

Issues Facing the U.S. Money Management Industry

Presentation to the
SEC Asset Management Advisory Committee

Michael L. Goldstein

FMMI Inc.

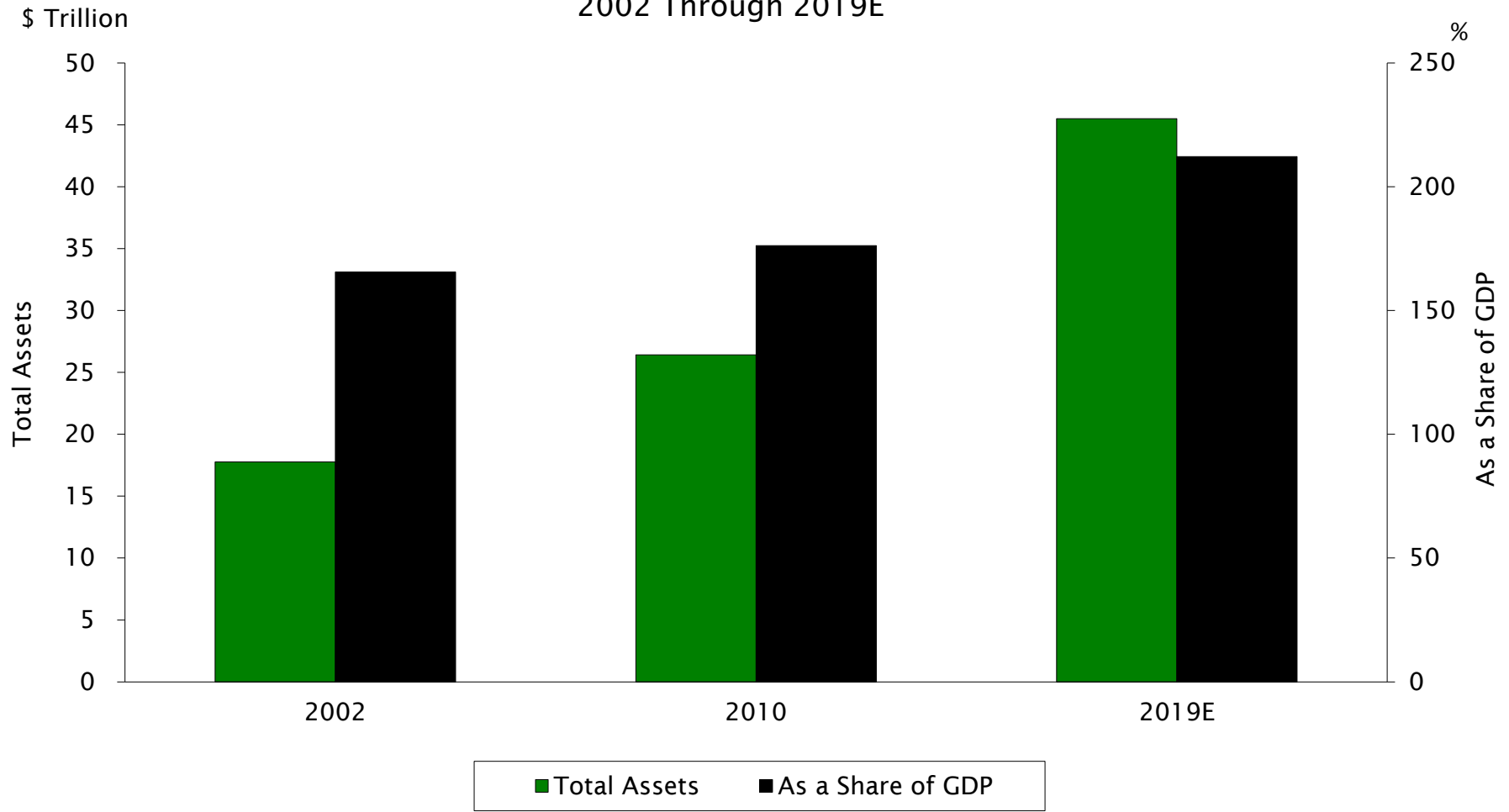
Issues Facing the U.S. Money Management Industry

Topics

- The Really Big Picture
- The Rise of Indexing and Investor Price Sensitivity
- What is Advice?
- Conclusions

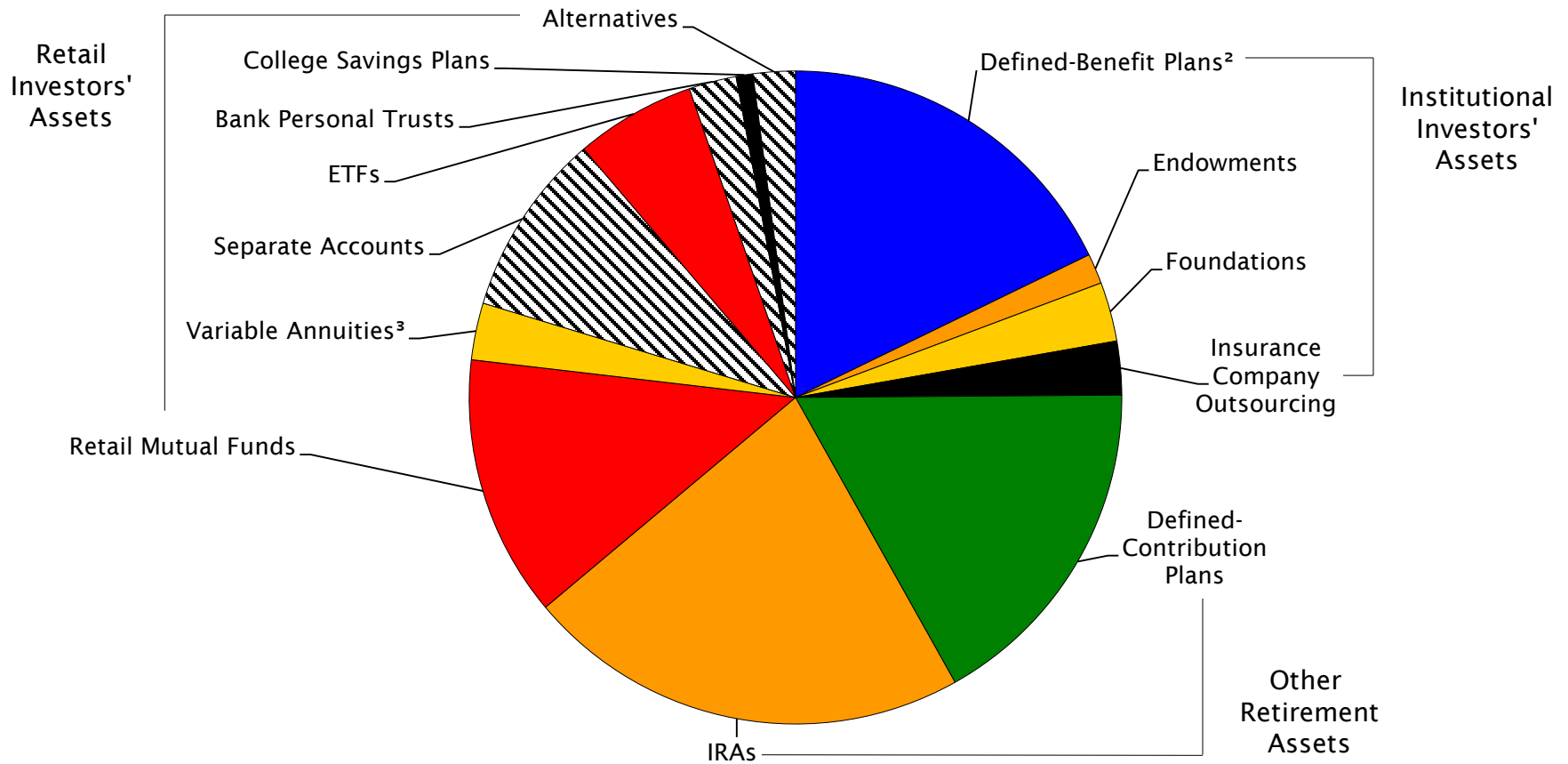
The U.S. Industry is Around \$45 Trillion in Size...

U.S. Money Management Industry Assets
Total and as a Share of GDP
2002 Through 2019E



...And It Has a Retail Character...

The U.S. Money Management Industry
Sources of Assets Under Management¹
2018



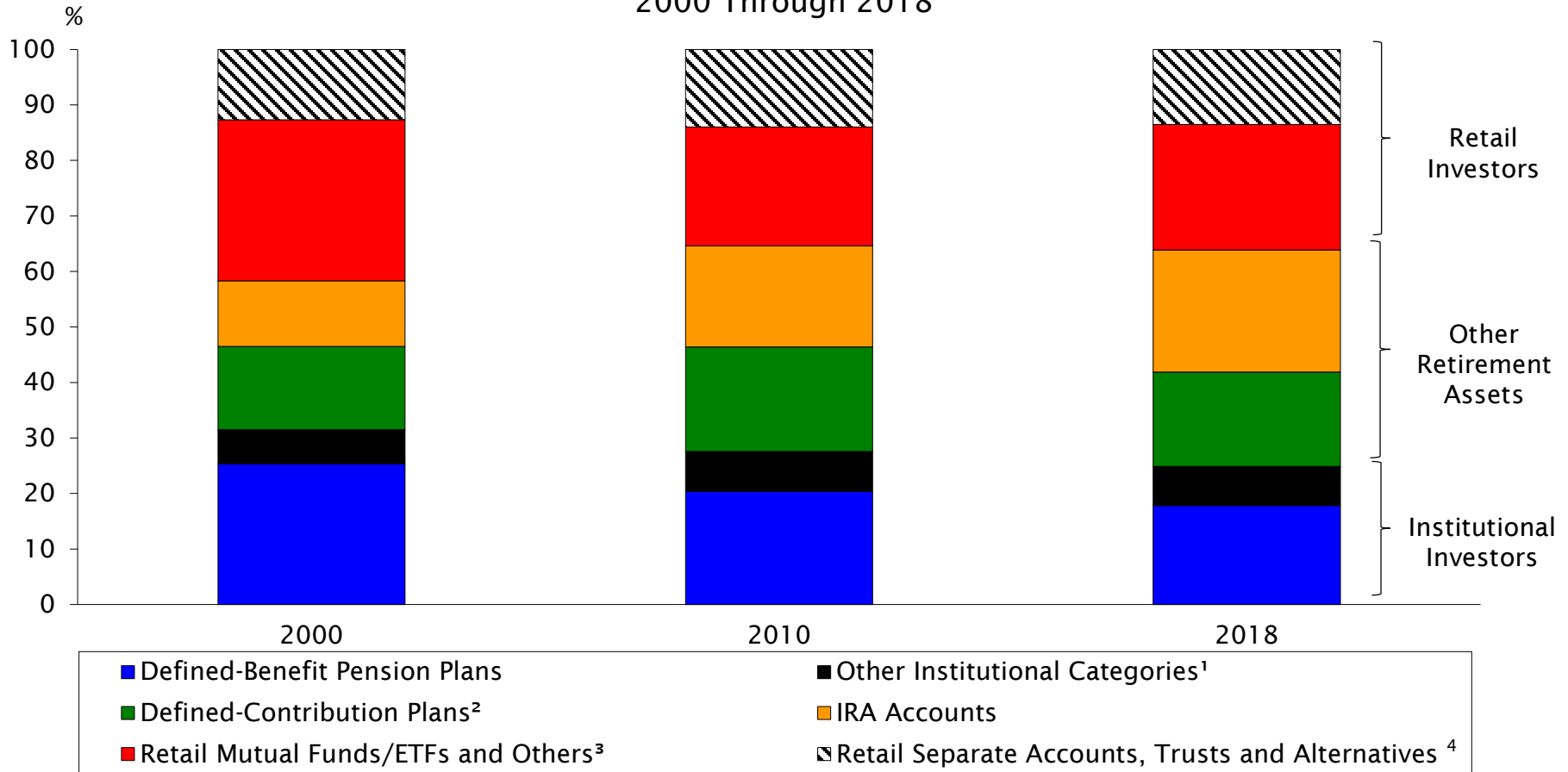
¹ Not including federal government pension plans.

² Excludes unfunded portion.

³ Excludes variable annuities held in defined-contribution and IRA retirement plans.

...That's Increased Over Time...

The U.S. Money Management Industry
Composition of Assets Under Management
2000 Through 2018



¹ Endowments, foundations and outsourced insurance assets.

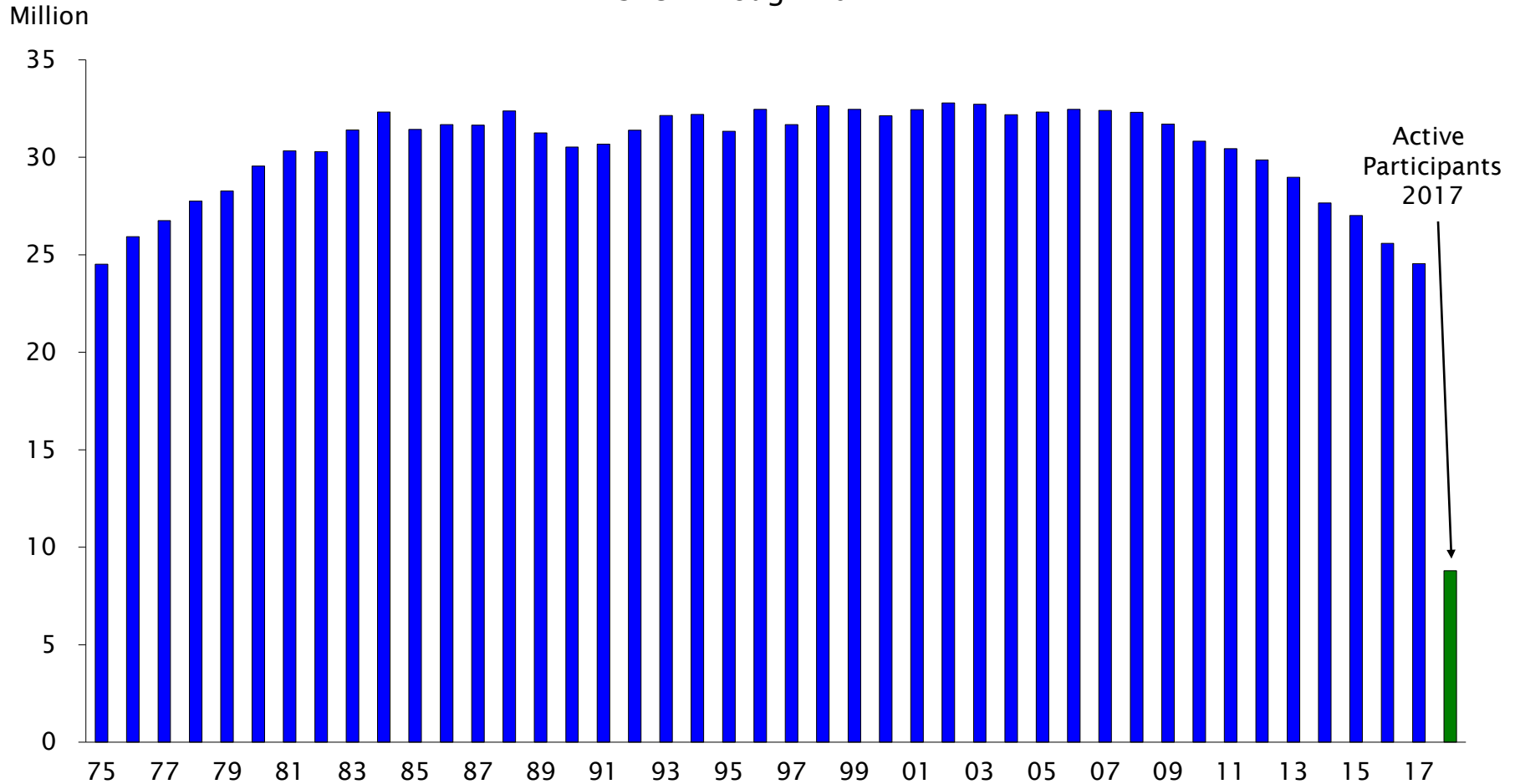
² Includes 401(k), 403(B), 457 and union defined-contribution plans.

³ Includes variable annuities and college savings plans.

⁴ Includes hedge funds and private equity funds.

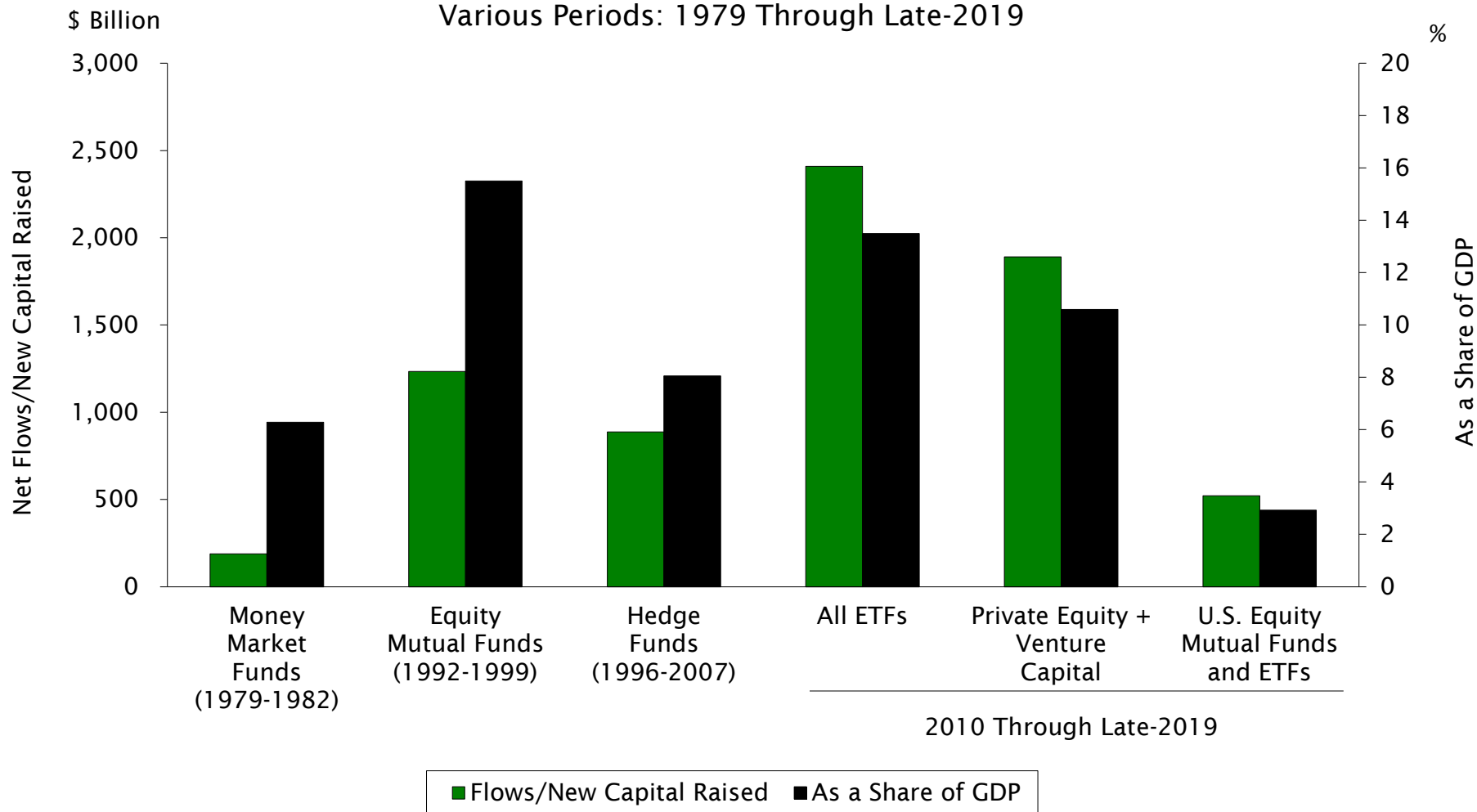
...As the ERISA Era Has Come Full Circle

Corporate Defined-Benefit Plans
Number of Participants
1975 Through 2017



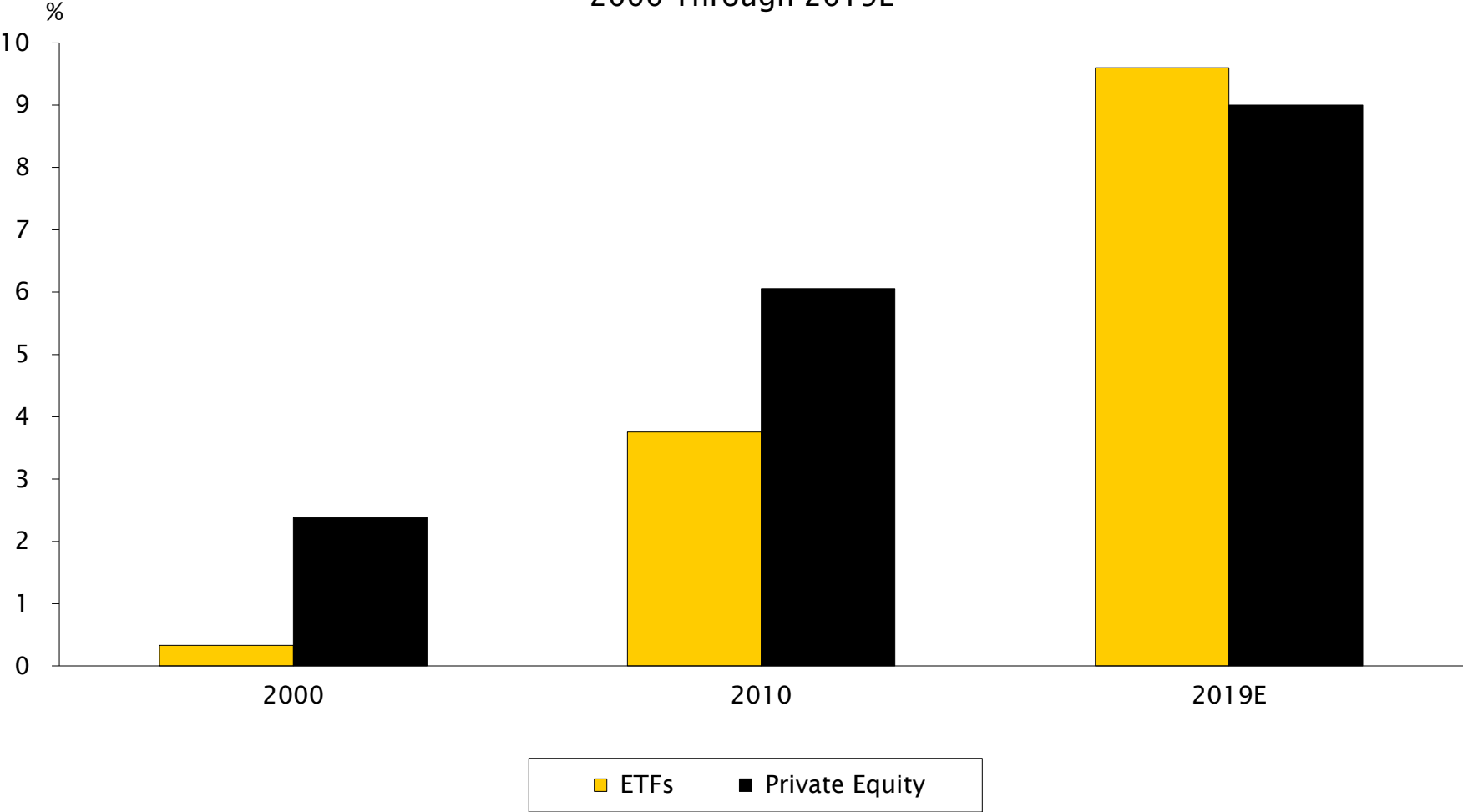
The Stars Aligned to Produce a Series of Fund-Raising Booms...

Net Flows Into Mutual and Hedge Funds and ETFs
and New Capital Raised by Private Equity and Venture Capital Firms
Totals and as a Share of GDP
Various Periods: 1979 Through Late-2019



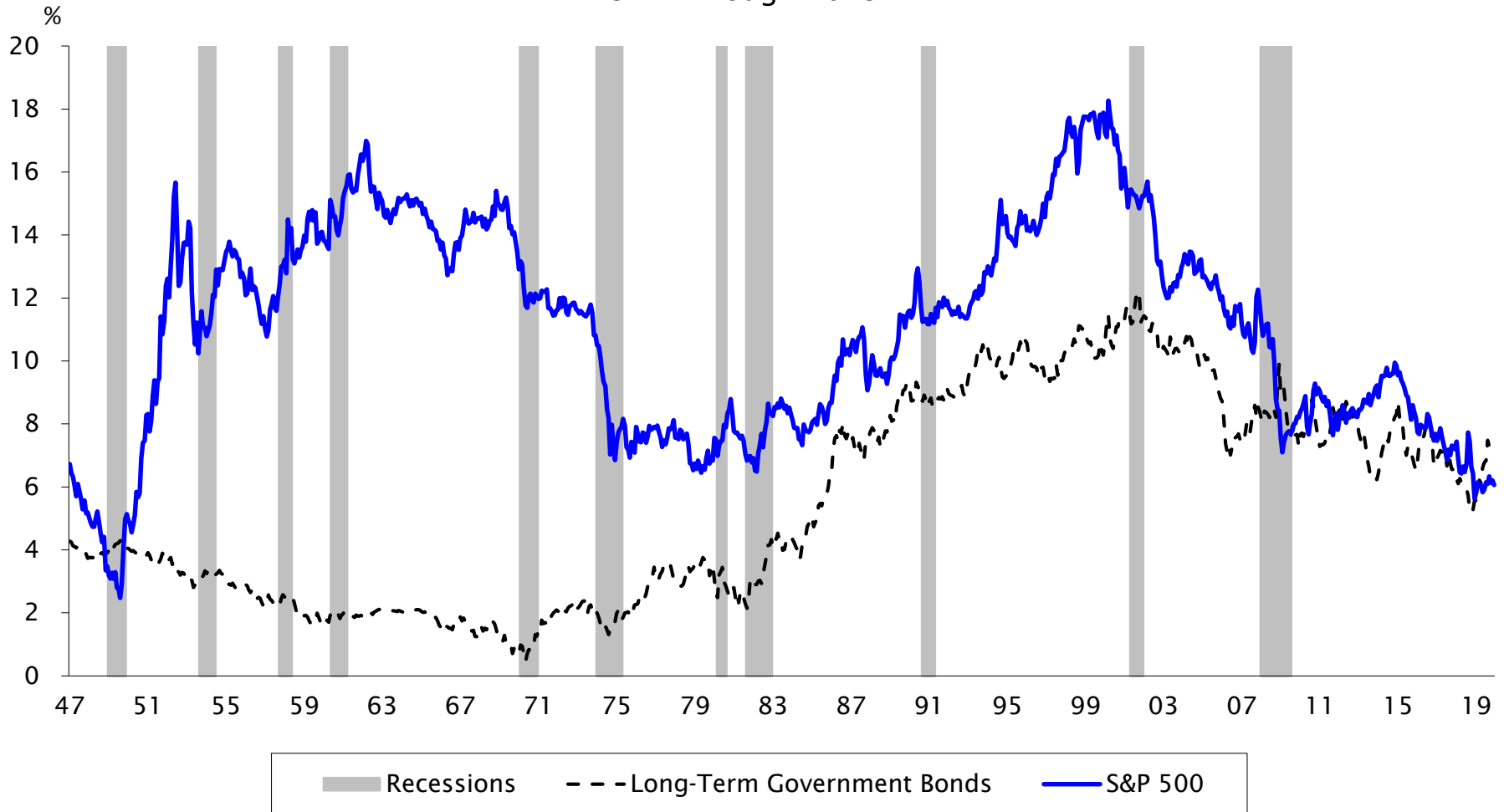
...That Have Once Again Transformed the Character of the Industry

The U.S. Money Management Industry
ETF and Private Equity Assets as a Share of The Industry Total
2000 Through 2019E



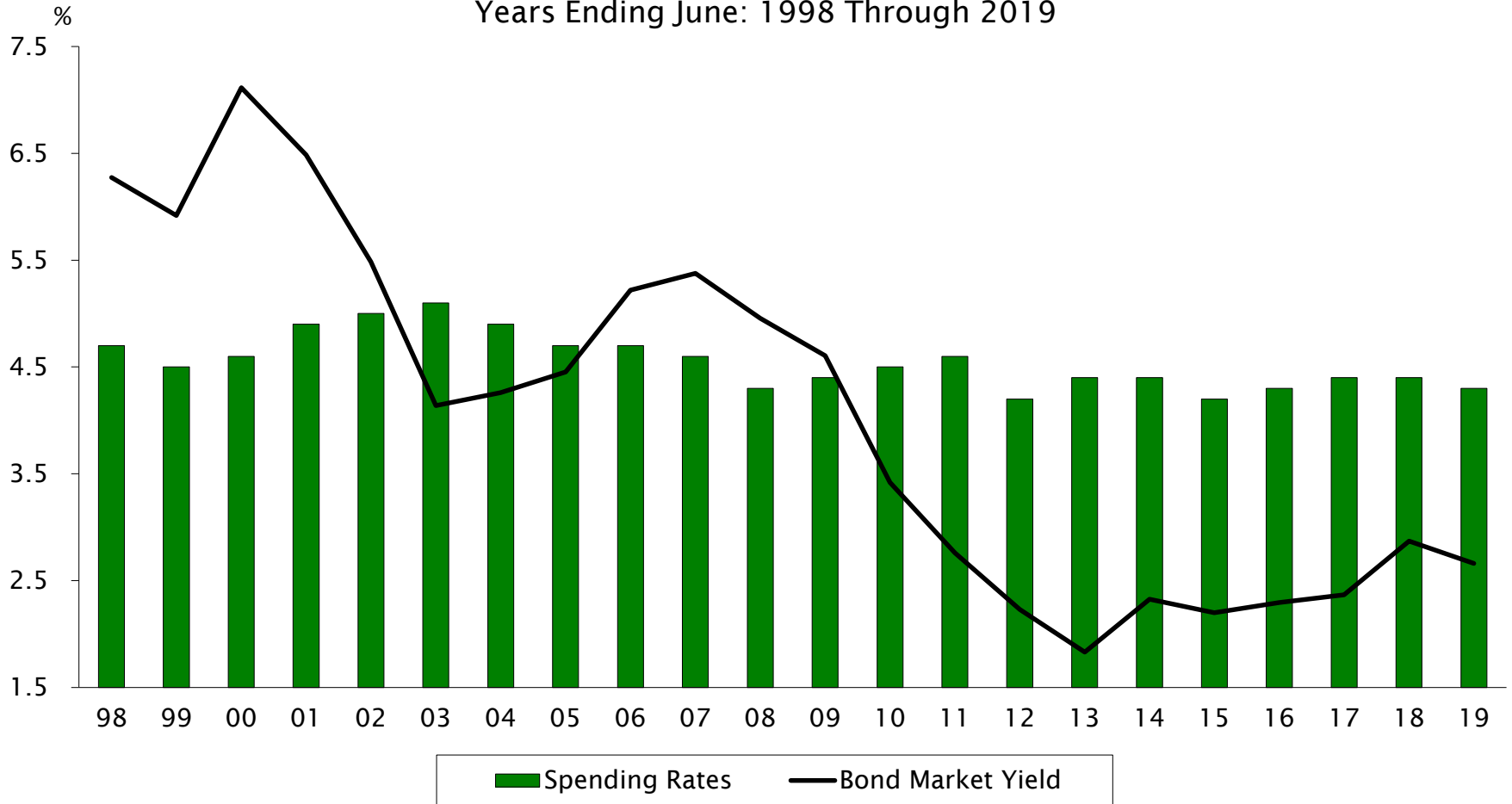
Returns Impact Retail Investor Behavior...

The S&P 500 and Long-Term Government Bonds
Annualized Trailing 20-Year Returns
1947 Through 2019



...And That of Institutions as Well

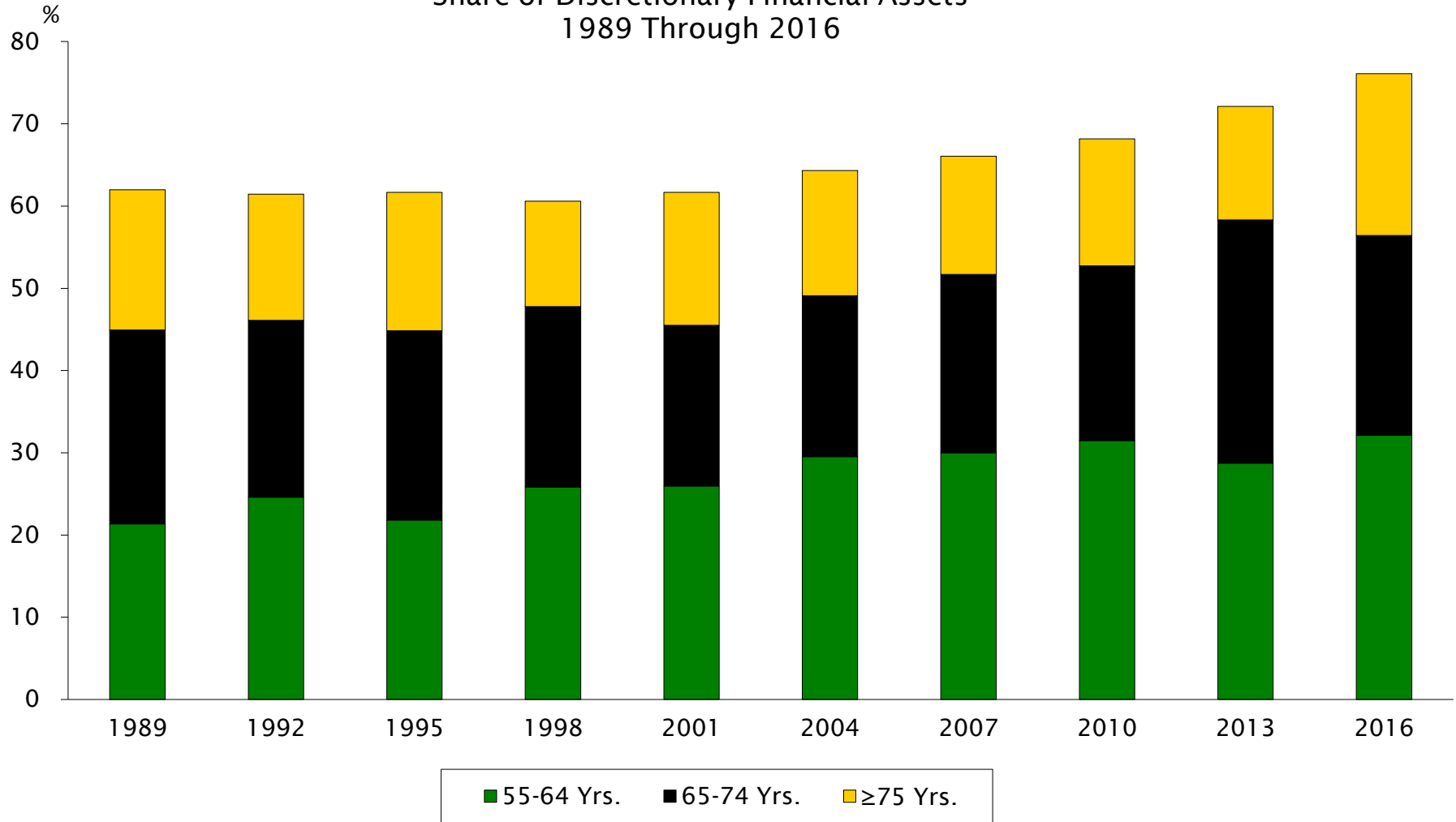
U.S. Endowments
Average Spending Rates
and Composite Yield of the U.S. Bond Market¹
Years Ending June: 1998 Through 2019



¹Based on the Bloomberg Barclays US Aggregate Index.

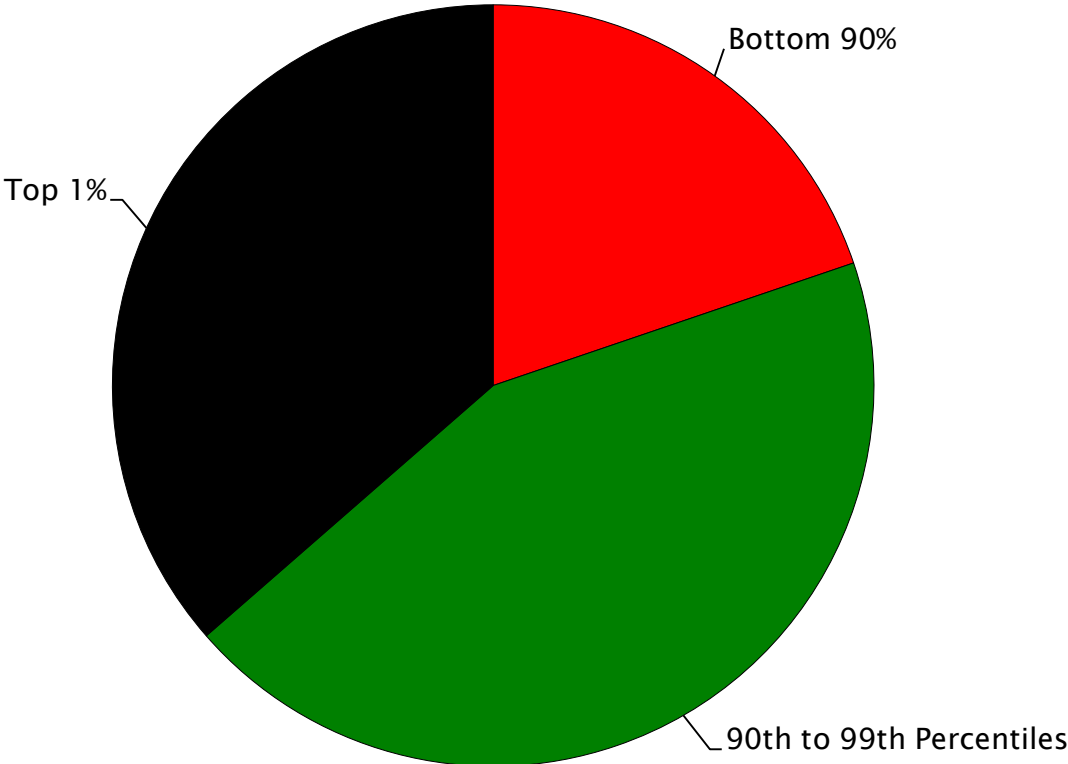
The Aging of Boomers Has Been a Critical Dynamic...

U.S. Households Age 55 Yrs. and Older
Share of Discretionary Financial Assets
1989 Through 2016



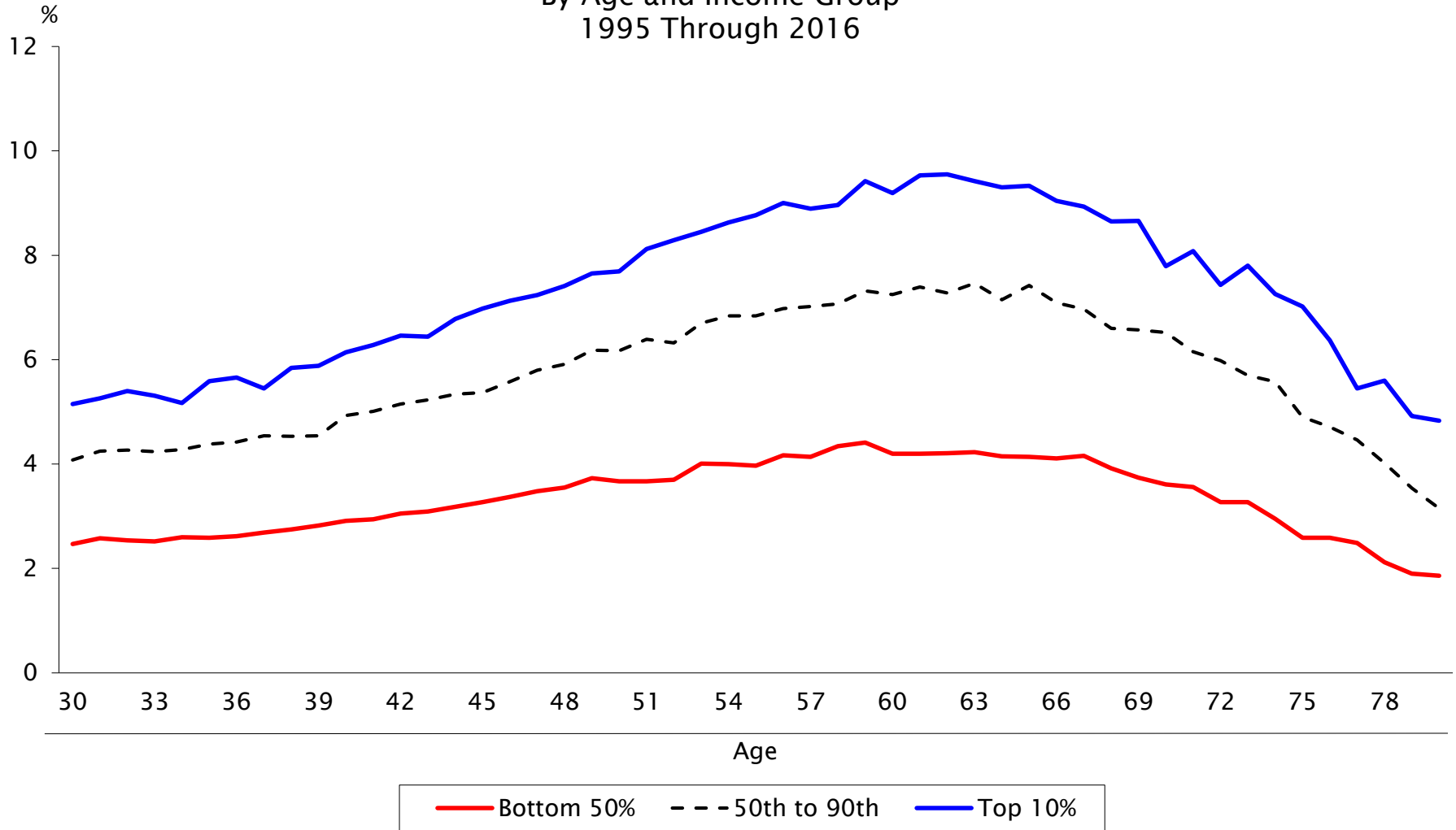
...That's Been Boosted By Skewness in the Distribution of Wealth...

U.S. Households
Distribution of Discretionary Financial Assets
By Net Worth Cohort
2016



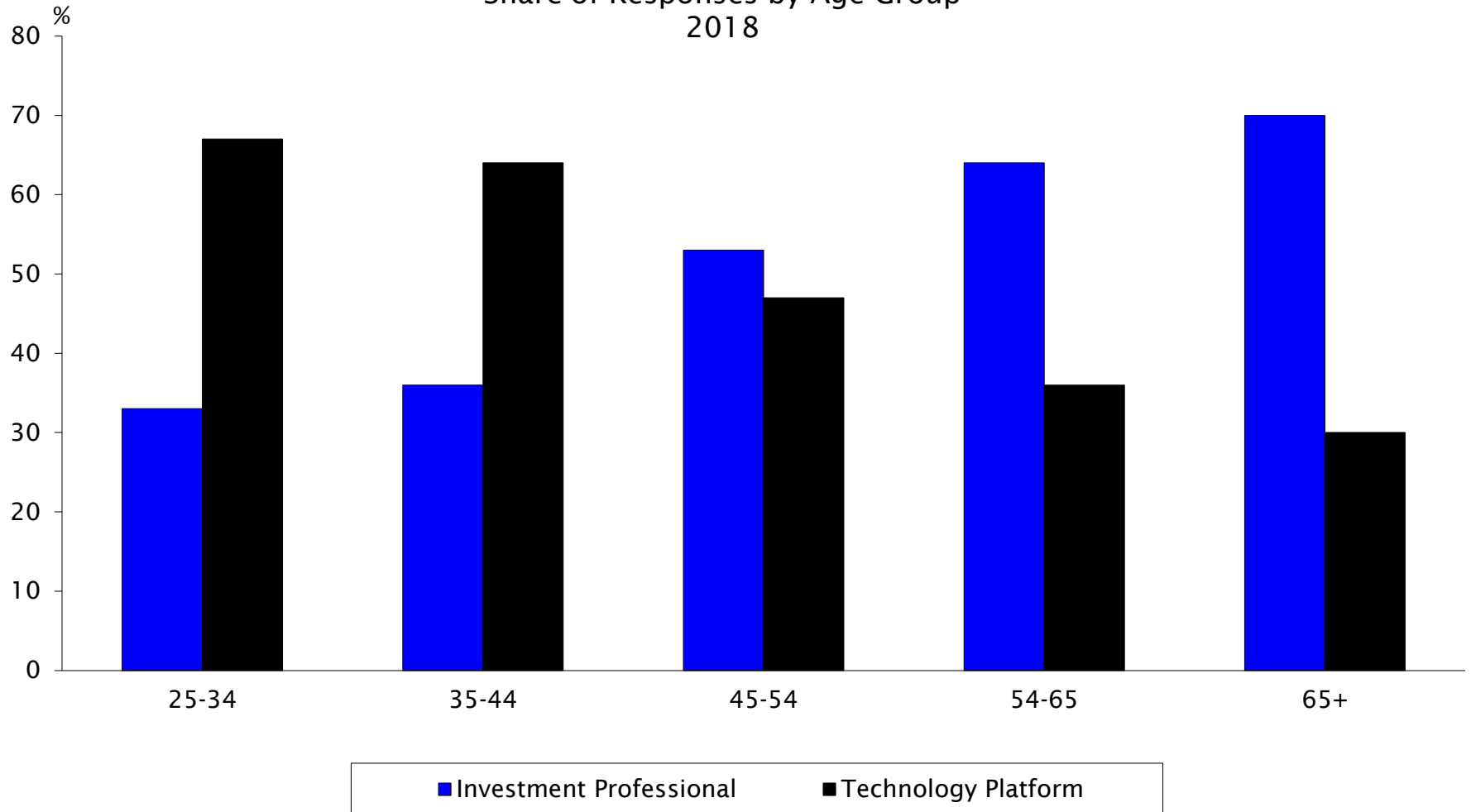
...And the Combination of the Two Has Shown Up in Inheritances

Probability of Receiving an Inheritance
By Age and Income Group
1995 Through 2016



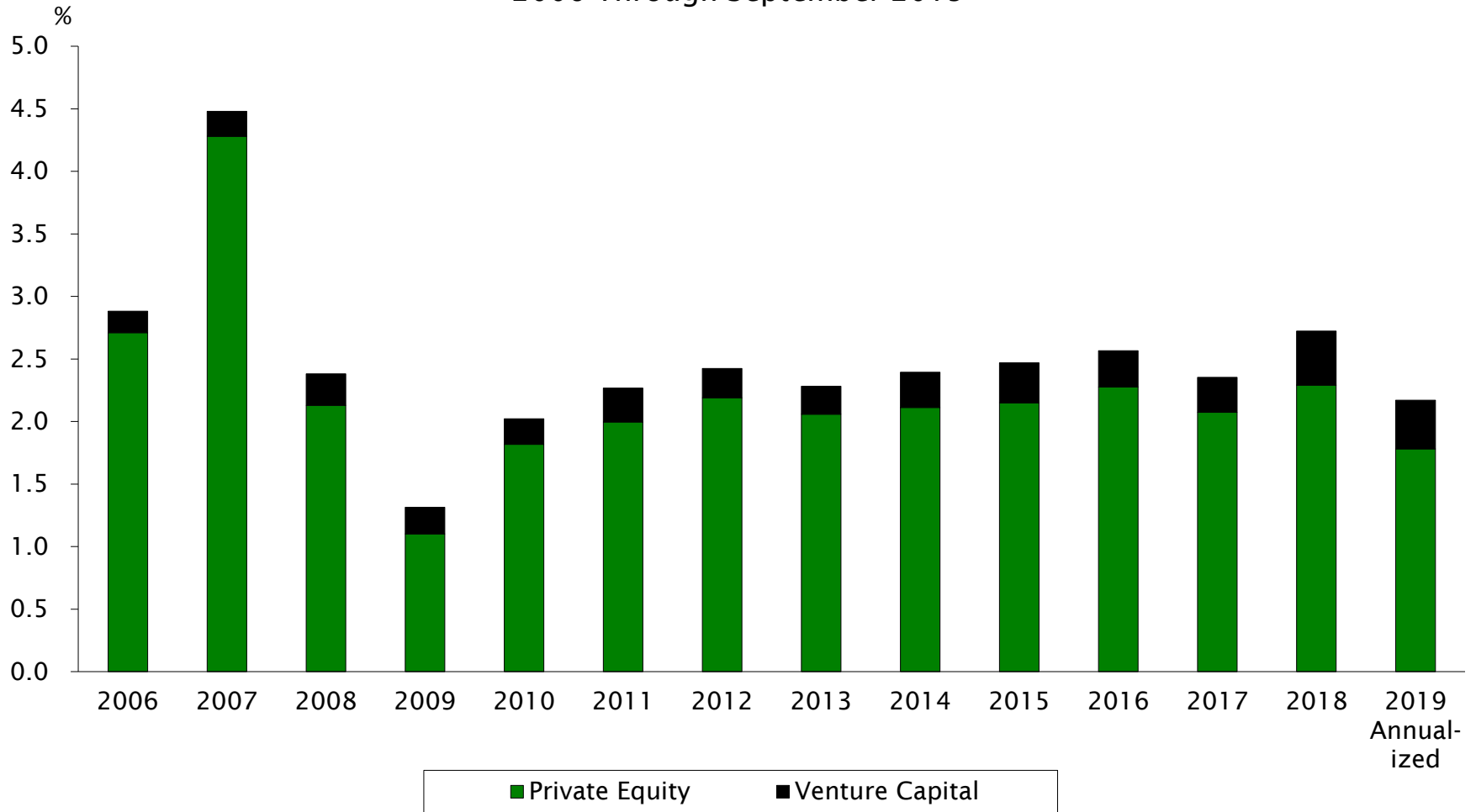
Demographics Have Worked to Slow the Rates of Change

What Will be More Important in Three Years?
An Investment Professional or the Latest Investment Technology Platform
Share of Responses by Age Group
2018



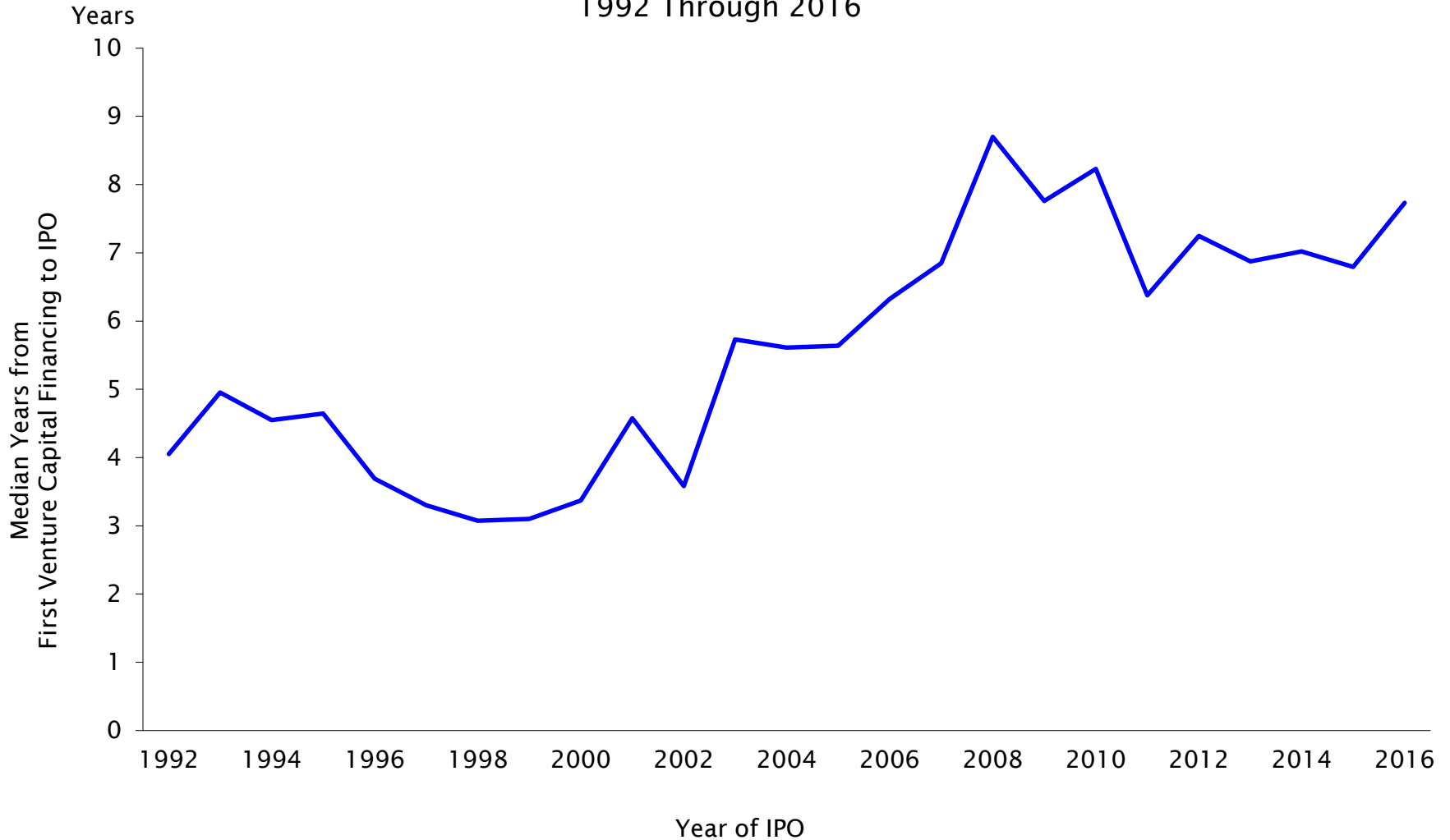
The Impact of Private Capital on the System Has Been Consistent...

U.S. Private Equity and Venture Capital
New Investments as a Share of the Market Value of U.S. Publicly-Traded Equities
2006 Through September 2019



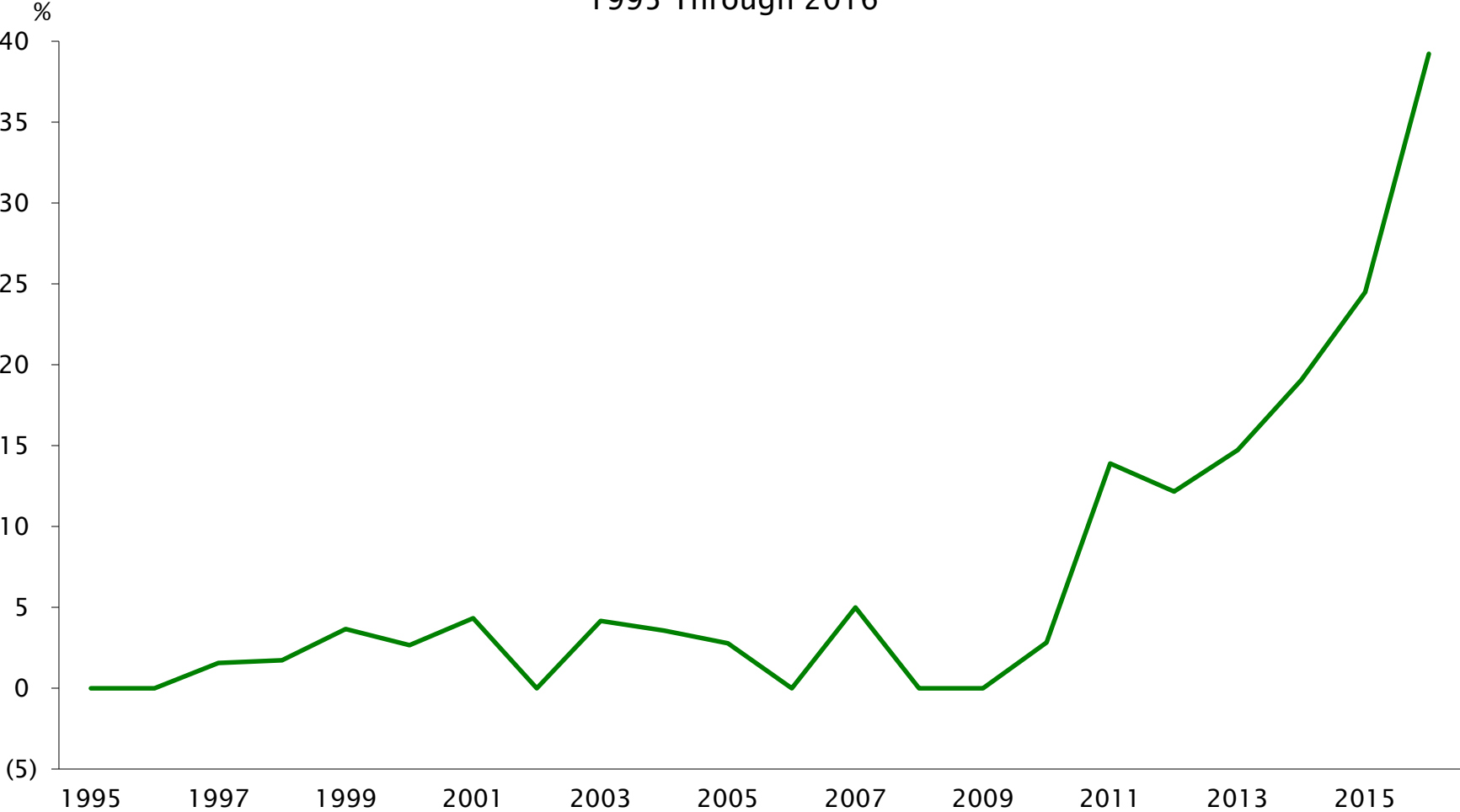
...And Start-Ups Have Stayed Private Longer...

Median Age of Venture Capital-Backed Start-Ups
at the Time of Their IPO
1992 Through 2016



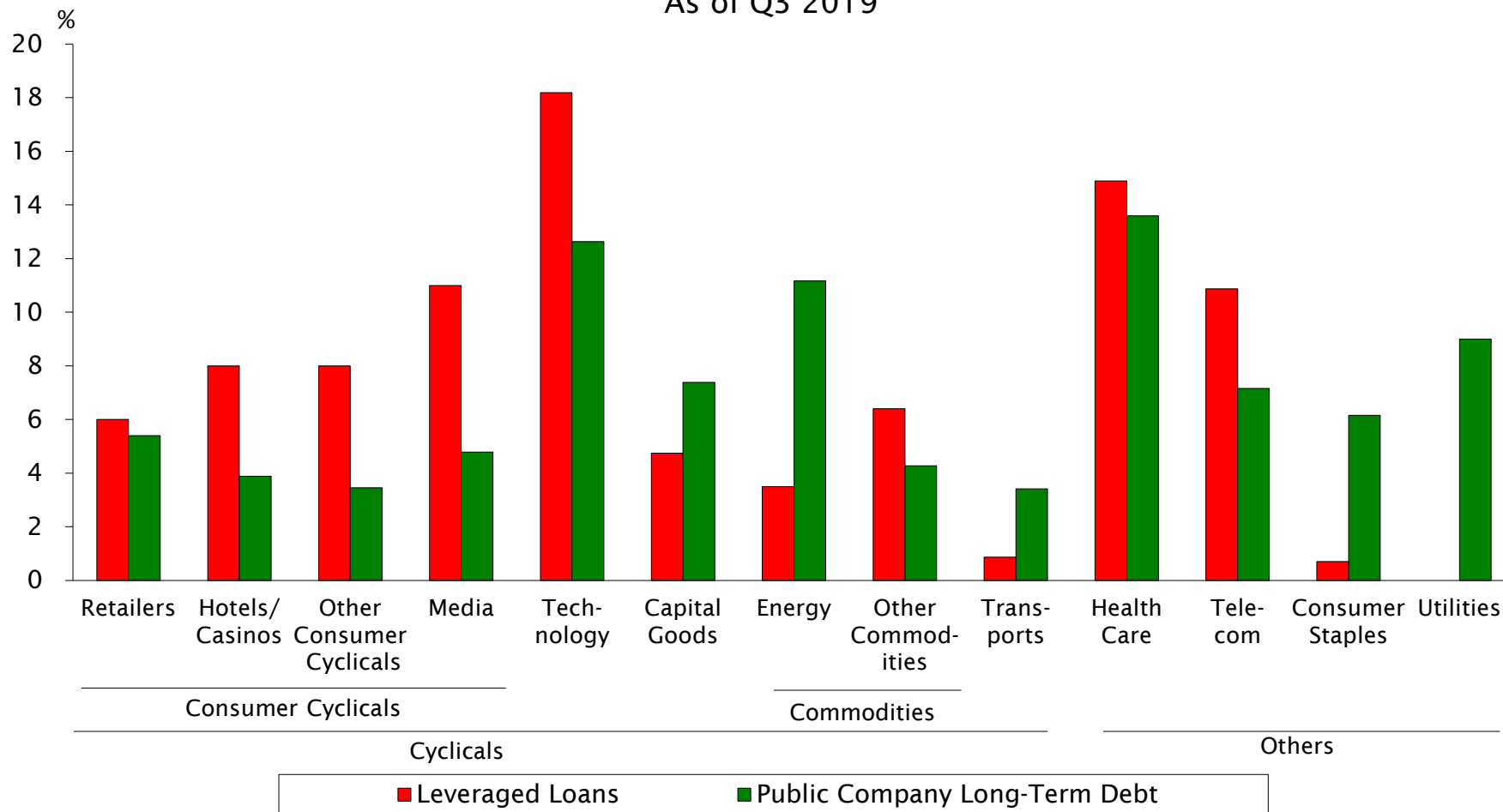
...As the Investor Bases Have Converged

Venture Capital-Backed IPOs
Share of Pre-IPO Investments Coming from Mutual Funds
1995 Through 2016



The Sector Mix of the Debt Tells a Story

Sector Mix of Corporate Debt Outstanding
Leveraged Loans Compared to the Long-Term Debt of Public Companies¹
As of Q3 2019



¹The public company data is the long-term debt of the largest 1,500 stocks.

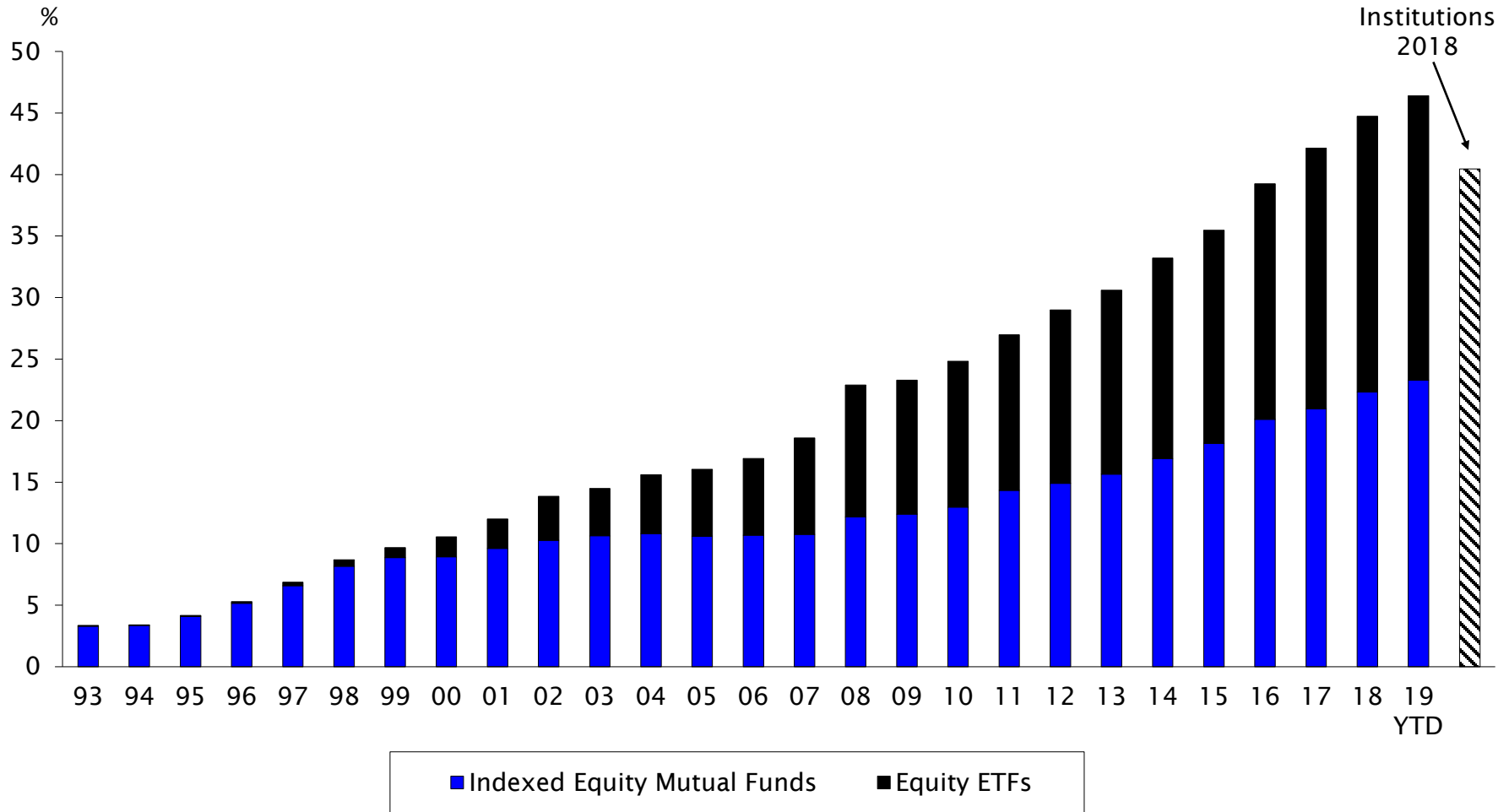
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Topics

- The Really Big Picture
- The Rise of Indexing and Investor Price Sensitivity

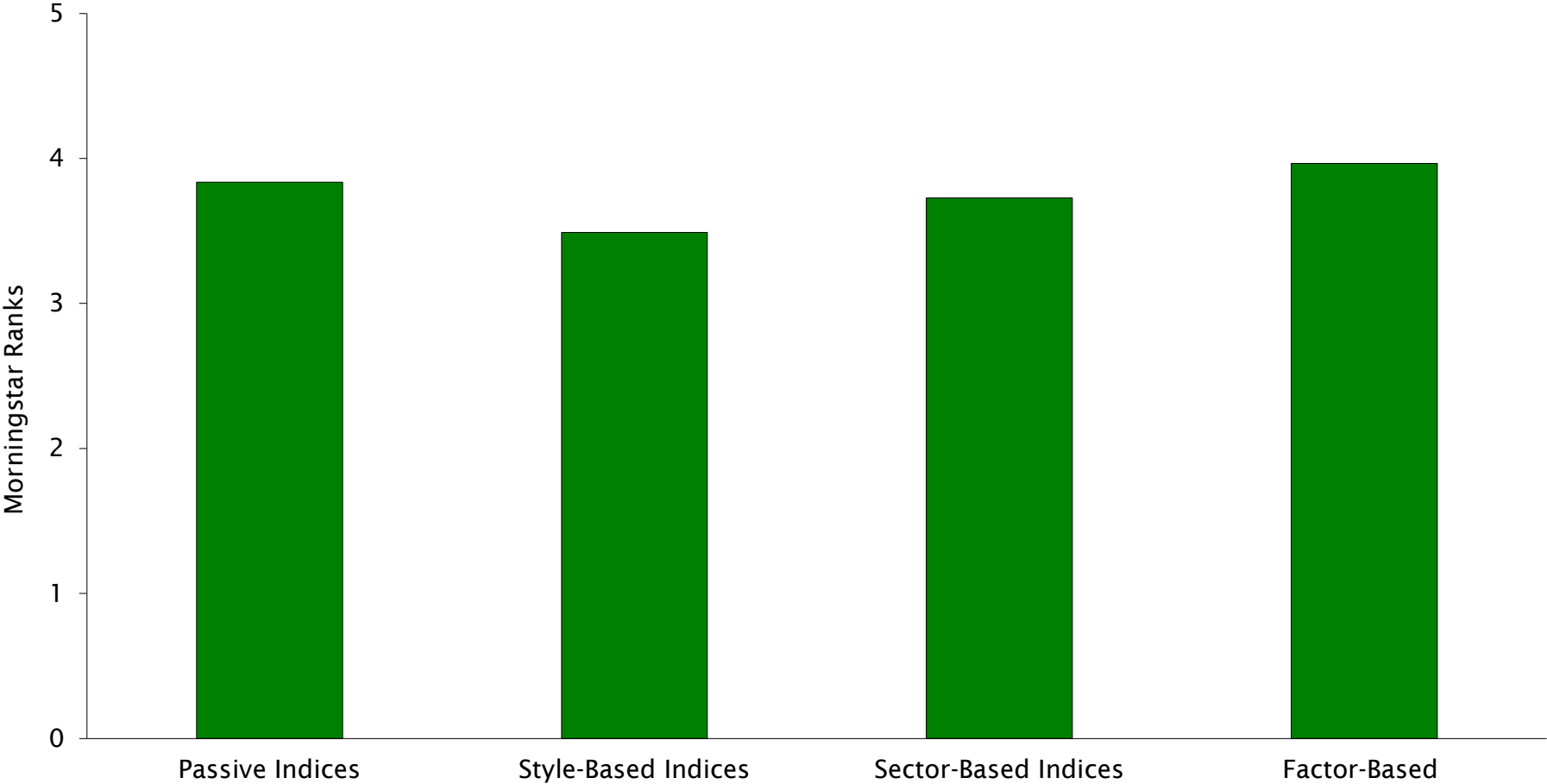
Indexing Gained Enormous Share in the 2010s...

Indexed Equity Fund and ETF Assets
Share of All Long-Term Equity Mutual Fund and ETF Assets
1993 Through November 2019



...As There Was No Need to Venture Elsewhere

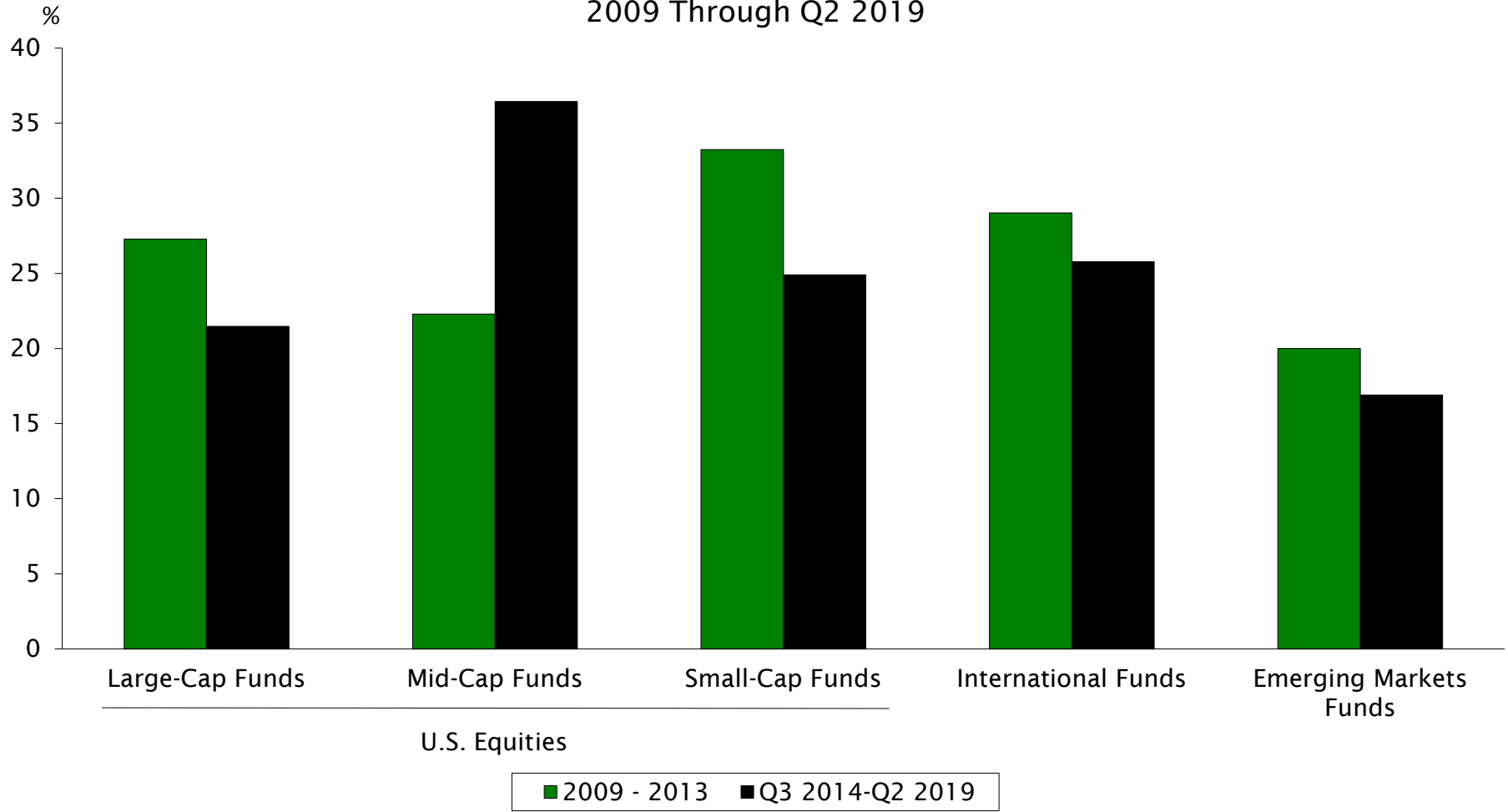
U.S. Equity ETFs
Average Morningstar Star Ranks¹
As of November 2019



¹Asset-weighted averages.

The Performance of Active Managers Has Been a Big Part of the Story...

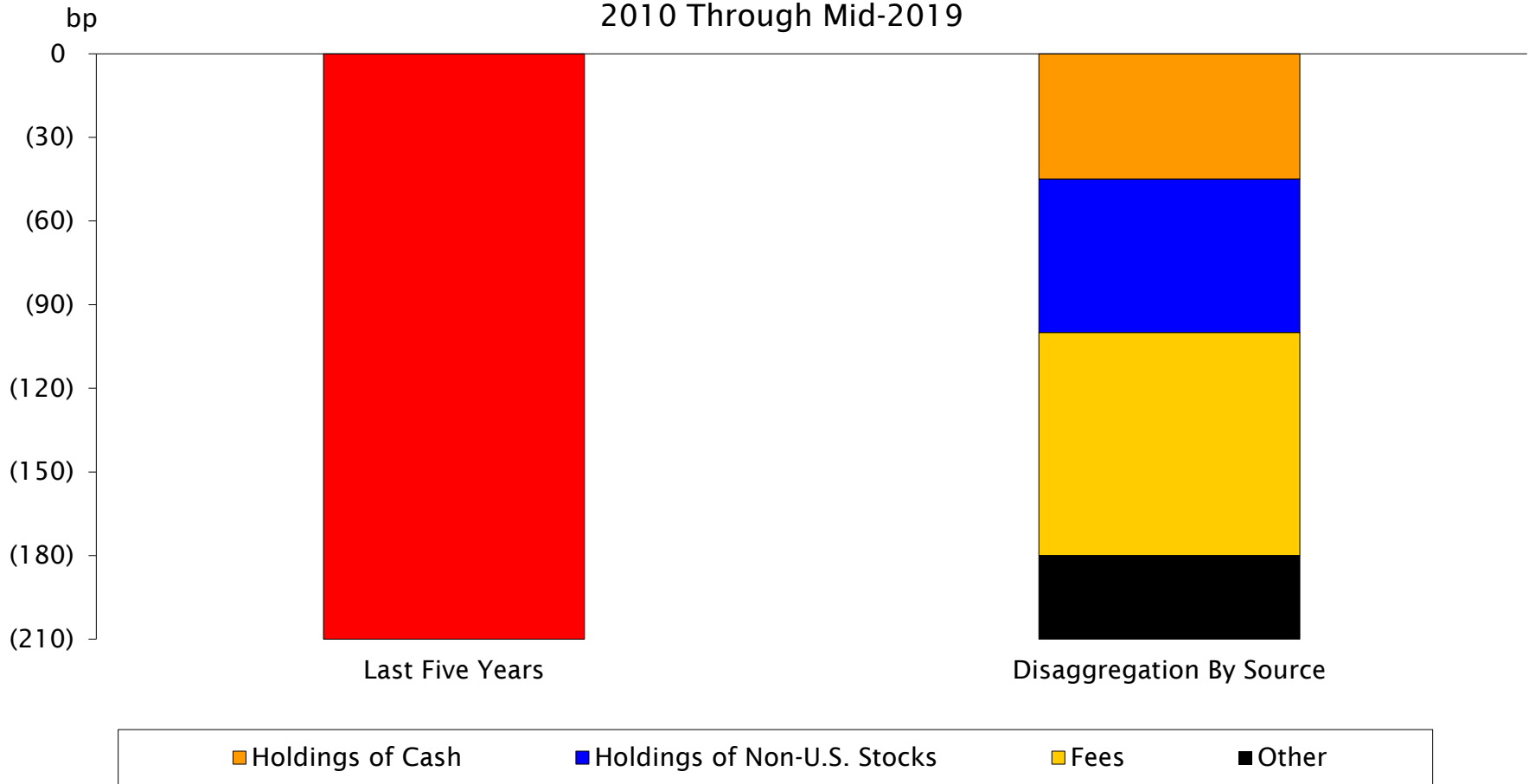
Actively-Managed Equity Mutual Funds
Share Outperforming Their Benchmarks¹
2009 Through Q2 2019



¹Includes funds that have disappeared, via merger or otherwise.

...And the Classic Rationales Tell Most of the Tale

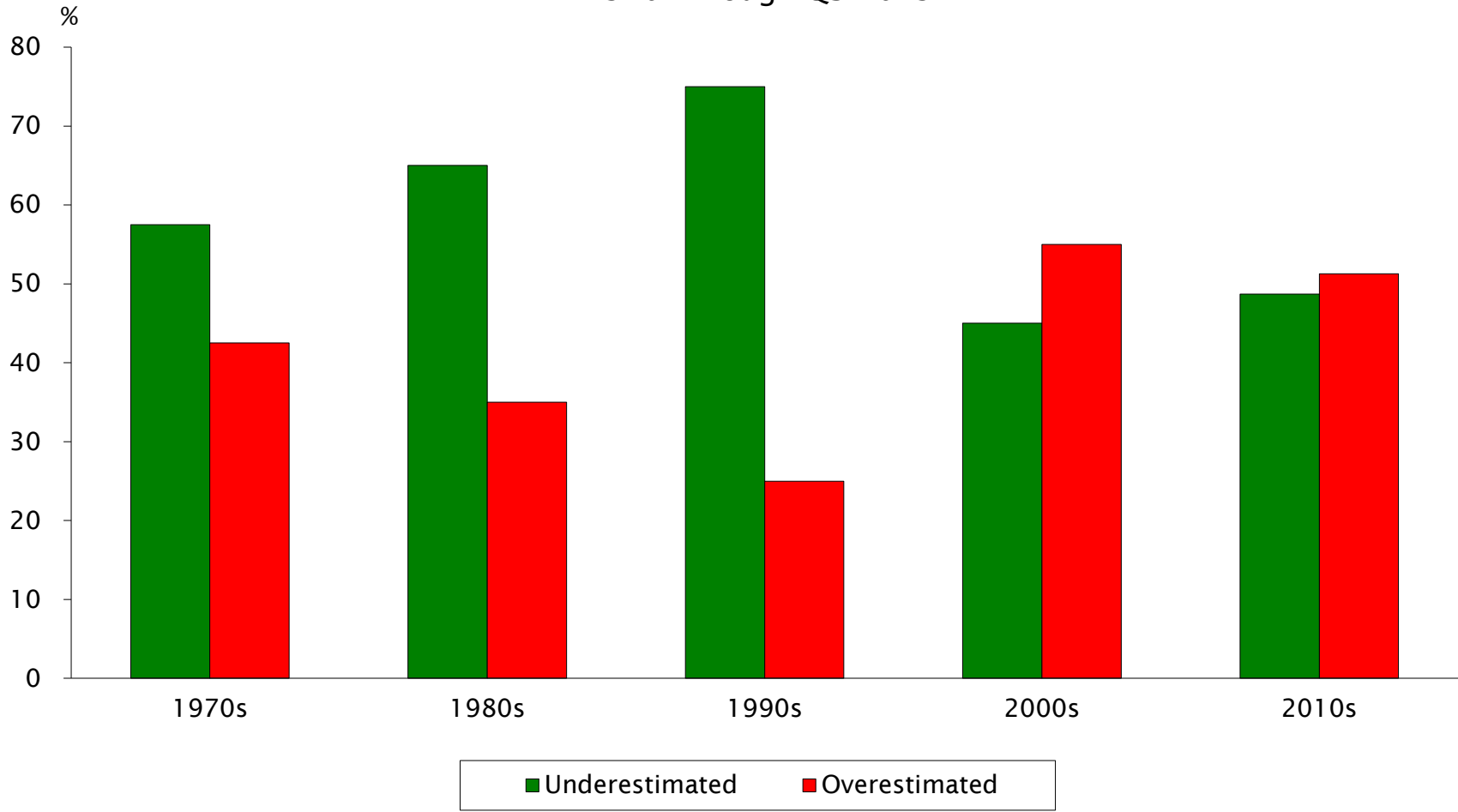
Actively-Managed Large-Cap U.S. Equity Mutual Funds
Annualized Underperformance Relative to the S&P 500¹
2010 Through Mid-2019



¹Equally-weighted composite.

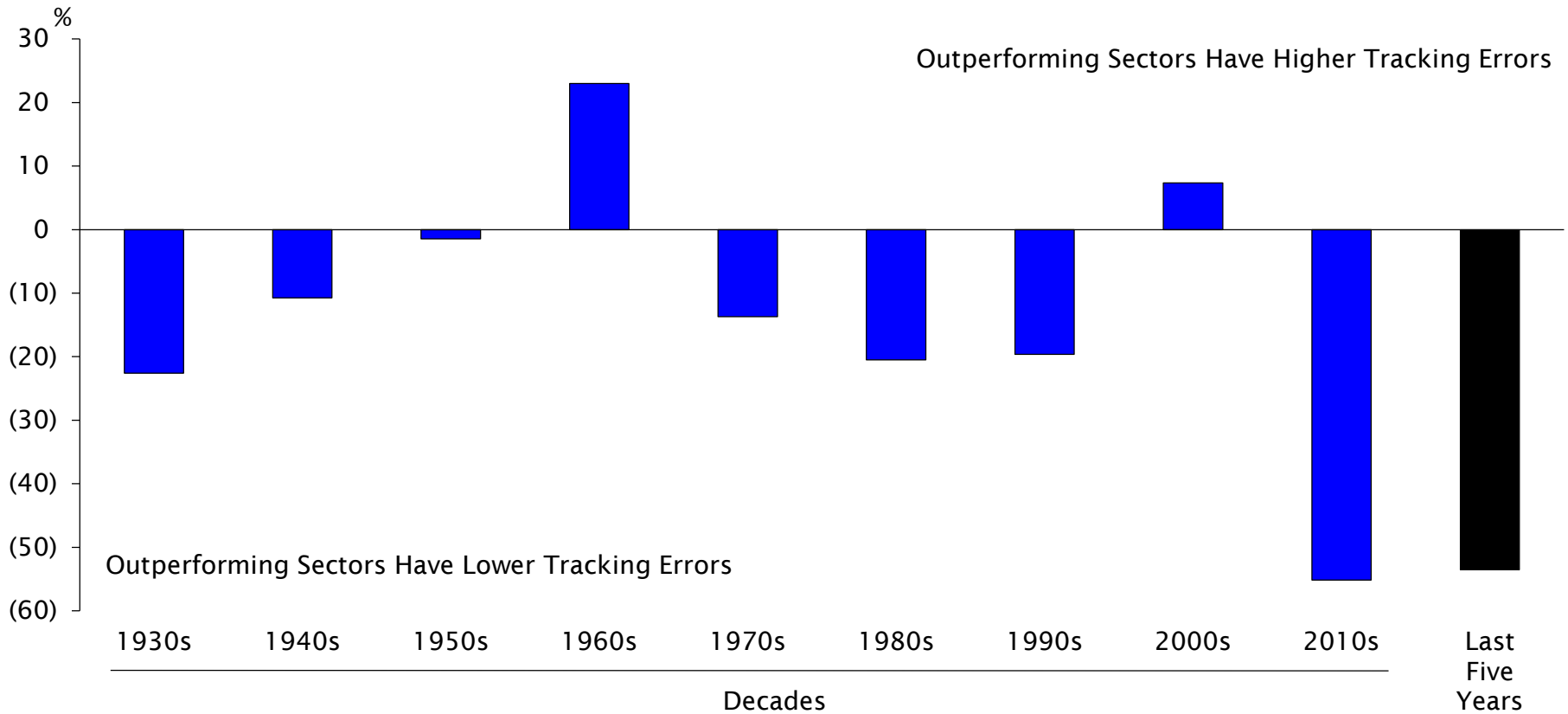
The Economy Hasn't Cooperated...

U.S. Real-GDP Quarterly Growth Rate Forecasts
Share of Quarters Underestimated and Overestimated by Decade
1970 Through Q3 2019



...And It's Been a Mistake to Be Too Active...

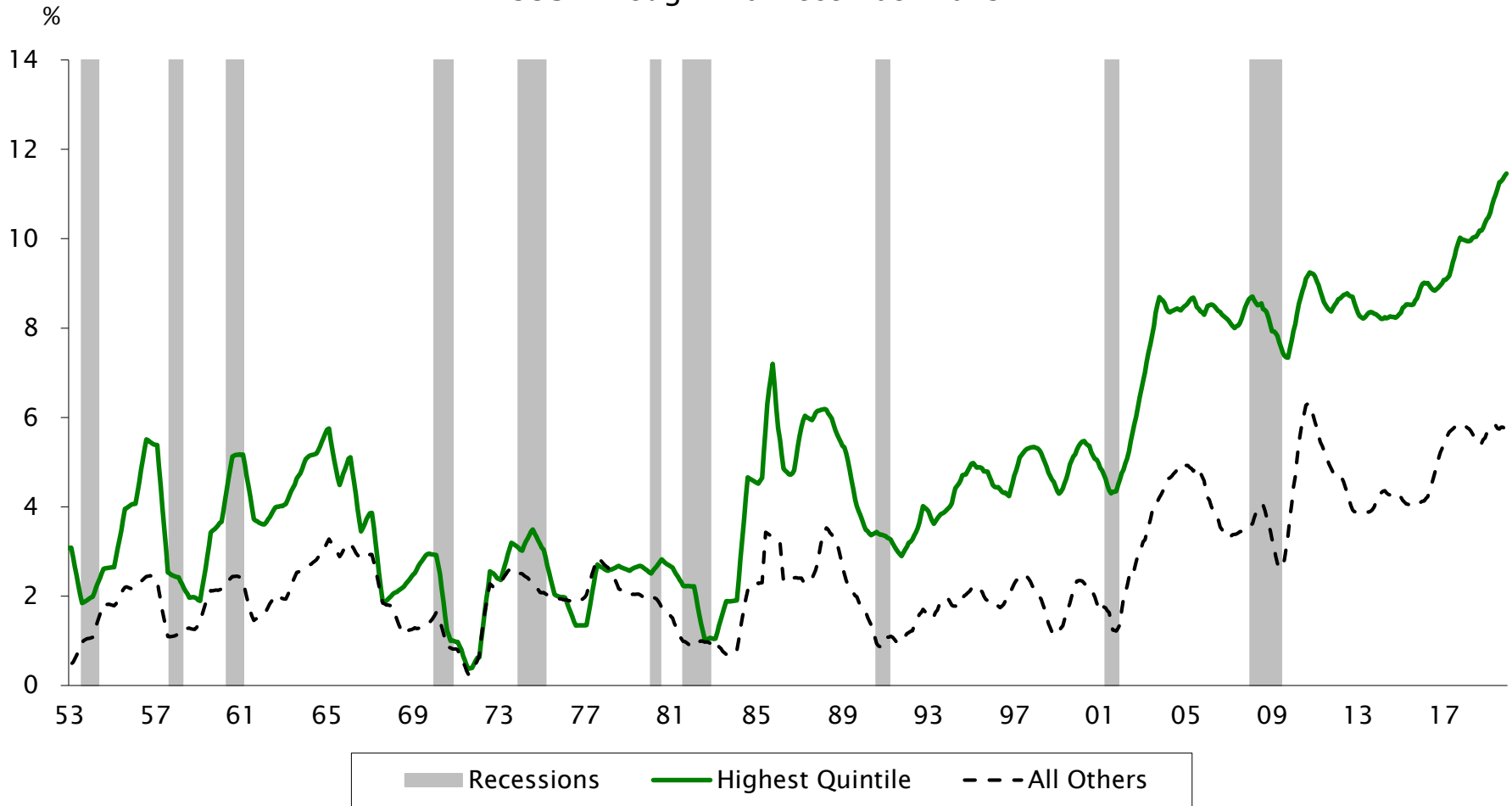
Large-Capitalization Stocks
Correlation Between Sectors' Relative Returns and Their Tracking Error¹
1930 Through 2019



¹ Relative returns and tracking error computed over a trailing three-year window using monthly, capitalization-weighted data.

...As the Margins of the Largest Companies Nearly Tripled

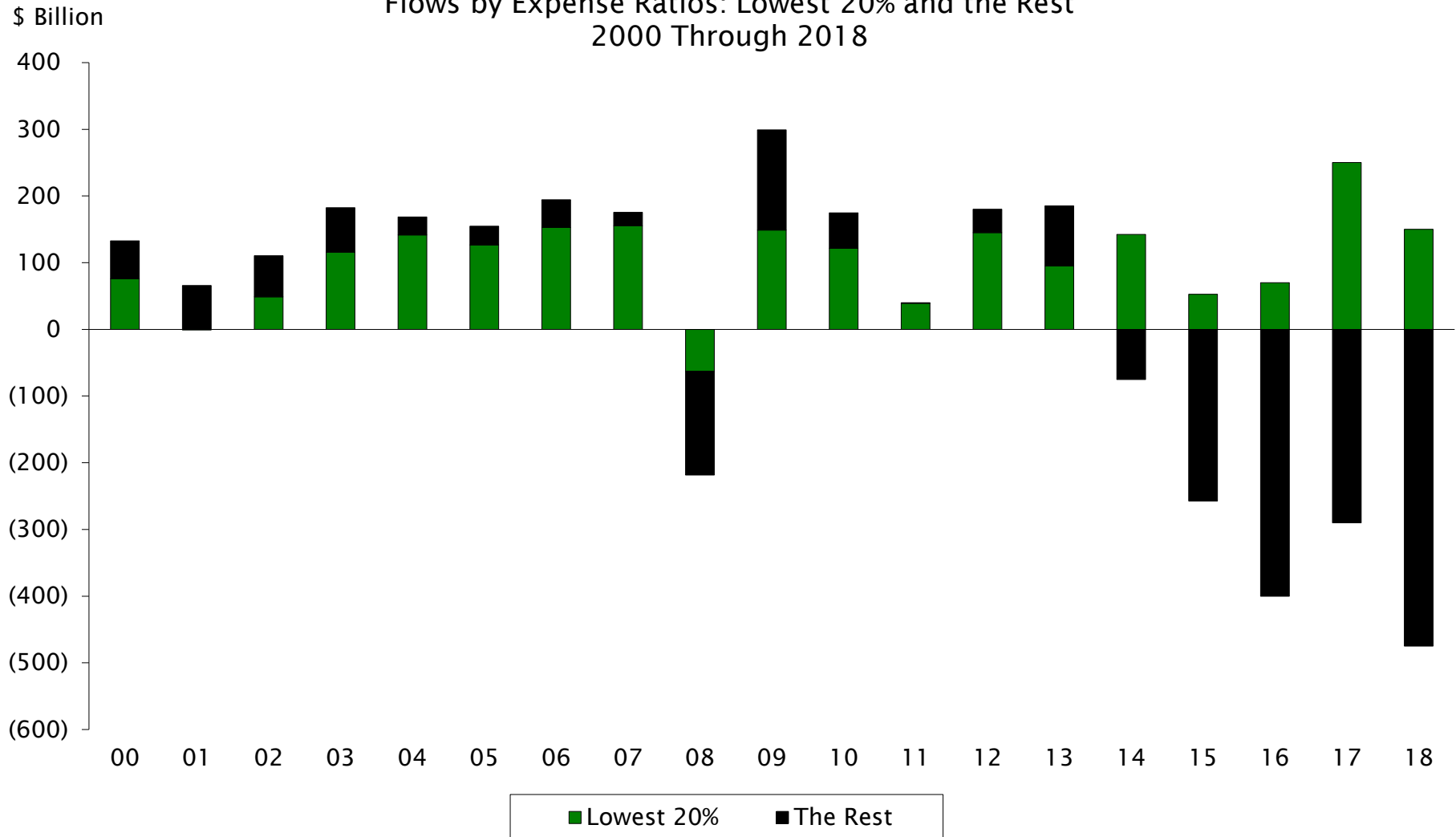
Large-Capitalization Stocks
Free Cash Flow Margins By Quintiles of Market Capitalization¹
1953 Through Mid-December 2019



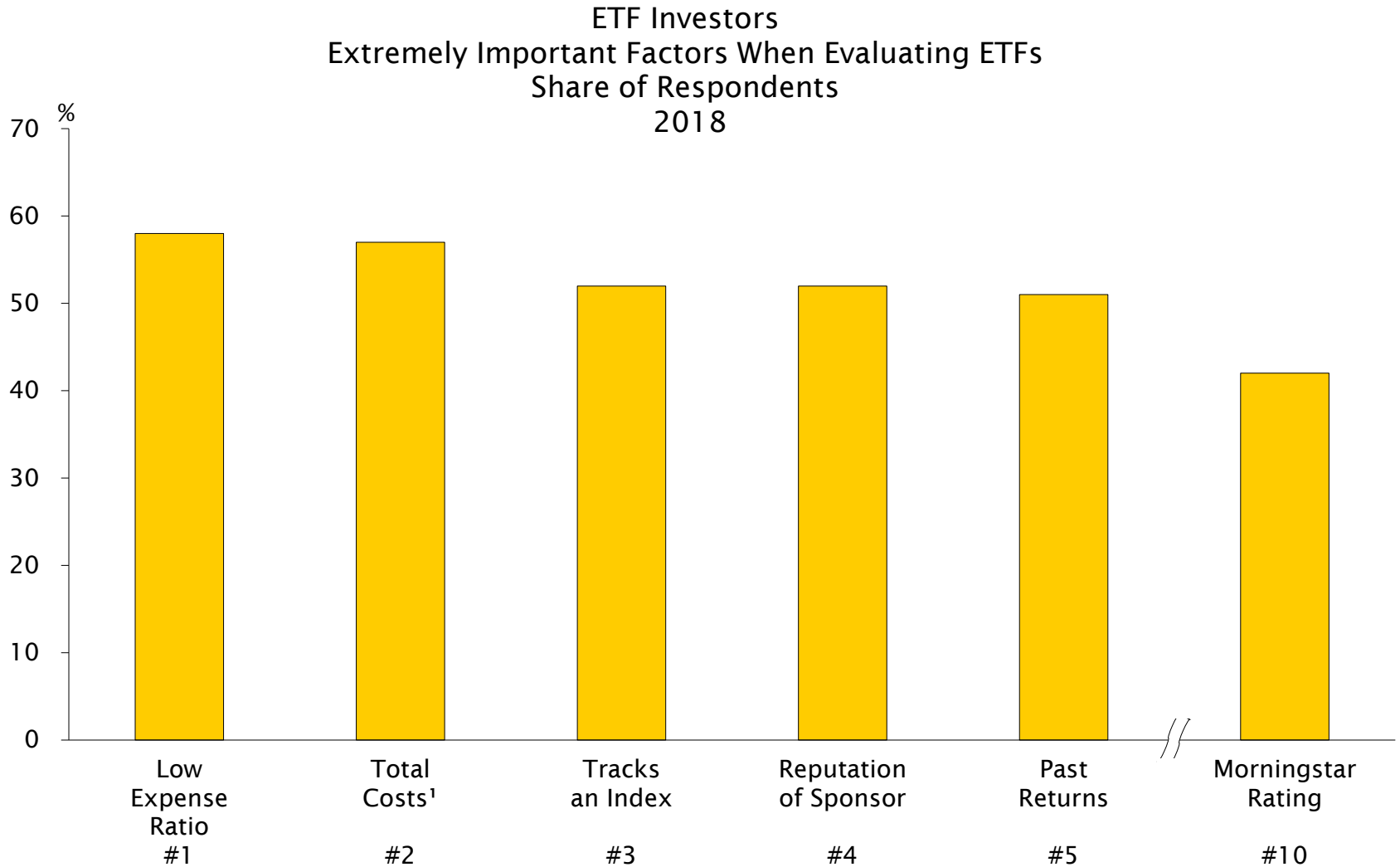
¹ Measured in aggregate; trailing four-quarter data smoothed on a trailing six-month basis.

Pricing Has Become a Focus...

Actively-Managed Mutual Funds
Flows by Expense Ratios: Lowest 20% and the Rest
2000 Through 2018



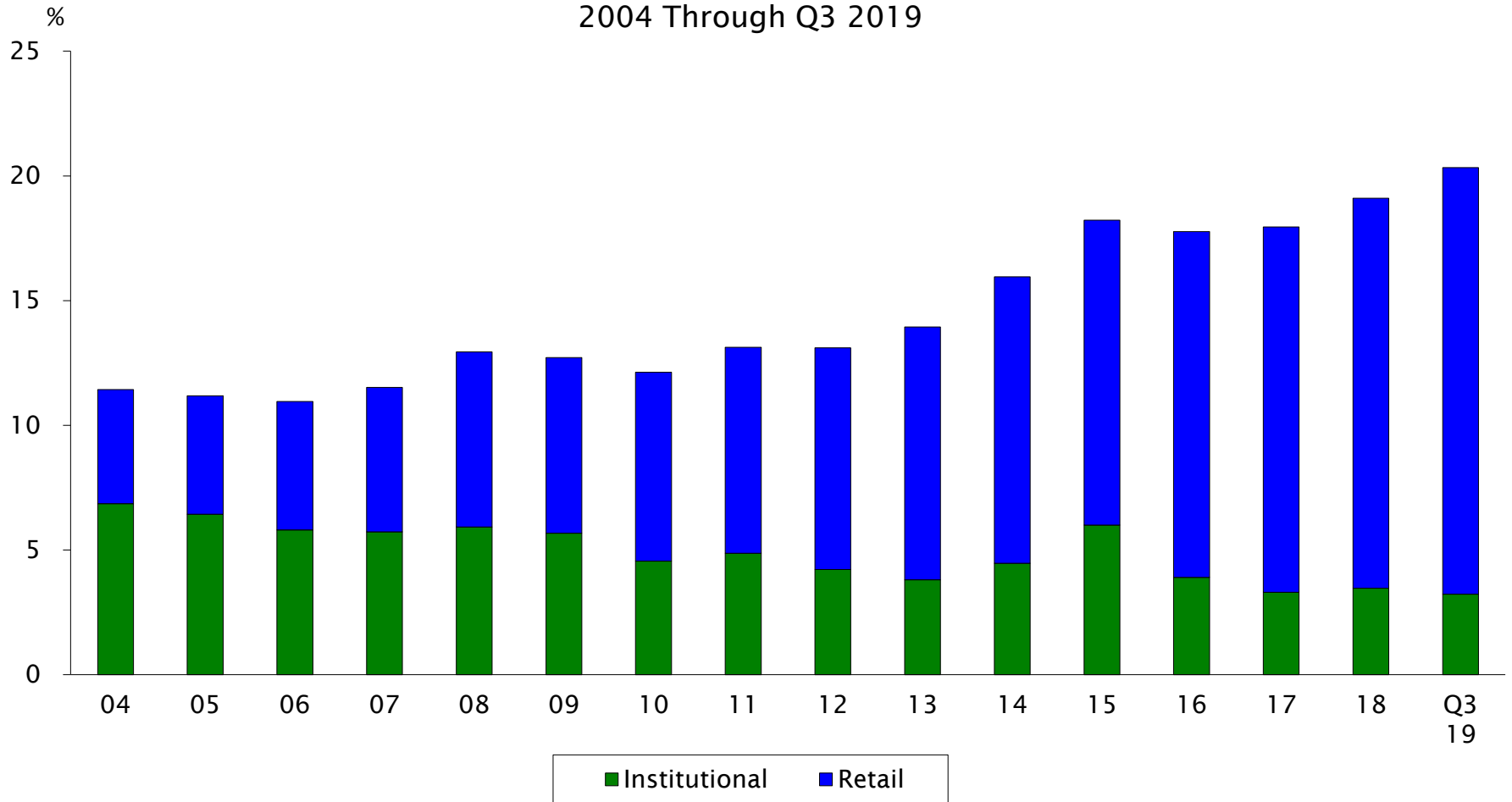
...And Ratings Have Mattered Less Than in the Past



¹ Expense ratios, commissions, bid/ask spreads.

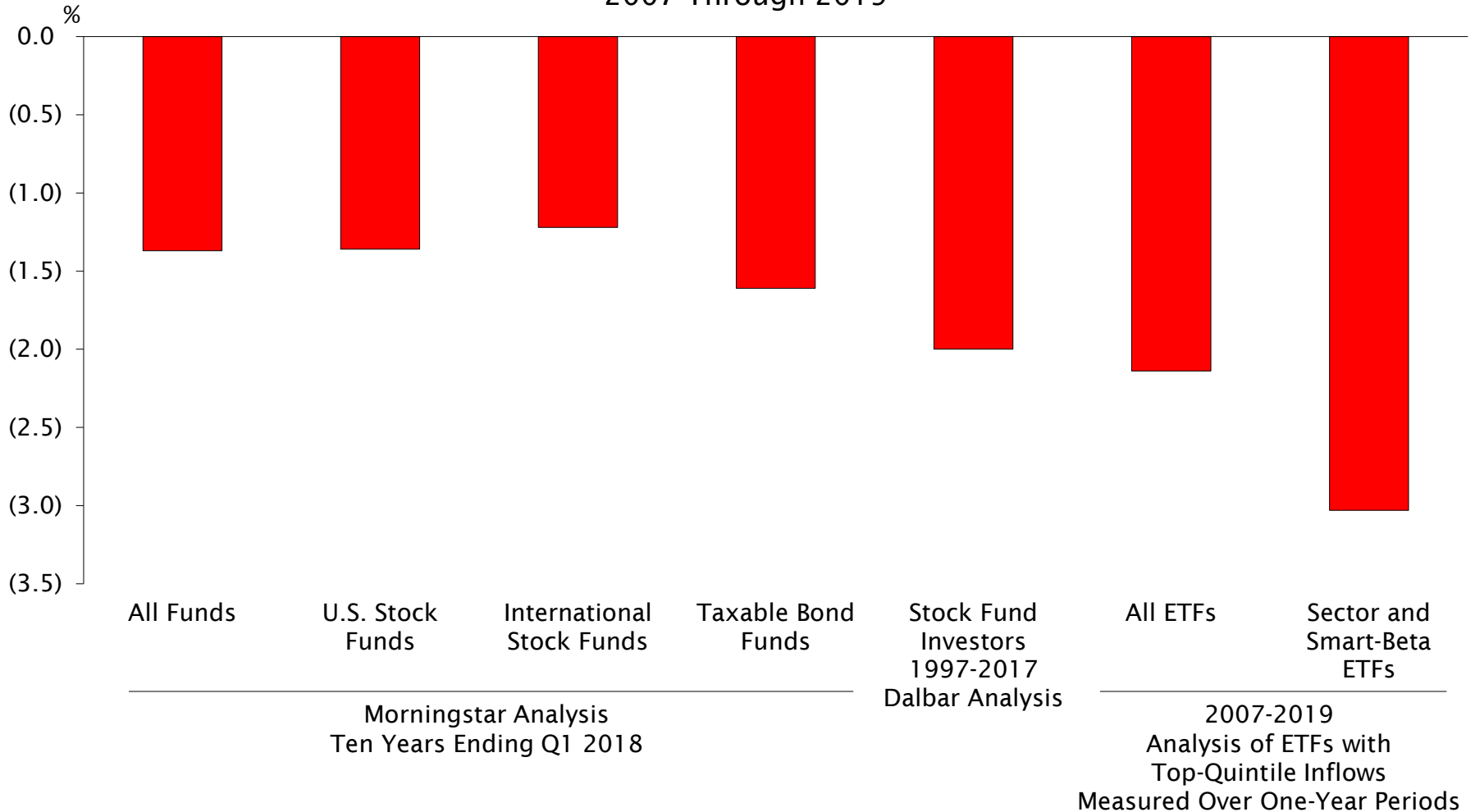
The Tail Doesn't Look Large Enough to Wag the Dog...

Institutional and Retail Investors
Indexed Equity Assets
As a Share of the U.S. Large-Cap Market
2004 Through Q3 2019



...Although the Mistiming of Investments Remains an Issue

Mistiming by Mutual Fund and ETF Investors
Realized Versus Asset Class Returns
2007 Through 2019



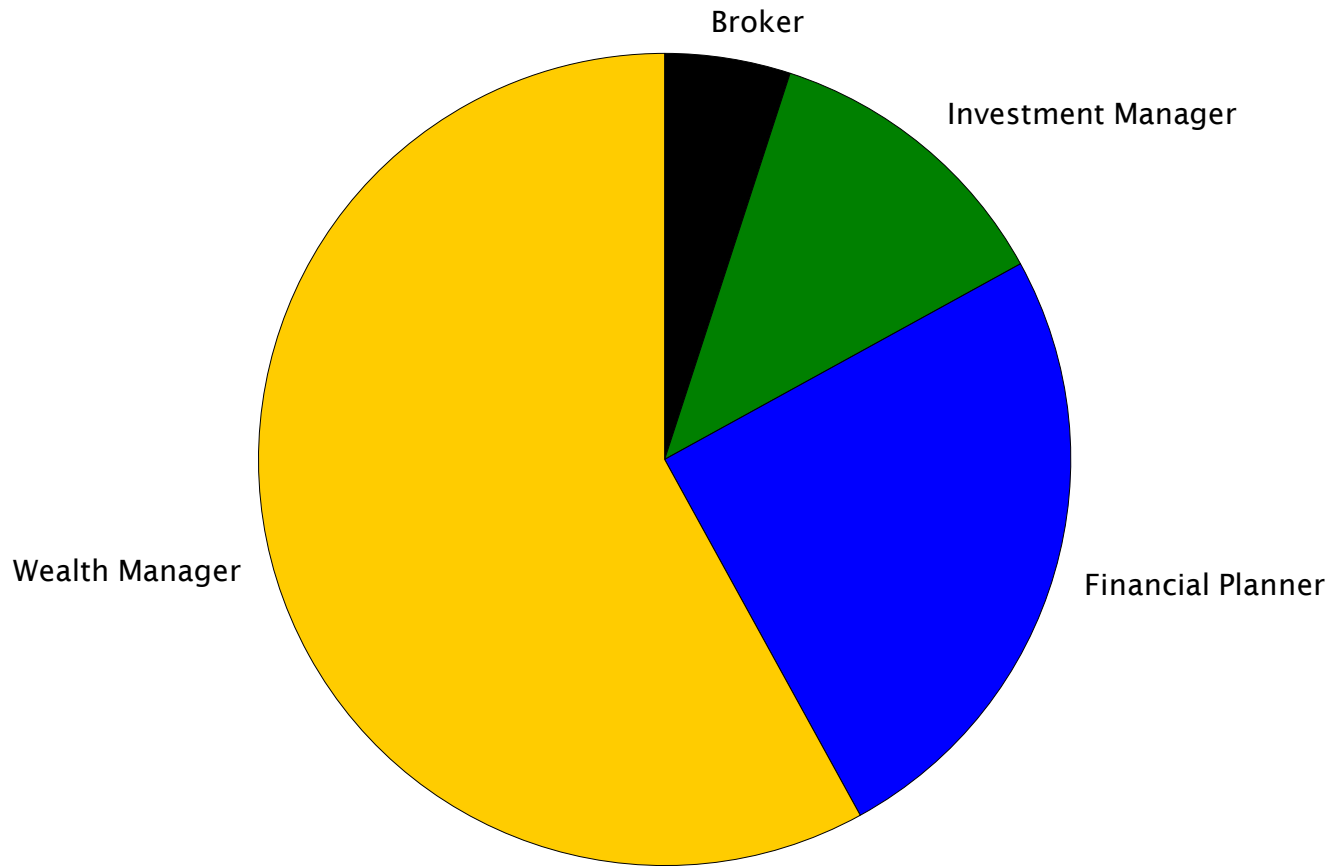
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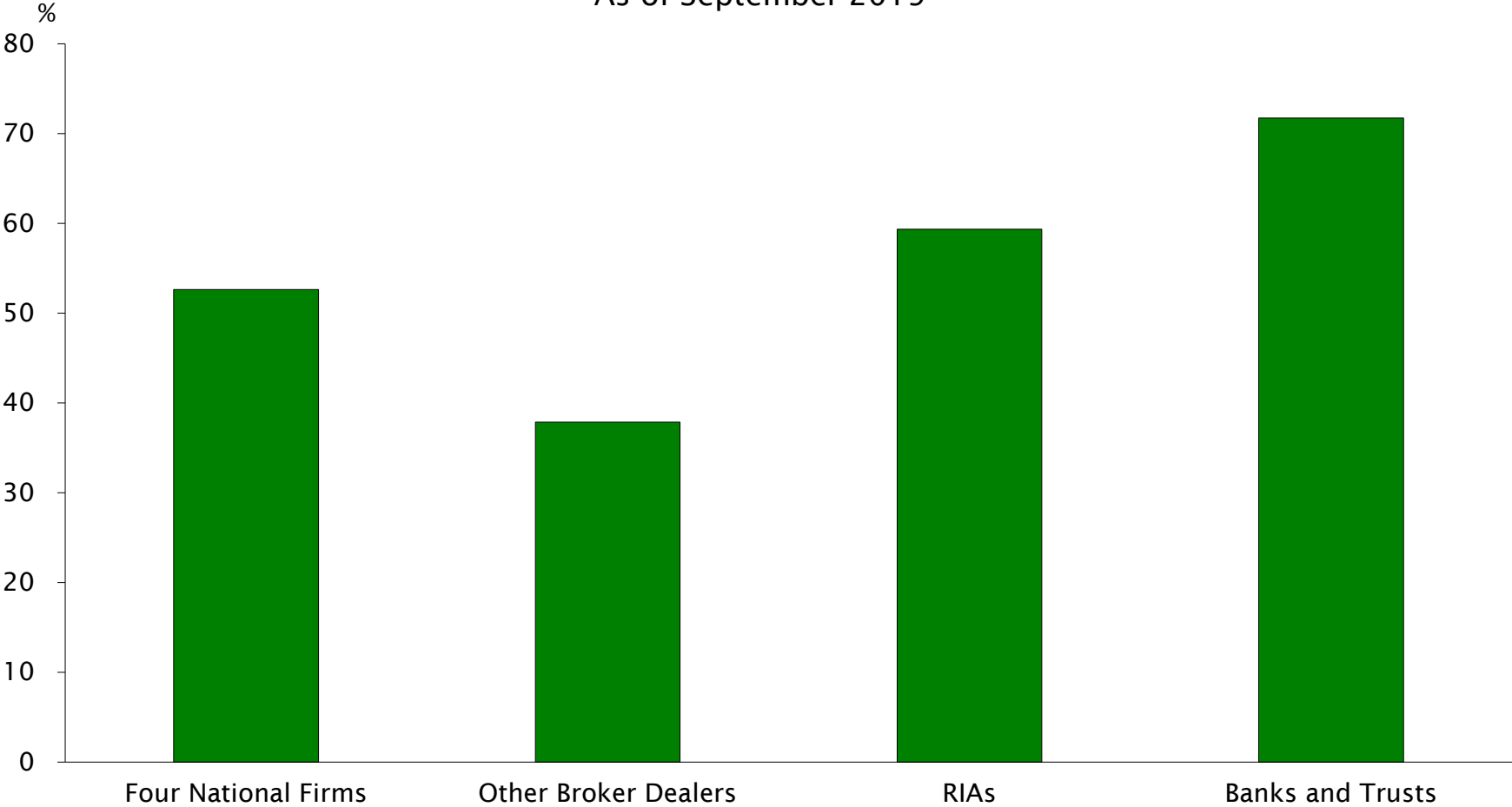
Financial Advisors are Now Wealth Managers...

Financial Advisor Job Descriptions
Share of Respondents
2018



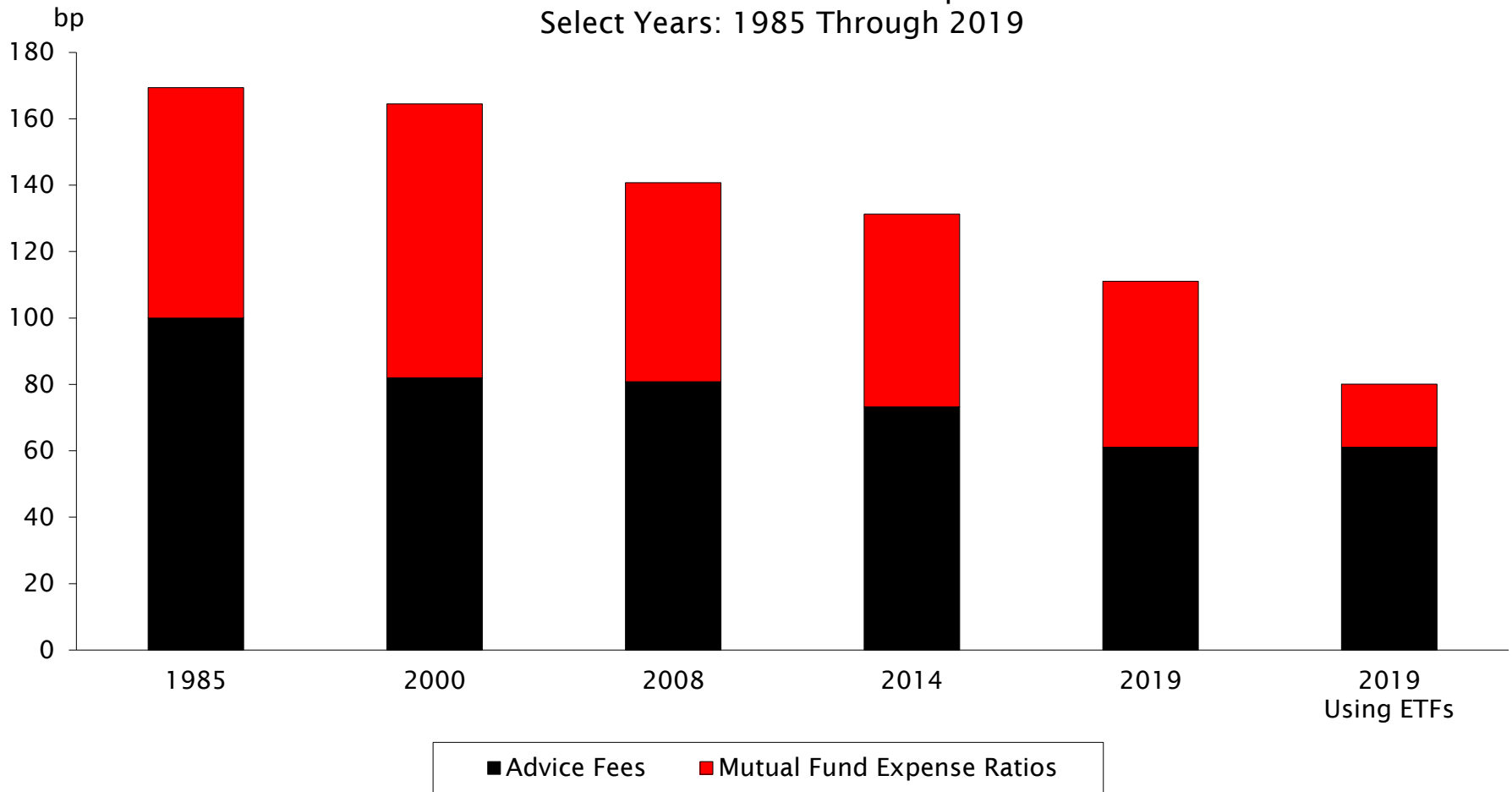
...With Indexing at the Heart of What They Do

U.S. Equity Mutual Fund and ETF Holdings by Channel
Share in Index Funds and ETFs
As of September 2019



The Price of Advice Has Gradually Come Down...

National Full Service Brokerage Firms¹
Fees for Advice Plus Mutual Fund Expense Ratios²
Select Years: 1985 Through 2019

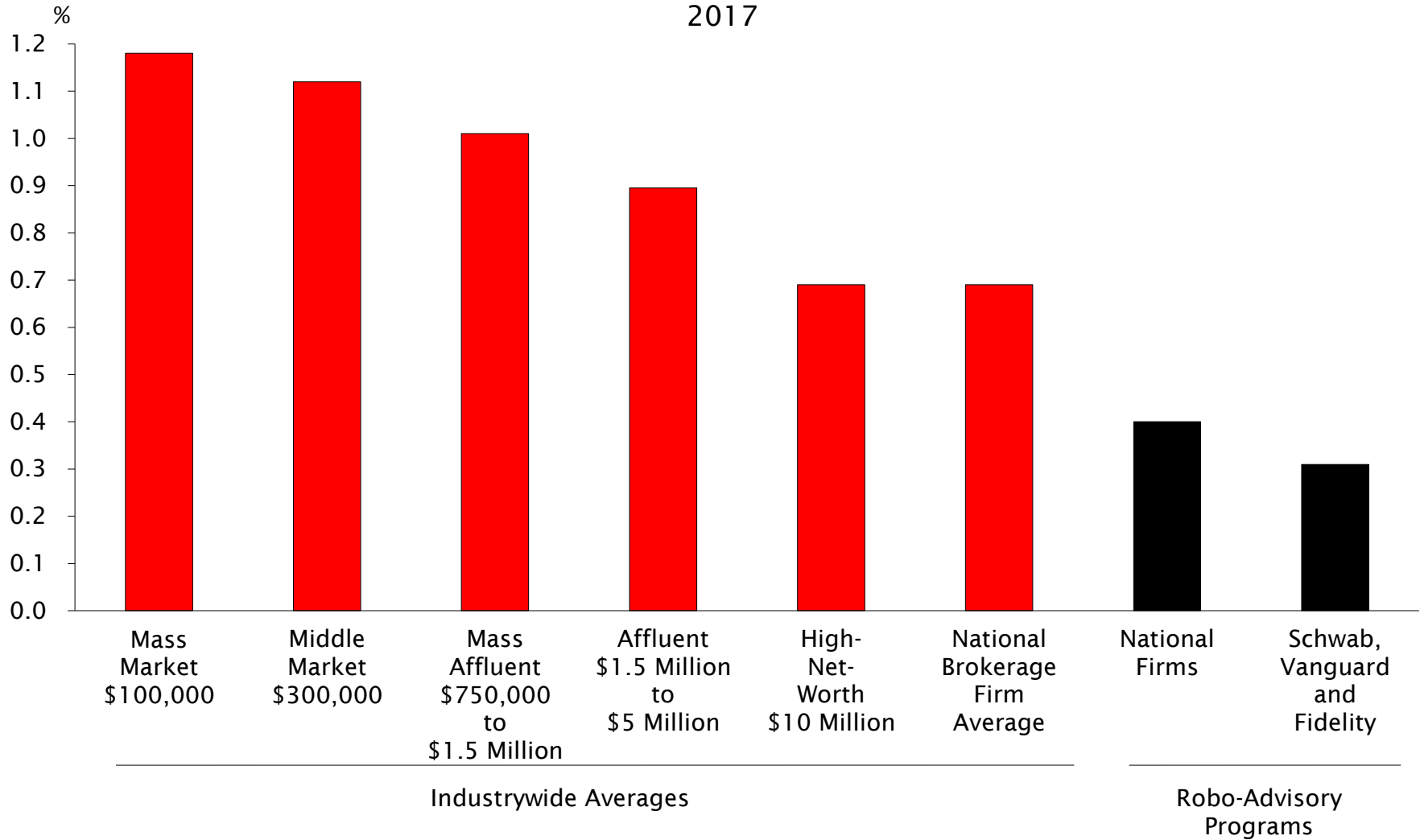


¹Currently Morgan Stanley Smith Barney, Wells Fargo and Company, Bank of America Merrill Lynch and UBS Wealth Management.

²Mutual fund expense ratios are asset-weighted and exclude 12B-1 fees.

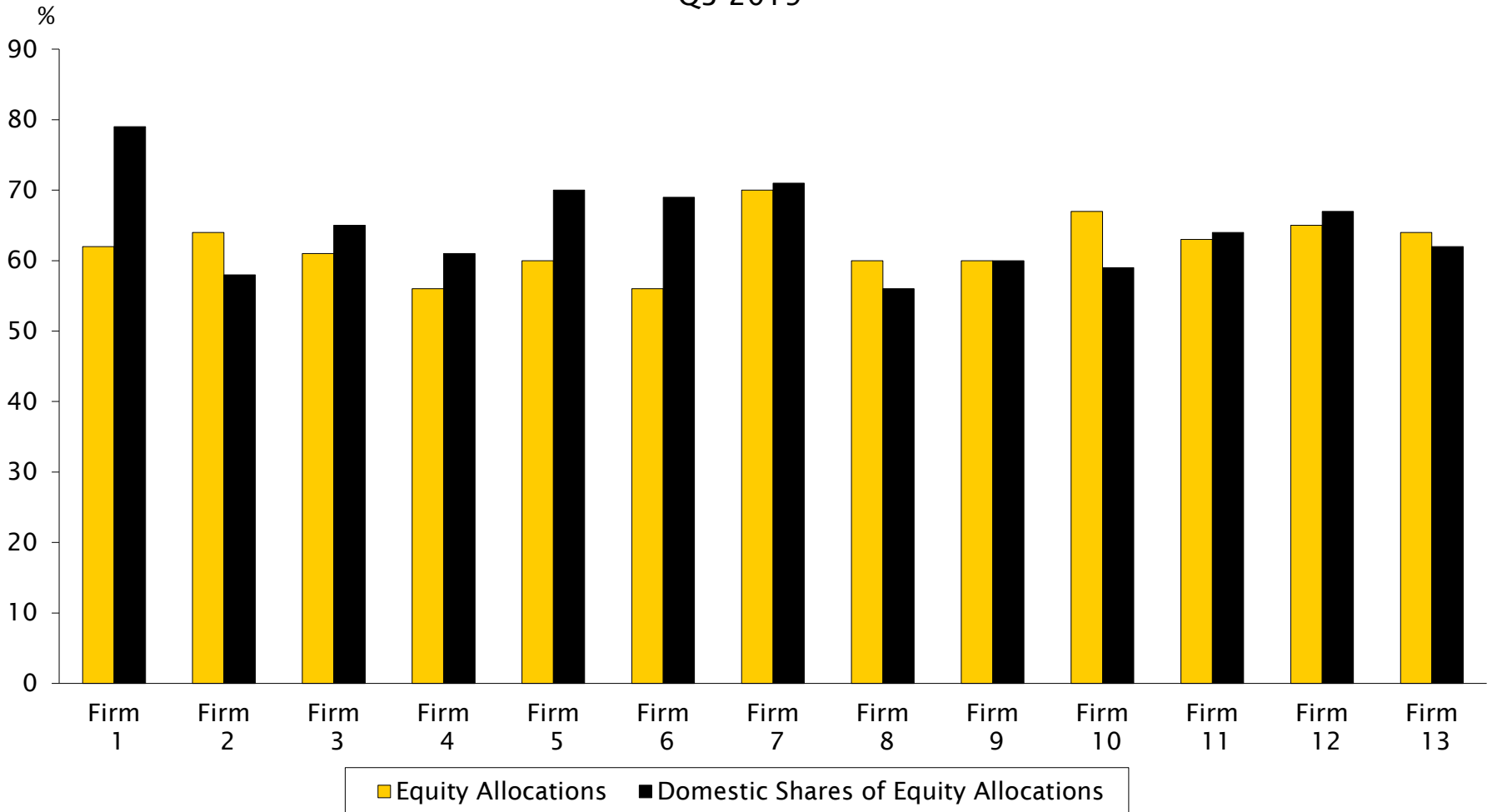
...And the Pressure is from Both Outside and Within

The Price of Advice
Asset-Weighted Fees by Market Segment
2017



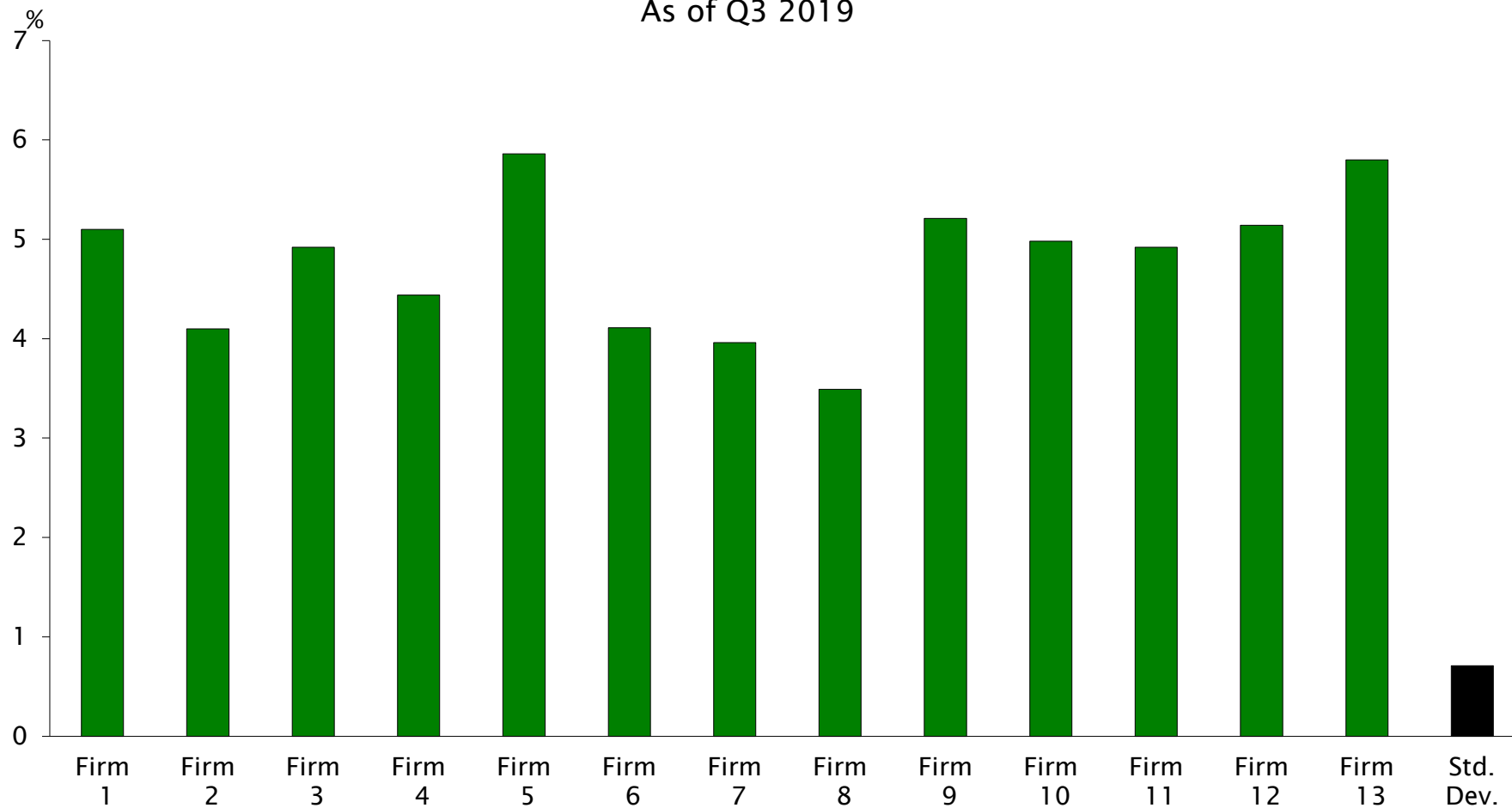
Most Robo-Advisory Asset Allocation Schemes are Similar...

Robo Advisors
Equity Allocations in Taxable Accounts and Their Domestic Shares
Q3 2019



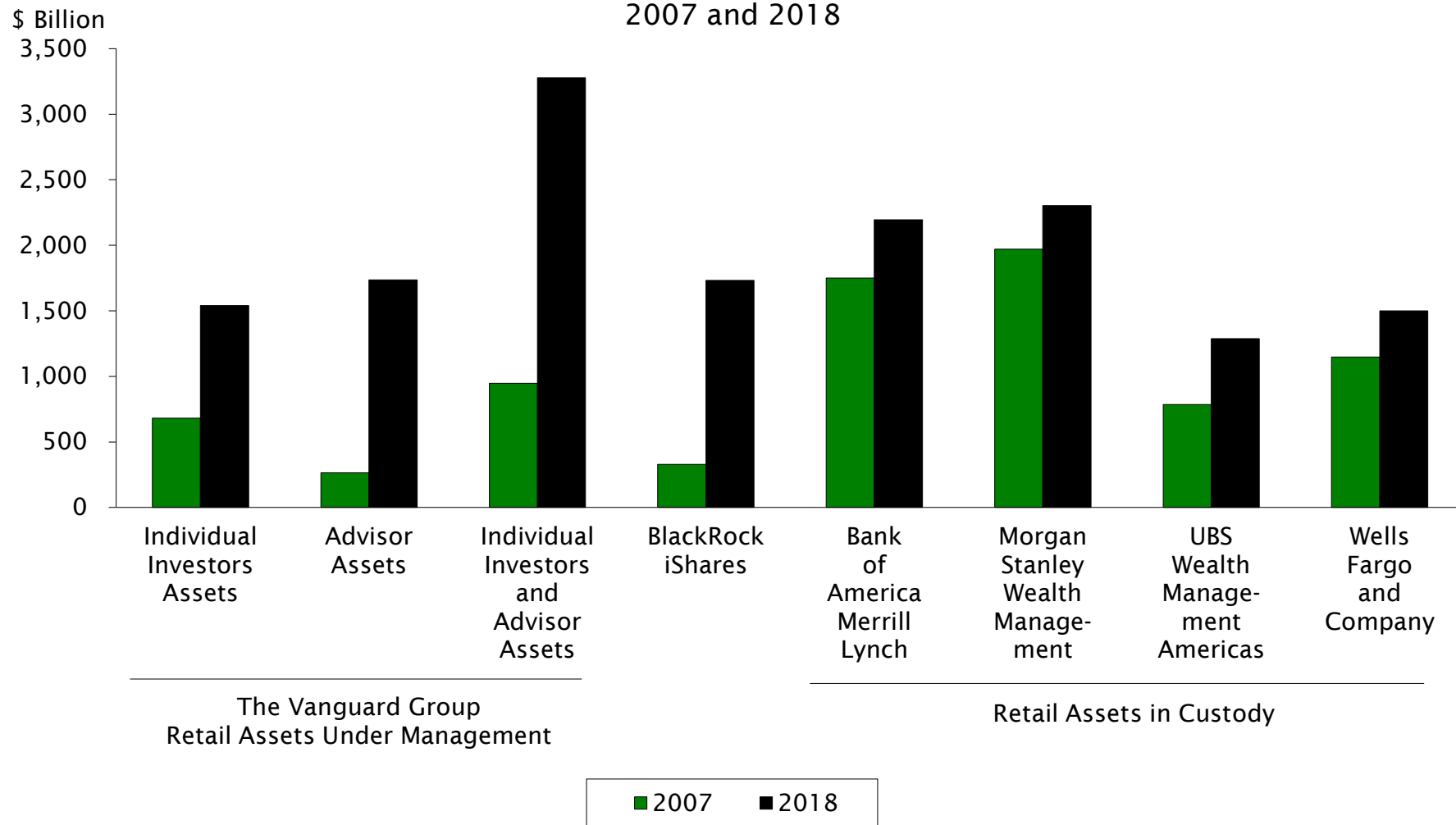
...As Apparent in the Distribution of Returns

Robo Advisors
Trailing Two-Year Annualized Returns in Taxable Accounts
As of Q3 2019



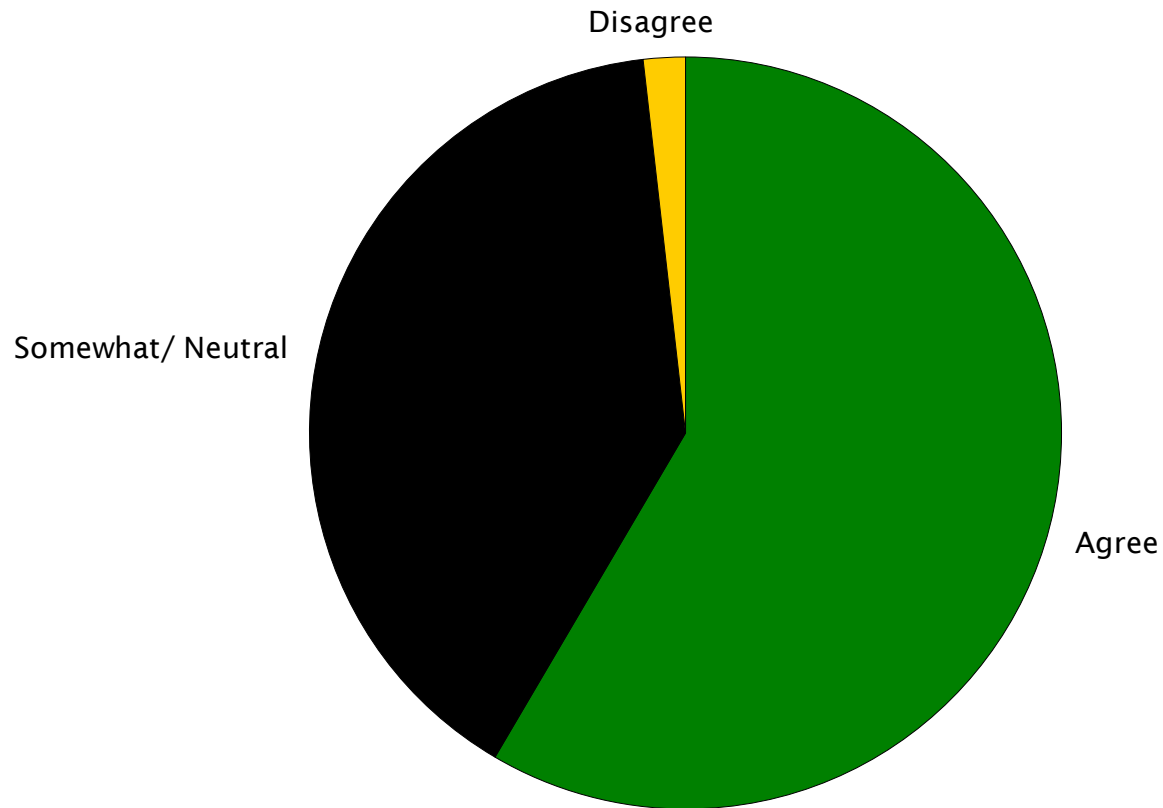
There's Been a Shift in the Landscape

The Vanguard Group, iShares and the National Full-Service Brokerage Firms
Retail Assets Under Management/In Custody
2007 and 2018



The Bar for Service Keeps Moving Up

U.S. Defined-Contribution Plans Employer Has Responsibility to Improve Employee Financial Wellness: Share Agreeing 2018



Issues Facing the U.S. Money Management Industry

Conclusions

- The trends in the industry are byproducts of those in the global economy. Demand fosters supply.
- The dominance of the baby boomer generation among asset holders has created inertia, thus far limiting disruption on some fronts.
- The nature of the advice proposition has changed with the shift toward indexing.
- The distinction between money managers and distributors has become increasingly blurred.
- Corporate free cash flow generation, low-cost money management/liquidity along with cheap leverage were the themes of the 2010s.