

# The Passive Vs. Active Fund Monitor

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## → Summary

This report describes the competitive landscape for passively and actively managed funds since 2006 in Canada and the United States.

In 2018, Canadian passive funds increased their market share from 10.0% to 10.5% on the back of a positive flow of \$9 billion. Meanwhile, Canadian active funds attracted \$6 billion. We estimate that Canadian passive funds post a weighted average Management Expense Ratio of 0.30%, compared to a substantial 1.66% for active funds. In the U.S., passive funds increased their market share from 35% to 37%. U.S. passive funds attracted \$453 billion. Meanwhile, active funds experienced an outflow of \$304 billion.

Since 2007, Canadian passive funds have doubled their market share, from 4.8% to 10.5%. During that period, passive funds attracted a cumulative \$70 billion in net new money compared to \$83 billion for active funds. Since 2006, U.S. passive funds have more than doubled their market share, from 16% to 37%, and attracted a net money flow of \$3.8 trillion, compared to a modest \$583 billion for active funds.

Overall, passive funds are slowly gaining ground in Canada, while grabbing market share at a fast pace in the U.S. If passive funds keep increasing market share at the current rate, they could represent 50% of the U.S. fund industry by 2025. We also highlight the substantial savings realized by the Canadian investors who choose passive funds. Considering the 1.36% fee difference between active and passive fund fees, we estimate this net saving to \$1.6 Billion dollar for 2018. In our opinion, an individual active manager needs exceptional skill to overcome such a high hurdle in favor of passive funds and outperform a basic, total market fund.

This report was written by Raymond Kerzérho, 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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This report describes the competitive landscape for passively and actively managed funds over the last thirteen 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. We also document the difference in fees between passive and active funds in Canada.

# 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 maintain a consistent methodology between the U.S. and Canadian market data. 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 mutual funds and ETFs, which are considered similar in characterization to active funds due to their investment approach. Consequently, we include the latter three subcategories among active funds<sup>1</sup>. Lastly, the Canadian mutual fund data excludes segregated funds sold by life insurance companies.

<sup>1</sup>In contrast with previous editions of the Passive vs. Active Fund Monitor, funds from Dimensional Fund Advisors have been reclassified into actively-managed funds to reflect the methodology used by Morningstar for U.S.-domiciled mutual funds.

## 2 Canadian Market 2007–2018

### 2.1 Market Share

In 2018, the market share of passive funds increased 0.5%, from 10.0% to 10.5%. The data for Canada displays a positive trend in terms of passively managed funds taking an increasing percentage of the market, from a meager 4.8% in 2007 to 10.5% currently. Correspondingly, the market share of actively managed funds has fallen from 95.2% of the market to 89.5%.

The Canadian data shows not only an upward trend in the market share of passive funds, but also a strong growth rate for these funds between the years 2007 and 2018. Passive funds experienced an impressive 381% growth rate during this period, compared to 109% for active funds. In other words, passive funds grew almost four times faster than active funds during the 2007–2018 period. However, passive fund gains in market share have not been steady, as periods with solid gains (2007-2009, 2012 and 2017-18) did alternate with periods of stagnation (2010-2011, 2013-2016).

**Table 1: Assets Under Management in Canada (CAD Billions)**

	PASSIVE	ACTIVE
2007	24	480
2008	22	360
2009	34	448
2010	39	488
2011	43	535
2012	55	579
2013	63	633
2014	71	744
2015	79	868
2016	94	944
2017	115	1,036
2018	117	1,003

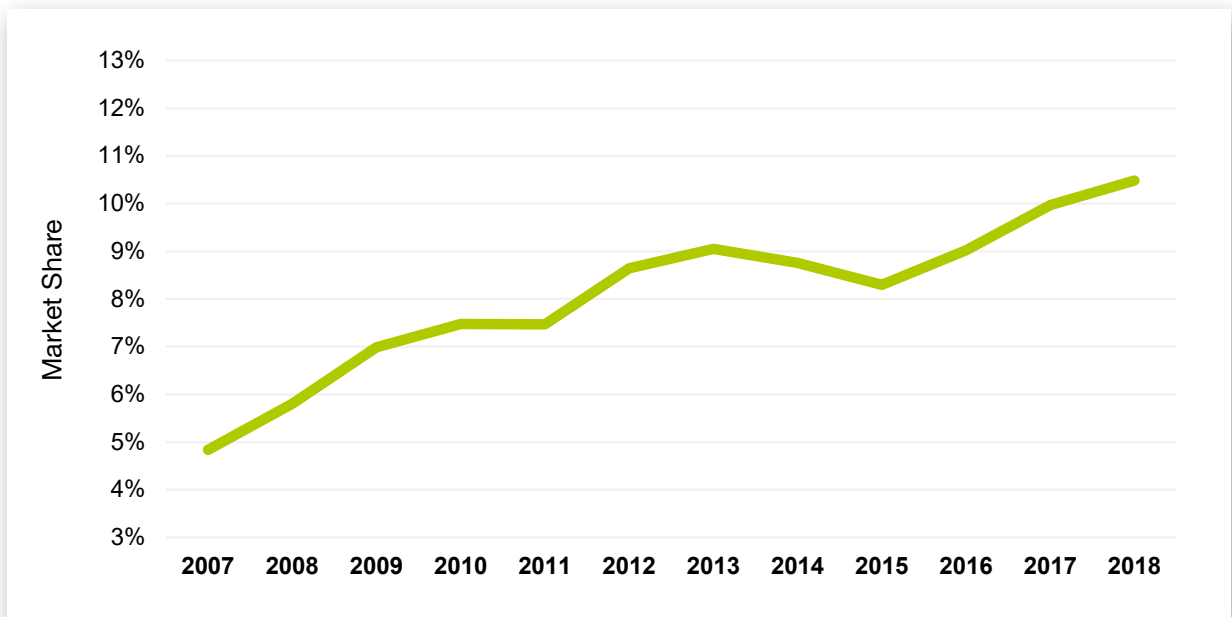
Source: Morningstar

**Table 2: Market Share—Canada**

	PASSIVE	ACTIVE
2007	4.8%	95.2%
2008	5.8%	94.2%
2009	7.0%	93.0%
2010	7.5%	92.5%
2011	7.5%	92.5%
2012	8.6%	91.4%
2013	9.1%	90.9%
2014	8.8%	91.2%
2015	8.3%	91.7%
2016	9.0%	91.0%
2017	10.0%	90.0%
2018	10.5%	89.5%

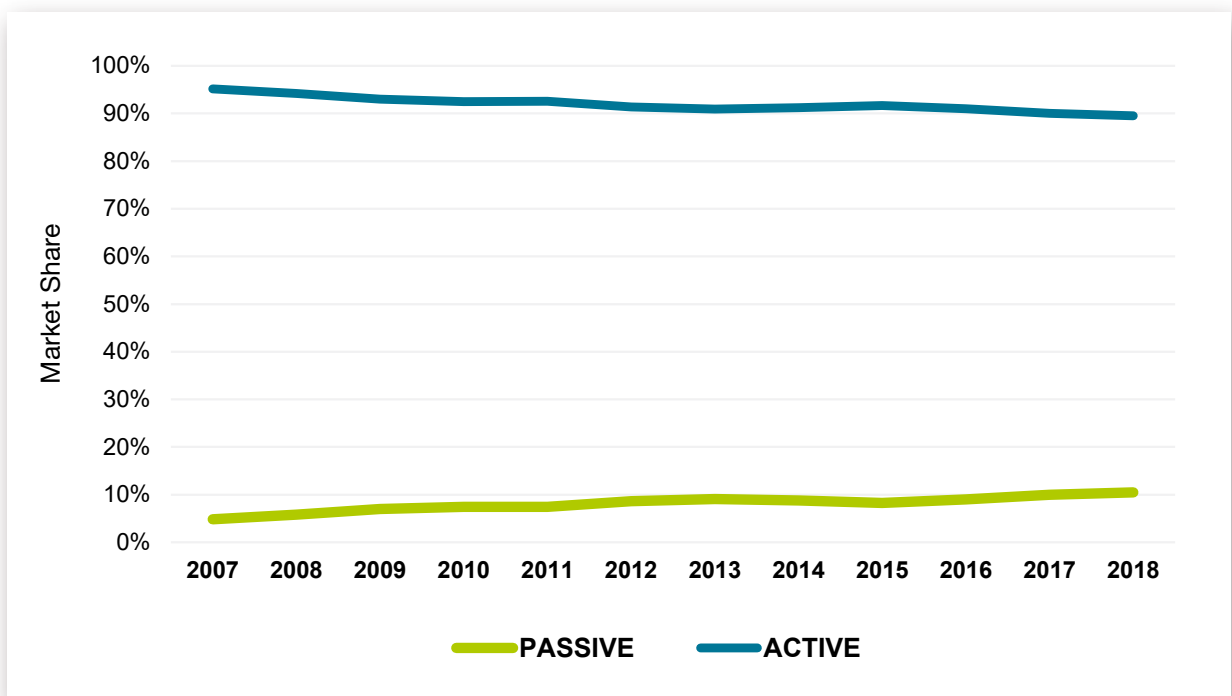
Source: Morningstar

### Chart 1: Passive Fund Market Share in Canada



Source: Morningstar

### Chart 2: Passive & Active Fund Market Share in Canada



Source: Morningstar

## 2.2 Flow of Funds

Chart 3 shows the flow of money into passive and active Canadian funds between 2008 and 2018. In 2018, passive funds collected \$9.1 billion, compared to \$6.3 billion for active funds. As regards multi-year trends, the net flow into passive funds has been stable and positive every year since 2008. Over that same period, the flow of money in and out of active funds has been highly volatile. In fact, Canadian active funds faced significant net withdrawals from 2008 to 2010, during and shortly after the great financial crisis. However, active funds have strongly recovered since 2014, with solid positive inflows.

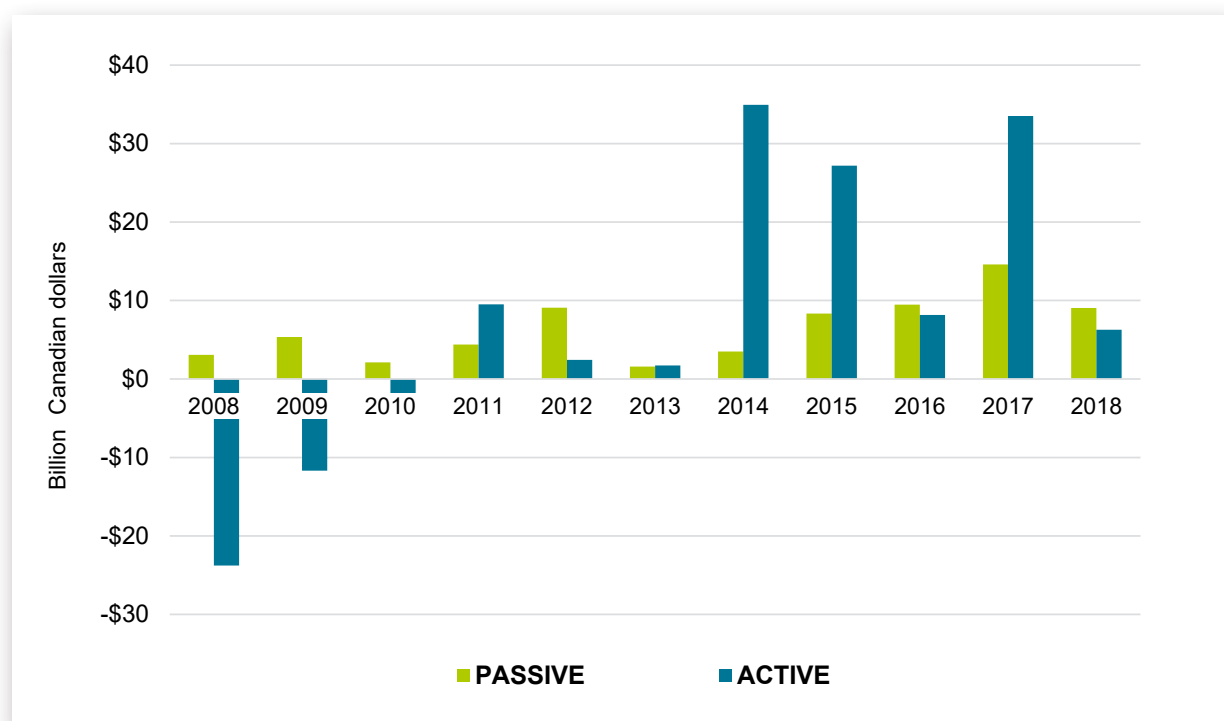
Overall, since 2008, Canadian passive funds have attracted a \$70 billion net inflow, compared to \$83 billion for active funds.

**Table 3: Canadian Flow of Funds into Passive and Active Funds (CAD Billions)**

	PASSIVE	ACTIVE
2008	3.1	-23.8
2009	5.4	-11.7
2010	2.1	-4.8
2011	4.4	9.5
2012	9.1	2.4
2013	1.6	1.7
2014	3.5	34.9
2015	8.4	27.2
2016	9.5	8.2
2017	14.6	33.5
2018	9.1	6.3

Source: Morningstar

**Chart 3: Canada Flow of Funds - Passive vs. Active**



Source: Morningstar



## 2.3 Passive vs. Active Management Expense Ratio

We estimate the weighted average management expense ratio (MER) for Canadian Passive ETFs to 0.24%, compared to 0.64% for active ETFs. Passive mutual funds cost an average MER of 0.74% compared to 1.73% for active mutual funds. All-in-all, we estimate the weighted average MER to 0.30% for passive mutual funds and ETFs, compared to 1.66% for their active counterpart. According to our analysis, passive funds in general offer a 1.36% saving compared to active funds.

**Table 4: Management Expense Ratios for Passive and Active Funds**

	ACTIVE	PASSIVE	DIFFERENCE
ETFs	0.64%	0.24%	0.40%
Mutual Funds	1.73%	0.74%	0.99%
ETFs + Mutual Funds	1.66%	0.30%	1.36%

Source: Morningstar

# 3 U.S. Market 2006–2018

## 3.1 Market Share

In 2018, the market share of passive funds increased by two percentage points, from 35% to 37%. Over thirteen years, the data shows a significant increase in market share for passively invested funds, from 16% to 37% between 2006 and 2018. The market share of active funds, on the other hand, fell from 84% to 63% over the same period. Passive funds also experienced an astonishing growth rate of approximately 420% in 2006–2018, compared to only 66% for active funds. The growth rate of passively managed funds outpaced that of active ones by a ratio of 6:1. In dollar terms, passive funds increased their assets under management (AUM) by \$5.1 trillion compared to \$4.3 trillion for active funds. Active funds increased their AUM mostly on the back of the market gains having a larger asset base. By contrast, passive funds have attracted a lot more money in the last 13 years than have active funds (details in Section 3.2).

**Table 5: Assets Under Management in the U.S. (USD Trillions)**

	PASSIVE	ACTIVE
2006	1.2	6.5
2007	1.5	7.2
2008	1.1	4.7
2009	1.5	6.3
2010	1.9	7.3
2011	2.0	7.2
2012	2.5	8.3
2013	3.2	9.8
2014	3.7	10.4
2015	4.0	10.0
2016	4.8	10.3
2017	6.3	11.8
2018	6.3	10.8

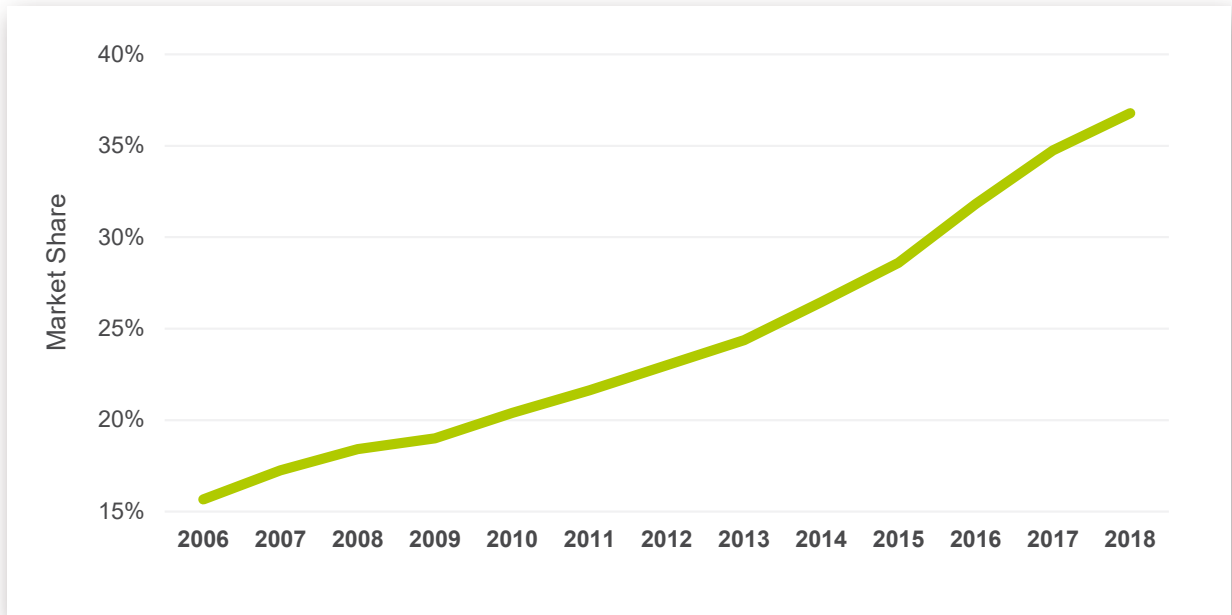
Source: Morningstar

**Table 6: Market Share—U.S.**

	PASSIVE	ACTIVE
2006	16%	84%
2007	17%	83%
2008	18%	82%
2009	19%	81%
2010	20%	80%
2011	22%	78%
2012	23%	77%
2013	24%	76%
2014	26%	74%
2015	29%	71%
2016	32%	68%
2017	35%	65%
2018	37%	63%

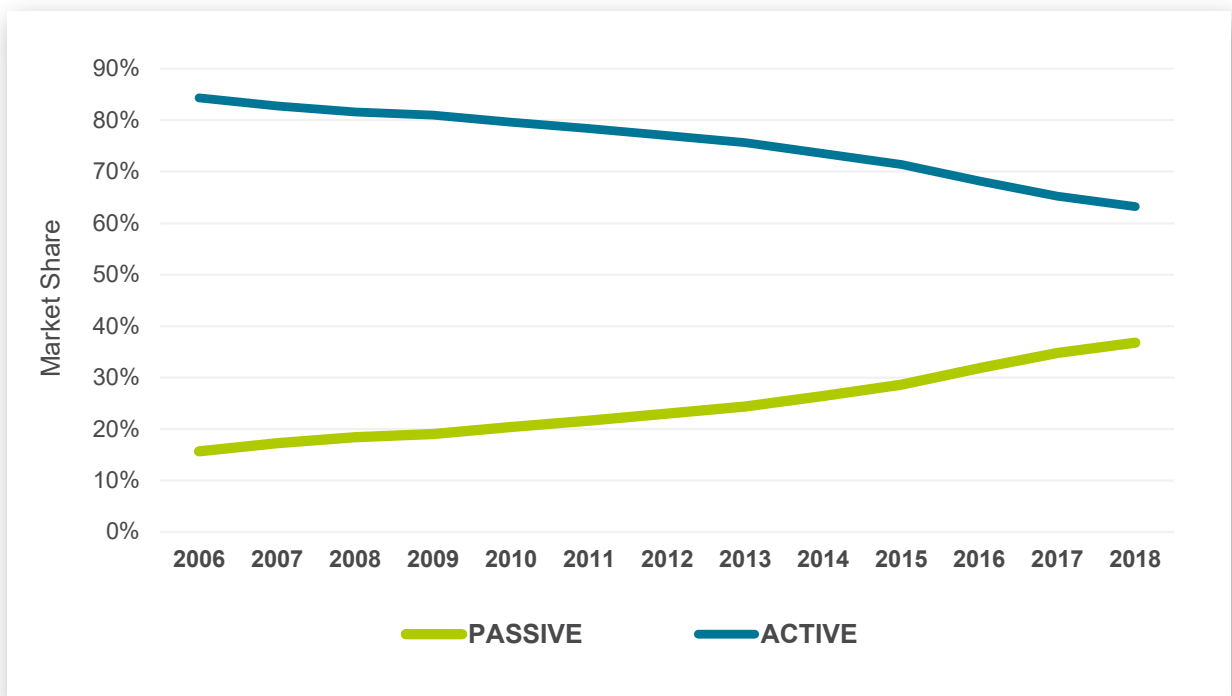
Source: Morningstar

Chart 4: Passive Fund Market Share in the U.S.



Source: Morningstar

Chart 5: Passive & Active Fund Market Share in the U.S.



Source: Morningstar

## 3.2 Flow of Funds

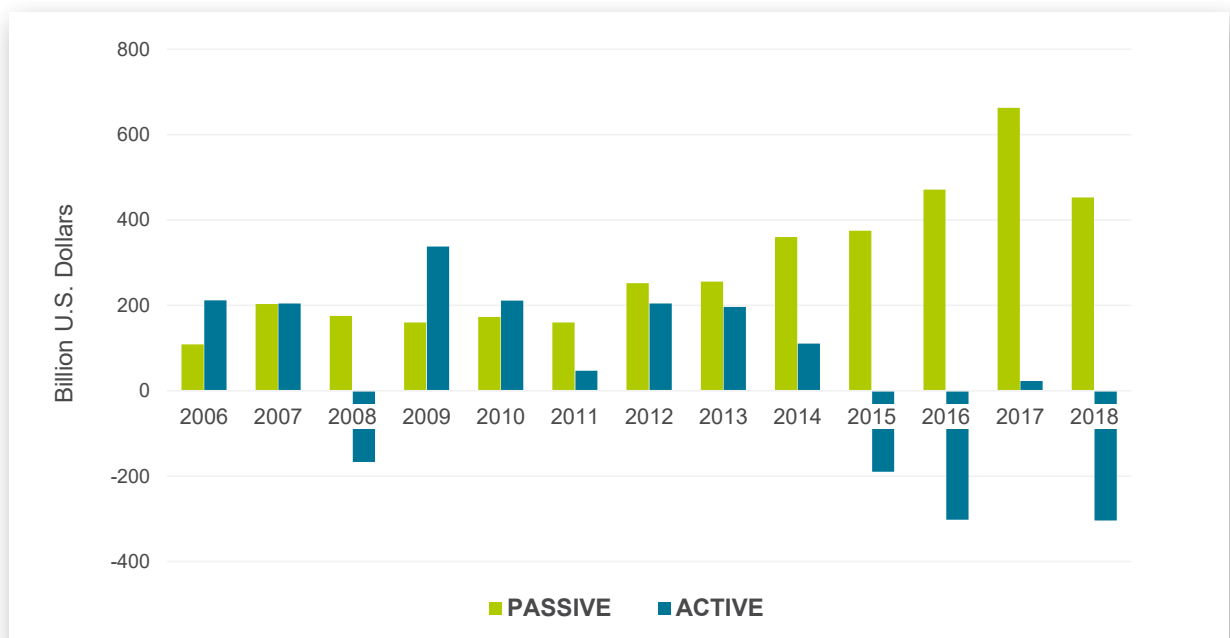
Chart 6 illustrates the flow of U.S. money into passive and active funds between 2006 and 2018. In 2018, passive funds attracted \$453 billion in new money, whereas active funds suffered outflows of \$304 billion. Since 2006, the flows in and out of active funds have been very volatile. Active funds were hit by negative cash flows in four different years: 2008, 2015, 2016 and 2018. The negative flow of funds out of active funds stands in stark contrast to the positive figures for passive fund investments, which have attracted more than \$350 billion in new money in each of the last five years. From 2006 to 2018, passive funds attracted \$3.8 trillion in net new money, compared to only \$583 billion for active funds.

Table 7: U.S. Flow of Funds into Passive and Active Funds (USD Billions)

	PASSIVE	ACTIVE
2006	109	212
2007	203	205
2008	176	<b>-167</b>
2009	160	338
2010	173	211
2011	160	47
2012	252	205
2013	256	196
2014	360	110
2015	375	<b>-190</b>
2016	471	<b>-302</b>
2017	663	23
2018	453	<b>-304</b>

Source: Morningstar

Chart 6: US Flow of Funds - Passive vs. Active



Source: Morningstar

## 4 Conclusion

The competitive landscape is better understood in light of the similarities and differences between the Canadian and U.S. retail fund markets.

Since 2007–2008, both Canadian and U.S. passive funds attracted positive net new money steadily, whereas the flow of funds toward active management has been extremely volatile. It is also true that passive funds have at least doubled their market share on both sides of the border. But the data also reveals major differences between the Canadian and U.S. markets.

The passive investment industry is huge in the U.S. compared to Canada. With \$6.3 trillion (USD) in assets under management, the U.S. completely dwarfs Canada's tiny \$117 billion (CAD). Even after adjusting for the exchange rate and the size difference between the U.S. and Canadian economies, U.S. passive funds manage seven times more money than their Canadian counterparts.

While Canadian passive funds are gaining ground very slowly, U.S. passive funds are growing extremely fast. Back in 2006, U.S.-domiciled active funds managed \$5 for every dollar managed by passive funds. Nowadays, this ratio has fallen to less than \$2 for \$1. Meanwhile, in Canada, this ratio of actively to passively managed funds is still at more than \$8 for \$1. Furthermore, our 10.5% estimate for the Canadian market share of passive funds may be overstated, because a large portion of the Canadian mutual fund marketplace is occupied by funds of funds, which were excluded from our analysis to maintain consistency with the Morningstar U.S. fund methodology and to avoid double-counting issues.

We also highlight the substantial savings realized by the Canadian investors who choose passive investing. Considering the 1.36% fee difference between active and passive fund MERs, we estimate this net saving to \$1.6 billion dollar in 2018. In our opinion, an individual active manager needs exceptional skills to overcome such an advantage in favor of passive funds.

# Appendix A: Canadian ETF Data

Source: Morningstar

**Table 8: Assets Under Management (CAD Billions)**

	PASSIVE	ACTIVE
2007	12.4	4.2
2008	12.0	5.4
2009	19.3	7.6
2010	22.9	8.6
2011	25.2	9.8
2012	33.8	11.4
2013	38.1	11.6
2014	45.7	15.6
2015	52.9	18.3
2016	66.5	26.5
2017	85.1	36.2
2018	89.9	40.4

**Table 9: Market Share**

	PASSIVE	ACTIVE
2007	68.7%	31.3%
2008	71.7%	28.3%
2009	72.6%	27.4%
2010	72.0%	28.0%
2011	74.7%	25.3%
2012	76.6%	23.4%
2013	74.5%	25.5%
2014	74.3%	25.7%
2015	71.5%	28.5%
2016	70.2%	29.8%
2017	69.0%	31.0%
2018	74.9%	25.1%

**Table 10: Flow of Funds (CAD Billions)**

	PASSIVE	ACTIVE
-	-	-
2008	2.8	2.1
2009	4.1	1.4
2010	1.2	0.7
2011	3.4	1.6
2012	7.3	1.6
2013	2.8	0.6
2014	5.0	3.7
2015	9.2	2.4
2016	9.7	4.7
2017	14.8	7.7
2018	9.9	7.5

# Appendix B: Canadian Mutual Fund Data

Source: Morningstar

**Table 11: Assets Under Management (CAD Billions)**

	PASSIVE	ACTIVE
2007	12.0	476.1
2008	10.2	354.5
2009	14.3	440.1
2010	16.5	479.4
2011	18.0	525.1
2012	21.0	567.5
2013	24.9	621.5
2014	25.7	728.2
2015	25.6	849.7
2016	27.1	917.3
2017	29.6	999.7
2018	27.6	962.8

**Table 12: Market Share**

	PASSIVE	ACTIVE
2007	2.5%	97.5%
2008	2.8%	97.2%
2009	3.2%	96.8%
2010	3.3%	96.7%
2011	3.3%	96.7%
2012	3.6%	96.4%
2013	3.9%	96.1%
2014	3.4%	96.6%
2015	2.9%	97.1%
2016	2.9%	97.1%
2017	2.9%	97.1%
2018	2.8%	97.2%

**Table 13: Flow of Funds (CAD Billions)**

	PASSIVE	ACTIVE
-	-	-
2008	0.3	<b>-25.8</b>
2009	1.2	<b>-13.1</b>
2010	0.9	<b>-5.6</b>
2011	1.0	7.9
2012	1.7	0.8
2013	<b>-1.2</b>	1.1
2014	<b>-1.5</b>	31.2
2015	<b>-0.8</b>	24.8
2016	<b>-0.2</b>	3.5
2017	<b>-0.2</b>	25.8
2018	<b>-0.8</b>	<b>-1.2</b>

# Appendix C: U.S. ETF Data

Source: Morningstar

**Table 14: Assets Under Management (USD Billions)**

	PASSIVE	ACTIVE
2006	383	49
2007	548	75
2008	466	76
2009	687	106
2010	887	127
2011	936	126
2012	1,203	145
2013	1,476	225
2014	1,736	269
2015	1,859	277
2016	2,245	311
2017	3,036	404
2018	3,009	392

**Table 15: Market Share**

	PASSIVE	ACTIVE
2006	89%	11%
2007	88%	12%
2008	86%	14%
2009	87%	13%
2010	87%	13%
2011	88%	12%
2012	89%	11%
2013	87%	13%
2014	87%	13%
2015	87%	13%
2016	88%	12%
2017	88%	12%
2018	88%	12%

**Table 16: Flow of Funds (USD Billions)**

	PASSIVE	ACTIVE
2006	57	8
2007	123	22
2008	126	39
2009	98	22
2010	107	13
2011	100	17
2012	179	11
2013	142	44
2014	210	32
2015	219	25
2016	265	22
2017	420	45
2018	282	31



# Appendix D: U.S. Mutual Fund Data

Source: Morningstar

**Table 17: Assets Under Management (USD Trillions)**

	PASSIVE	ACTIVE
2006	0.8	6.4
2007	1.0	7.1
2008	0.6	4.6
2009	0.8	6.2
2010	1.0	7.2
2011	1.1	7.1
2012	1.3	8.1
2013	1.7	9.6
2014	2.0	10.1
2015	2.2	9.7
2016	2.6	10.0
2017	3.3	11.4
2018	3.2	10.4

**Table 18: Market Share**

	PASSIVE	ACTIVE
2006	11%	89%
2007	12%	88%
2008	11%	89%
2009	11%	89%
2010	12%	88%
2011	13%	87%
2012	14%	86%
2013	15%	85%
2014	17%	83%
2015	18%	82%
2016	20%	80%
2017	22%	78%
2018	24%	76%

**Table 19: Flow of Funds (USD Billions)**

	PASSIVE	ACTIVE
2006	53	204
2007	80	183
2008	51	-204
2009	63	315
2010	67	198
2011	61	29
2012	74	194
2013	118	154
2014	155	78
2015	170	-214
2016	202	-325
2017	244	-22
2018	171	-335

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