

# MUTUAL ADMIRATION

## ADVISORS HAVE LEARNED TO ADAPT TO CHANGES IN FUND OFFERINGS AND FEATURES.

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**I**n 1998, selling mutual funds was where it was at. The industry was coming off the greatest sales year in its history, with flowing trailers and growing assets. Strong markets could only go up—at least for two more years. Since the stock market collapse of the early millennium, mutual fund sales have slipped, and while less focused on selling, the industry is now more concerned with trying to shrink the fund manager playing field.

According to sales data from the Investment Funds Institute of Canada (IFIC), 1997 saw net mutual fund sales of \$51.7 billion. By 2007, sales had dropped to \$34.9 billion—no paltry figure though they still came in second for highest ever annual sales.

Enduring two massive bull runs and a bear in between, the amount of money in mutual funds has more than doubled—from \$289 billion in January 1998 to \$671

billion a decade later. Therefore, the margins for fund companies, which make their money on a management fee, have remained strong, if not phenomenal.

Managing wealth has become a core business for many non-traditional fund providers, such as banks and insurance companies. To be sure, consolidation of the industry has been so widespread that instead of a large number of medium-sized players controlling the helm, as was the case in 1998, the majority of the industry's assets now belong to a smaller group of fund giants—probably only a handful—compared with a dozen traded mutual fund complexes, notes Peter Loach, vice-president and managing director of investment fund research at BMO Nesbitt Burns.

Fewer players, however, did not result in fewer funds. In fact, Loach says the number of funds available in Canada when he start-

ed—2,000—has swollen to more than 6,000.

Joanne De Laurentiis, president and CEO of IFIC, says greater participation by Canadians in the mutual fund market can particularly be attributed to investors with more moderate incomes. “You can open up [a mutual fund] account through an advisor and if you want to contribute \$25 a month, you can do that now,” De Laurentiis says.

Historically, selling funds to the average Canadian is a low-margin business, unless you have a large economy of scale. The bank-owned fund companies, for example, have been able to realize huge profits by selling less to more clients through a solid distribution network of advisors.

This distribution model, along with an increasingly strong product lineup, is widely credited as the reason the fund arm of RBC Finan- **continued on page 17**

continued from page 15 cial, RBC Asset Management, is now the country's largest retail mutual fund company.

"Our statistics show three in five Canadians now own mutual funds," says De Laurentiis. She says this model has further created a comfort factor among Canadians who've turned to mutual funds as their risk tolerances have increased. The risk profile of a Canadian household balance sheet (compiled by Investor Economics), shows household wealth in market-sensitive assets now stands at more than 60%.

But, notes Rudy Luukko, this doesn't mean Canadians have become more risk-tolerant than their U.S. counterparts—it's more like fund offerings are becoming more risk-averse. The investment funds editor for Morningstar Canada says the late 1990s were the peak of the growth-stock boom in the U.S. In Canadian dollars, the Nasdaq 100 grew by 95.6%, the S&P 500 rose 37.7%, while the TSX Composite Index declined.

"Investors turned to the riskier funds ... which just kept going up," Luukko explains. "It is a lot easier to invest in riskier funds when you're winning ... When the whole growth stock boom went bust starting in 2000, that really prompted a change in the collective mindset of investors."

Indeed, a good percentage of the growth in sales of mutual funds can be attributed to placements in balanced funds and wrap products that market themselves on simplicity and diversification to offset risk.

According to IFIC, fund-of-funds products had 16.2 billion in net new sales in 2007. "These one-ticket solutions have certainly been one of the big changes of the last decade," says Loach. "They have chipped away at the mutual-fund flows to a degree, but that hasn't

stopped the fact that mutual funds will remain the main vehicle for retail investors who save for retirement."

### Funds Evolve, Advisors Adapt

In a changing marketplace, advisors who see the mutual fund as the main retirement-savings vehicle for their clients have had to alter their business models—either by turning to selling a wider array of products, or by completely changing their compensation models to offset dwindling new sales.

The most profound movement has been the shift from selling mutual funds on deferred sales charge. According to Investor Economics, in December 2000 DSC represented 75.1% of total load funds in Canada. At the end of 2007, this number had dropped to 55%. Advisors are now opting for no-load funds that pay a trailing commission to fund their businesses, or the concept of a fee-based model, charging for advice.

John De Goey, a CFP and senior advisor with Burgeonvest Securities in Toronto, transitioned to the fee-only model in 1999 so he doesn't receive any embedded compensation from fund companies. He believes the main elements of financial advice are largely unchanged but the development of alternatives to mutual funds, such as exchange-traded funds (ETFs), means advisors need to become more adept at product allocation.

ETFs, popular in the U.S., pose a unique challenge for the mutual fund industry. They let a client invest in a stock market index for a fraction of the cost, while being marketed on the assumption that the majority of mutual funds do not beat their benchmarks.

De Goey is a big fan of ETFs but he says many advisors ignore using them because they don't offer the same compensation as traditional mutual funds.

He believes if consumers become more cost-conscious, ETFs will become a staple of Canadian portfolios. De Goey acknowledges that one in seven mutual funds beats its index benchmark, which means about 85% don't.

"On a balance of probabilities, if you have seven mutual funds, one will beat the benchmark and six will lag. Is it worth paying the additional 1% of your assets or more for the cost of active management?"

On the flip side, the mutual fund industry, in partnership with the insurance industry, is seeing huge growth with higher-fee segregated funds that offer principal protection and guaranteed income for retiring boomers. Investors, with the help of advisors, are willing to pay a premium if it offers peace of mind, as demonstrated by Manulife Financial's guaranteed minimum withdrawal product, IncomePlus, which generated more than \$3 billion in sales in its first 18 months.

De Laurentiis says IFIC believes the new wave of boomer-oriented funds will help the mutual fund industry realize annualized returns of 9% growth over the next decade. "We all know the demographic story ... the one about the baby boomers," she notes. "That's the big bulge going through—a lot of financial products have tended to track that group. [Boomers] are certainly looking at developing more products that provide investors with an income stream." <sup>AE</sup> **NOBLE**

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