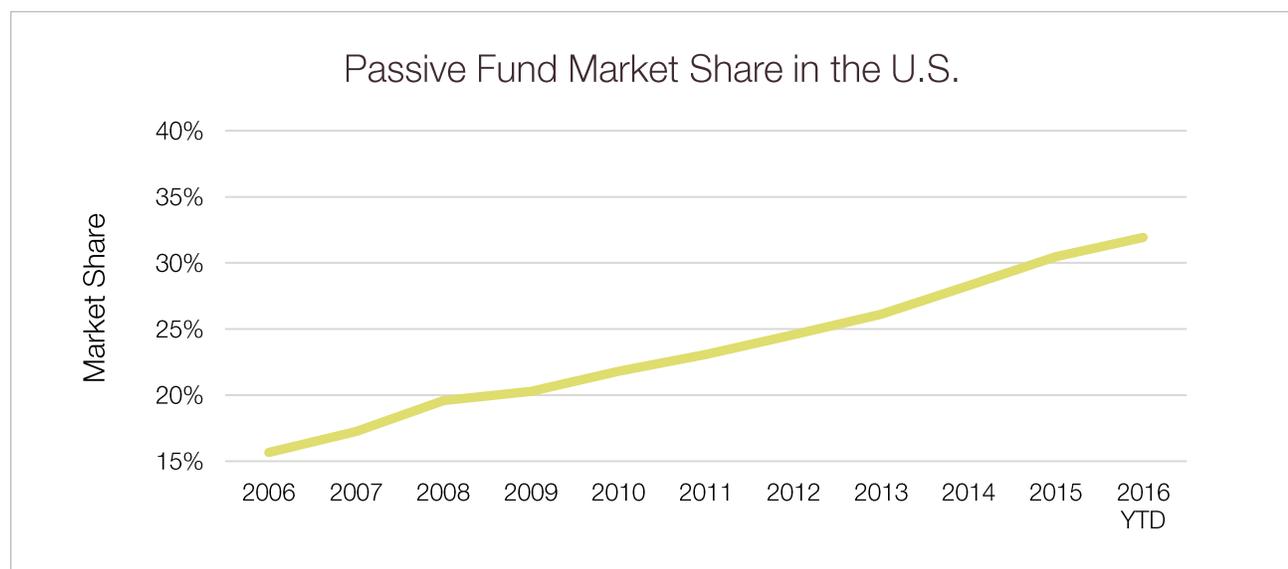
Source: Morningstar Direct

TABLE 5: MARKET SHARE—U.S.

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016 YTD
ACTIVE	84%	83%	80%	80%	78%	77%	75%	74%	72%	70%	68%
PASSIVE	16%	17%	20%	20%	22%	23%	25%	26%	28%	30%	32%

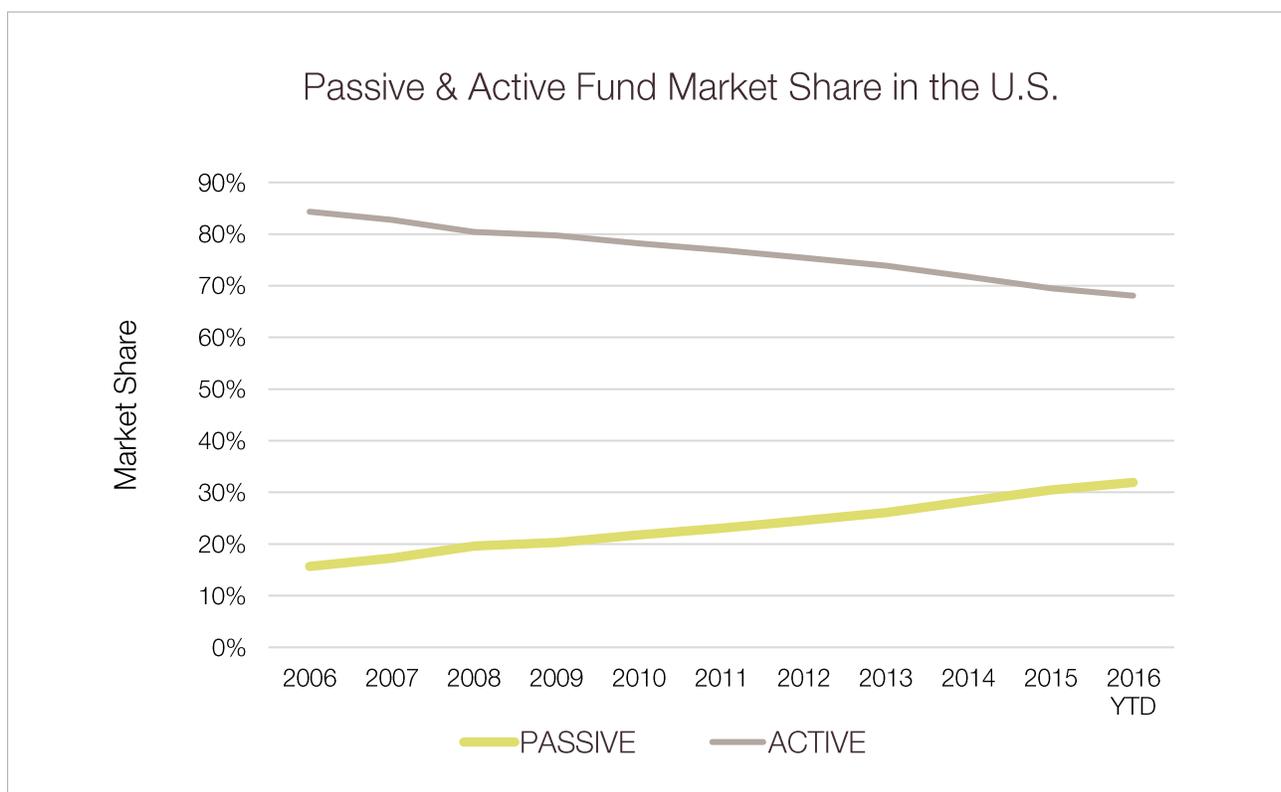
Source: Morningstar Direct

CHART 4



Source: Morningstar Direct

CHART 5



Source: Morningstar Direct

In the first six months of 2016, the market share of passive funds increased two percentage points, from 30% to 32%. Data shows a significant increase in market share for passively invested funds, from 16% to 32% of the market between 2006 and 2016 YTD. The share of the market of active funds, on the other hand, fell from 84% to 68% in the same time period. Passive funds also experienced an astonishing growth rate of approximately 280% in 2006–2016, compared to 51% for active funds. The growth rate of passively managed funds outpaced that of their active counterpart by a ratio of 5.5:1. However, in dollar terms, both passive and active funds increased their assets under management (AUM) by the same amount, namely, \$3.4 and \$3.3 trillion respectively. Similarly to the Canadian market, active funds increased their AUM mostly on the back of having the market gains on a larger asset base, as passive funds attracted more new money in the last 10½ years than did active funds (details in Section 3.2).

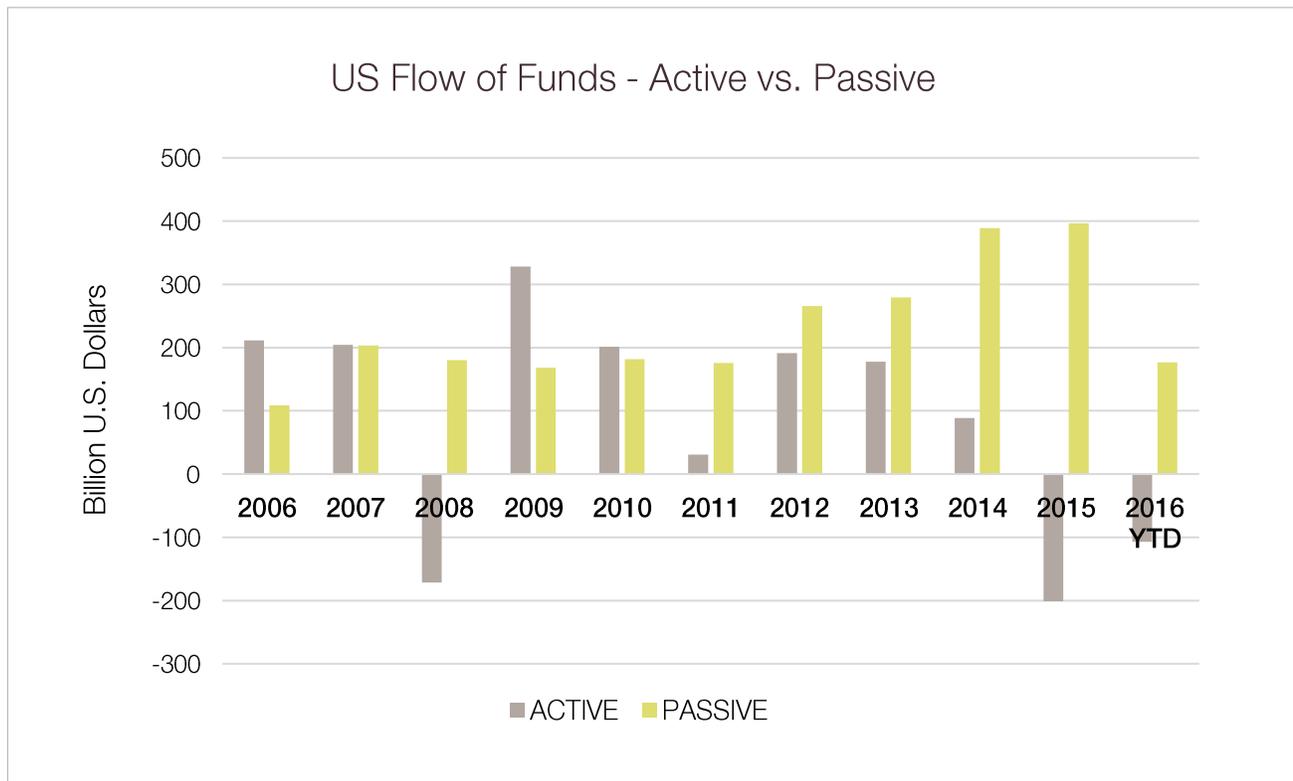
3.2 Flow of funds

TABLE 6: U.S. FLOW OF FUNDS INTO ACTIVE AND PASSIVE FUNDS (USD BILLIONS)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016 YTD
ACTIVE	212	205	-172	328	201	31	191	178	89	-201	-107
PASSIVE	109	203	180	168	182	175	266	280	389	397	177

Source: Morningstar Direct

CHART 6



Source: Morningstar Direct

Chart 6 illustrates the flow of U.S. money into active and passive funds between 2006 and 2016. Year to date, passive funds have attracted \$177 billion in new money, whereas active funds have experienced \$107 billion in outflows. The data shows that, unlike the volatility of active fund input, passive fund additions have been consistently positive since 2006. Active funds show negative cash flows in 3 different years: 2008, 2015 and the current year as of June. The decreasing flow of funds into active funds stands in stark contrast to the growing figures for passive fund investments, which have increased significantly since 2014 and seem poised to retain this high growth into 2016. In each of the last 5 years, as well as in the last 6 months, passive funds attracted more investment than did active funds. From 2006 to 2016 YTD, passive funds have attracted \$2.5 trillion in net new money, compared to only \$954 billion for active funds.

Appendix A: Canadian ETF Data

(Source: Morningstar Direct)

TABLE 7: ASSETS UNDER MANAGEMENT (CAD BILLIONS)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016 YTD	2007-2016 GROWTH RATE
ACTIVE	3.8	5.0	7.2	8.2	9.5	11.1	11.3	15.4	18.1	22.7	501%
PASSIVE	14.2	14.1	23.7	29.4	32.8	43.8	50.0	59.4	68.8	77.6	448%

TABLE 8: MARKET SHARES

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016 YTD
ACTIVE	21.0%	26.2%	23.2%	21.9%	22.4%	20.3%	18.4%	20.6%	20.8%	22.6%
PASSIVE	79.0%	73.8%	76.8%	78.1%	77.6%	79.7%	81.6%	79.4%	79.2%	77.4%

TABLE 9: FLOW OF FUNDS (CAD BILLIONS)

	2008	2009	2010	2011	2012	2013	2014	2015	2016 YTD
ACTIVE	2.1	1.4	0.8	1.6	1.7	0.8	2.4	1.5	2.5
PASSIVE	3.7	6.1	2.8	4.7	9.0	3.7	4.6	9.6	7.2

Appendix B: Canadian Mutual Fund Data

(Source: Morningstar Direct)

TABLE 10: ASSETS UNDER MANAGEMENT (CAD BILLIONS)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016 YTD	2007-2016 GROWTH RATE
ACTIVE	436.0	311.0	381.0	418.3	447.9	485.9	497.7	554.7	614.9	615.9	41%
PASSIVE	4.6	3.3	6.5	7.9	8.9	10.2	14.5	15.9	16.8	17.0	266%

TABLE 11: MARKET SHARES

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016 YTD
ACTIVE	1.1%	1.1%	1.7%	1.9%	2.0%	2.1%	2.8%	2.8%	2.7%	2.7%
PASSIVE	98.9%	98.9%	98.3%	98.1%	98.0%	97.9%	97.2%	97.2%	97.3%	97.3%

TABLE 12: FLOW OF FUNDS (CAD BILLIONS)

	2008	2009	2010	2011	2012	2013	2014	2015	2016 YTD
ACTIVE	-26.2	-2.7	6.1	-3.5	10.6	4.7	20.5	11.4	-1.5
PASSIVE	0.3	0.6	0.7	0.7	0.6	0.2	0.2	0.6	0.0

Appendix C: U.S. ETF Data

(Source: Morningstar Direct)

TABLE 13: ASSETS UNDER MANAGEMENT (USD BILLIONS)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016 YTD	2006-2016 GROWTH RATE
ACTIVE	49	75	76	106	127	126	145	225	269	277	273	459%
PASSIVE	383	548	466	687	887	936	1,203	1,476	1,736	1,858	1,986	418%

TABLE 14: MARKET SHARES

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016 YTD
ACTIVE	11%	12%	14%	13%	12%	12%	11%	13%	13%	13%	12%
PASSIVE	89%	88%	86%	87%	88%	88%	89%	87%	87%	87%	88%

TABLE 15: FLOW OF FUNDS (USD BILLIONS)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016 YTD
ACTIVE	8	22	39	22	13	17	11	44	32	26	-5
PASSIVE	57	123	125	97	107	100	179	142	210	219	72

Appendix D: U.S. Mutual Fund Data

(Source: Morningstar Direct)

TABLE 16: ASSETS UNDER MANAGEMENT (USD TRILLIONS)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016 YTD	2006-2016 GROWTH RATE
ACTIVE	6.4	7.1	4.6	6.1	7.1	6.9	8.0	9.4	9.8	9.4	9.5	48%
PASSIVE	0.8	1.0	0.7	0.9	1.1	1.2	1.4	1.9	2.3	2.4	2.6	218%

TABLE 17: MARKET SHARES

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016 YTD
ACTIVE	89%	88%	87%	87%	86%	85%	85%	83%	81%	80%	78%
PASSIVE	11%	12%	13%	13%	14%	15%	15%	17%	19%	20%	22%

TABLE 18: FLOW OF FUNDS (USD BILLIONS)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016 YTD
ACTIVE	204	183	-209	306	188	14	180	133	57	-228	-104
PASSIVE	53	80	56	71	75	77	88	141	184	192	103



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