ETFs to Replace Half of Funds by 2015

By Howard J. Stock
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The mutual fund industry will be a shadow of its former self in just five years time, if the findings of a new study by Novarica pan out.

The *2009 Wealth Management Overview: Top Trends in Client Segmentation, Products, and Delivery Channels* report predicts that exchange-traded funds (ETFs) will replace as much as half of all mutual funds by 2015, dropping from 8,022 at the end of 2008 to 4,237 in only five years. Mutual fund assets will drop correspondingly from $9 trillion to $6.75 trillion over the same period.

“We’re projecting that mutual fund assets will return to their 2002 level and that the number of funds will be back to 1993 levels,” says Bob Ellis, principal at the New York City research firm. “They’re not dying out; they still have a role to play.”

But that role will be undermined by ETFs’ growth, Ellis reckons the number of ETFs will rocket to 2,618 in 2015, up from 708 at the end of last year, and will more than double their collective assets from $500 billion to $1.2 trillion.

Ellis’s projection is based on historical growth rates between 1994 and 2007. He expects passive ETFs to grow at 15% per year, and active ETFs to blossom from around 30 now to 325 by 2015. With all this expansion will come a decline in ETFs’ average size, from $967 million now to $433 million in 2015.

ETFs are starting to find their way into 401(k)s, as are variable annuities, which is contributing to their growth. But the primary reason mutual funds are losing ground is their cost to the investor, Ellis says. Passive ETFs, which charge as little as seven basis points, undercut actively managed mutual funds by 1% or more at a time when dire market conditions mean expense ratios are making mutual funds’ already dismal performance look even worse. Add to that ETFs’ convenience and their tax efficiency relative to mutual funds, and, “ETFs are always the most desirable option,” Ellis says.