Independent Directors Council
Promoting Excellence in Fund Governance

Shareholder Response to Market Volatility: FAQs

Frequently Asked Questions About Shareholder Response to Market Volatility

How do mutual fund shareholders respond to stock market volatility?

Historically, mutual fund investors have reacted calmly and without panic in response to stock market volatility. The Investment Company Institute has conducted a number of studies that show fund investors have never responded to sharp market breaks by redeeming shares en masse. Fund investors have an adequate understanding of investment risks and tend to take a long-term approach to their investments. While fund shareholders are not insensitive to long-term declines in stock prices, their response has been measured and gradual. There is no evidence that this long-established pattern of behavior will change.

Why do mutual fund shareholders react calmly?

ICI research indicates that fund shareholders typically are experienced investors with long-term investment objectives, such as retirement. Most fund shareholders made their first fund investment more than a decade ago. Fund investors tend to take periods of volatility in stride. ICI research finds that the "typical" shareholder is middle aged, employed with moderate household income, suggesting that retirement is still years in the future. Fund owners consistently indicate that they are not concerned with short-term market fluctuations.

Do mutual fund shareholders get professional investment advice?

Yes. Institute studies indicate that a majority of mutual fund shareholders use a professional financial adviser in making investment decisions about allocating financial assets. According to Institute research, an estimated 82 percent of new sales of long-term (equity, bond, and hybrid) funds were made through a third party or intermediary in 1999, up from 77 percent in 1990. During the same period, new sales of long-term funds made directly from fund companies to investors fell to 18 percent from 23 percent.

Do net redemptions from stock funds occur?

As with new sales, redemptions are a normal part of the mutual fund business. Net redemptions or outflows occur when the amount of shares redeemed exceeds the amount of new purchases of shares by investors. However, net redemptions are not generally a result of a spike in shareholder redemption, but rather a decrease in new sales. During market downturns, mutual fund shareholders typically slow the rate at which they purchase new shares of mutual funds, and outflows may occur as the result of slowing in sales. The largest outflow since 1945, measured as a percentage of stock fund assets, occurred during and immediately after the 1987 stock market break, yet amounted to only 3.1 percent of total stock fund assets. In March of 2001, $15.7 billion net redemption from domestic stock funds was recorded. That amounted to 54 cents for every $100 invested in stock funds.

What types of mutual funds do shareholders own?

The typical shareholder owns several funds. Equity funds are the most widely held type of fund, which 88 percent of shareholders own. Forty-eight percent of shareholders own money market funds, 42 percent own bond funds and 35 percent own hybrid funds, which invest in a mix of stocks and bonds.

Do mutual funds influence stock market prices?

There is no established correlation between mutual fund cash flows and stock market activity. In fact, Federal Reserve researchers have found no evidence that equity fund flows cause stock market prices to change. Funds account for only a minority of U.S. corporate stock. Households, pension funds and insurance companies hold about 80 percent of equities in the domestic stock market, while mutual funds hold about 20 percent.

How much of domestic stock mutual fund assets are held in retirement vehicles?

Nearly half (47.5 percent) of domestic stock mutual fund assets are held in retirement vehicles—such as 401(k) plans and individual retirement accounts. Such holdings are long-term in nature. Over the past two decades, the growth of IRAs and defined contribution plans has given U.S. households considerably more control over the portfolio allocation of their retirement assets. At the same time, mutual funds have become an increasingly important component of households' retirement accounts. Research indicates that most shareholders are unlikely to trade frequently or redeem fund shares precipitously.

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