

A low-angle, close-up shot of two runners' legs and feet as they jog on a dark asphalt road. A white dashed line runs down the center of the road. The background is a clear blue sky with some light clouds. The overall tone is energetic and forward-moving.

PWL

The Passive Vs. Active Fund Monitor

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This report was written by Raymond Kerzérho, PWL Capital Inc. The ideas, opinions, and recommendations contained in this document are those of the author and do not necessarily represent the views of PWL Capital Inc.

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Summary

This report describes the competitive landscape for passively and actively managed funds since 2010 in Canada and the United States.

In 2019, Canadian passive funds increased their market share from 11.1% to 12% on the back of a positive flow of \$15 billion. Meanwhile, Canadian active funds attracted \$19 billion. We estimate that Canadian passive funds post a weighted average Management Expense Ratio of 0.28%, compared to 1.59% for active funds. In the U.S., passive funds increased their market share from 37% to 39%. U.S. passive funds attracted \$488 billion. Meanwhile, active funds experienced an outflow of \$75 billion.

Since 2010, Canadian passive funds have increased their market share from 8% to 12%. During that period, passive funds attracted a cumulative \$84 billion in net new money compared to \$129 billion for active funds. During the same period, U.S. passive funds have increased their market share from 20% to 39%, and attracted a net money flow of \$3.7 trillion, compared to an outflow of \$79 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 will 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 1.31% fee difference between active and passive funds, we estimate this net saving to \$1.9 Billion dollar for 2019. In our opinion, an active manager needs exceptional skill to overcome such a high hurdle in favor of passive funds and outperform a basic, passive total market fund.

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This report describes the competitive landscape for passively and actively managed funds over the last ten 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 and the United States. 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. Lastly, the Canadian mutual fund data excludes segregated funds sold by life insurance companies.

In the section 2.3 “Passive vs. Active Management Expense Ratio in Canada”, we excluded the institutional share classes, since their MERs do not reflect all the fees being charged to investors¹. We also calculated the MERs for mutual funds excluding the most expensive “commission-based advice” mutual funds, which charge trailer fees as compensation to advisors.

¹ Institutional shares of mutual funds are generally offered to ultra-high net worth individuals and funds-of-funds. Their management fees are negotiated individually and are not accounted for in published MERs.

2 Canadian Market 2010–2019

2.1 Market Share

In 2019, the market share of passive funds increased 0.9%, from 11.1% to 12.0%. The data for Canada displays a positive trend in terms of passively managed funds taking an increasing percentage of the market, from 8% in 2007 to 12% currently. Correspondingly, the market share of actively managed funds has fallen from 92% of the market to 88%.

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 2010 and 2019. Passive funds experienced an impressive 280% growth rate during this period, compared to 143% for active funds. In other words, passive funds grew almost twice faster than active funds during the 2010–2019 period. However, passive fund gains in market share have not been steady, as periods with solid gains (2010–2013, and 2016–19) did alternate with a period of stagnation (2013–2015).

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

	PASSIVE	ACTIVE
2010	43	491
2011	48	535
2012	62	584
2013	71	643
2014	82	767
2015	89	894
2016	105	972
2017	128	1074
2018	129	1034
2019	163	1193
Growth 2010–2019	280%	143%

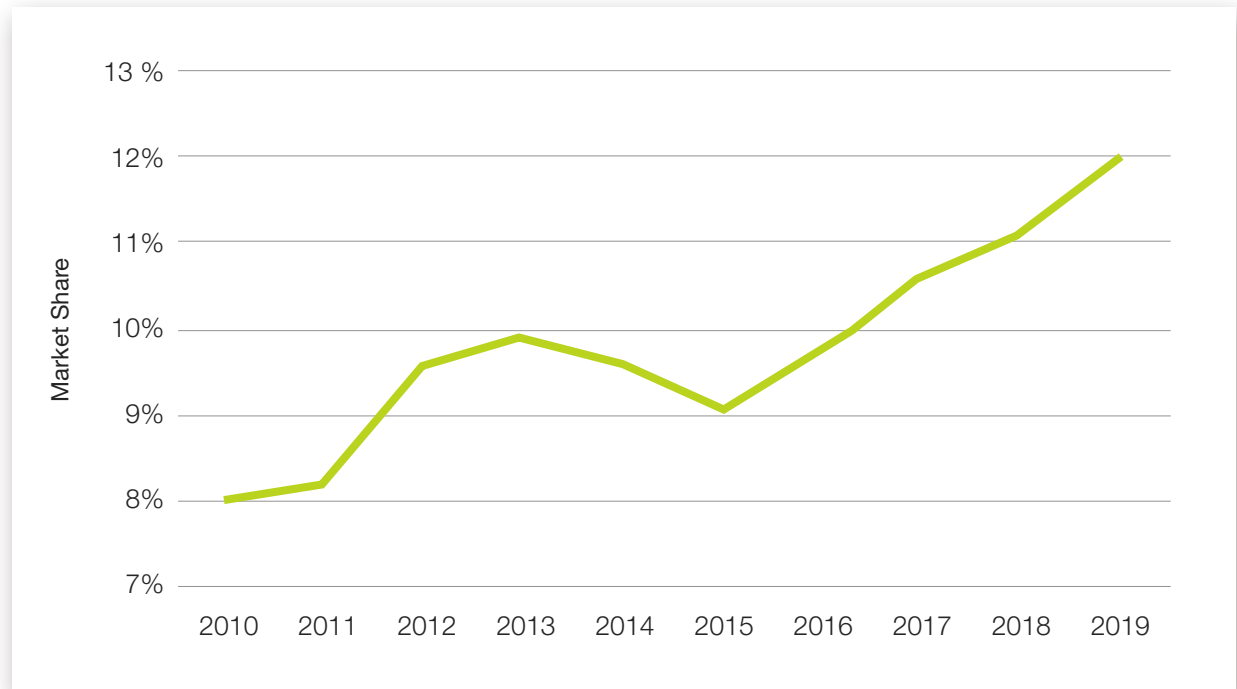
Source: Morningstar

Table 2: Market Share—Canada

	PASSIVE	ACTIVE
2010	8.0%	92.0%
2011	8.2%	91.8%
2012	9.6%	90.4%
2013	9.9%	90.1%
2014	9.6%	90.4%
2015	9.1%	90.9%
2016	9.8%	90.2%
2017	10.6%	89.4%
2018	11.1%	88.9%
2019	12.0%	88.0%

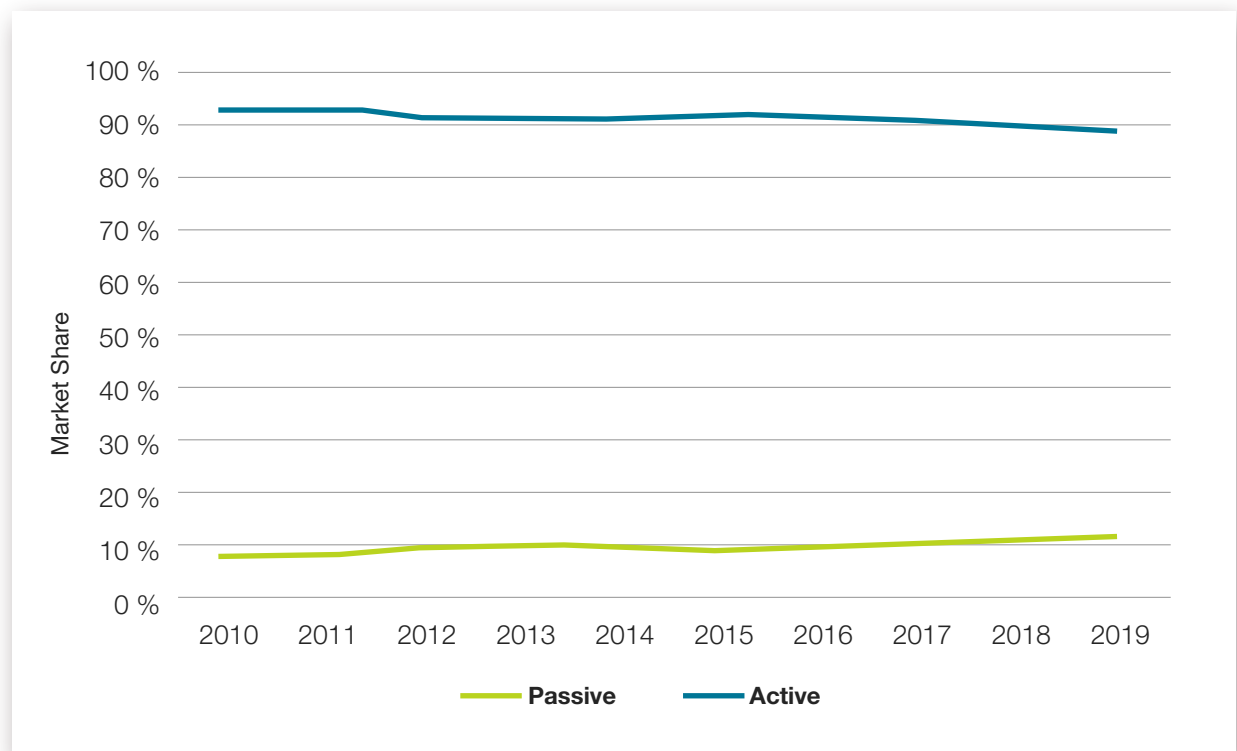
Source: Morningstar

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 2010 and 2019. In 2019, passive funds collected \$15 billion (a record), compared to \$19 billion for active funds. As regards multi-year trends, the net flow into passive funds has been stable and positive every year since 2010. Over that same period, the flow of money in and out of active funds has been highly volatile. In fact, Canadian active funds faced modest net withdrawals in 2010 to 2018.

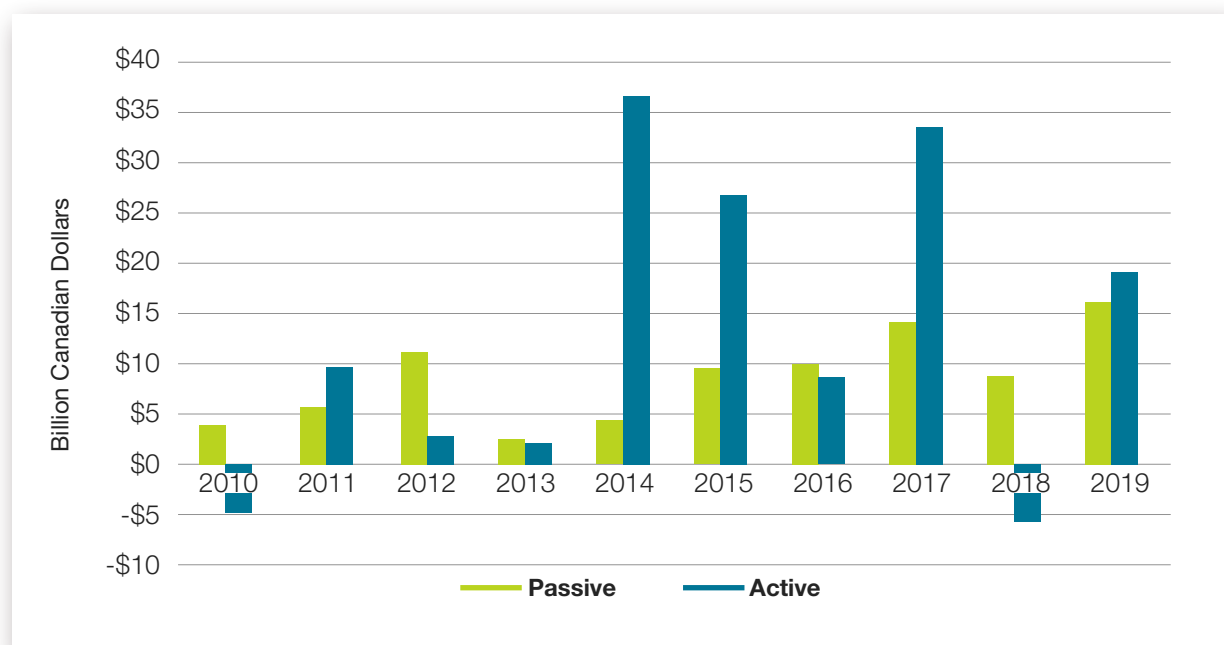
Overall, since 2010, Canadian passive funds have attracted a \$84 billion net inflow, compared to \$129 billion for active funds.

Table 3: Canadian Flow of Funds (CAD Billions)

	PASSIVE	ACTIVE
2010	3.7	-4.9
2011	5.6	9.7
2012	11.1	2.9
2013	2.3	2.1
2014	4.2	36.8
2015	9.5	26.9
2016	9.8	8.7
2017	14.1	33.8
2018	8.7	-5.9
2019	15.2	19.2
2010-2019	84.0	129.3

Source: Morningstar

Chart 3: Canada Flow of Funds



Source: Morningstar

2.3 Management Expense Ratios

We estimate the weighted average management expense ratio (MER) for Canadian active ETFs to 0.64%, compared to 0.23% for passive ETFs, resulting in a difference of 0.41%. Active mutual funds cost an average MER of 1.65% compared to 0.67% for passive mutual funds, a difference of 0.98%.

We have also performed the same calculations, this time excluding mutual funds that charge a trailer fee as compensation to financial advisers. With this exclusion, active mutual funds cost an average of 0.98%, compared to 0.41% for passive mutual funds, resulting in a 0.57% difference.

All-in-all, we estimate the weighted average MER to 1.59% for active mutual funds and ETFs, compared to 0.28% for their passive counterpart, resulting in a 1.31% difference between the cost of active and passive funds. If we exclude mutual funds that charge trailer fees, active mutual funds and ETFs combined display a weighted average MER of 0.98%, compared to 0.24% for passive products, a net difference of 0.74%.

Table 4: Management Expense Ratios

	ACTIVE	PASSIVE	DIFFERENCE
ETFs	0.64%	0.23%	0.41%
Mutual Funds	1.65%	0.67%	0.98%
Mutual Funds Excl. Trailer fees	0.98%	0.41%	0.57%
ETFs + Mutual Funds	1.59%	0.28%	1.31%
ETFs + Mutual Funds Excl. Trailer fees	0.98%	0.24%	0.74%

Source: Morningstar

3 U.S. Market 2010–2019

3.1 Market Share

In 2019, the market share of passive funds increased by two percentage points, from 37% to 39%. Over ten years, the data shows a significant increase in market share for passively invested funds, from 20% to 39%. The market share of active funds, on the other hand, fell from 80% to 61% over the same period. Passive funds also experienced an astonishing growth rate of 333% in 2010–2019, compared to only 74% for active funds. The growth rate of passively managed funds outpaced that of active ones by a ratio of 4:1. In dollar terms, passive funds increased their assets under management (AUM) by \$6.2 trillion compared to \$5.4 trillion for active funds. Active funds increased their AUM only on the back of the market gains, having recorded a net outflow during the period. By contrast, passive funds have attracted a huge amount money in the last 10 years (details in Section 3.2).

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

	PASSIVE	ACTIVE
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
2019	8.1	12.7
2010-2019 Growth	333%	74%

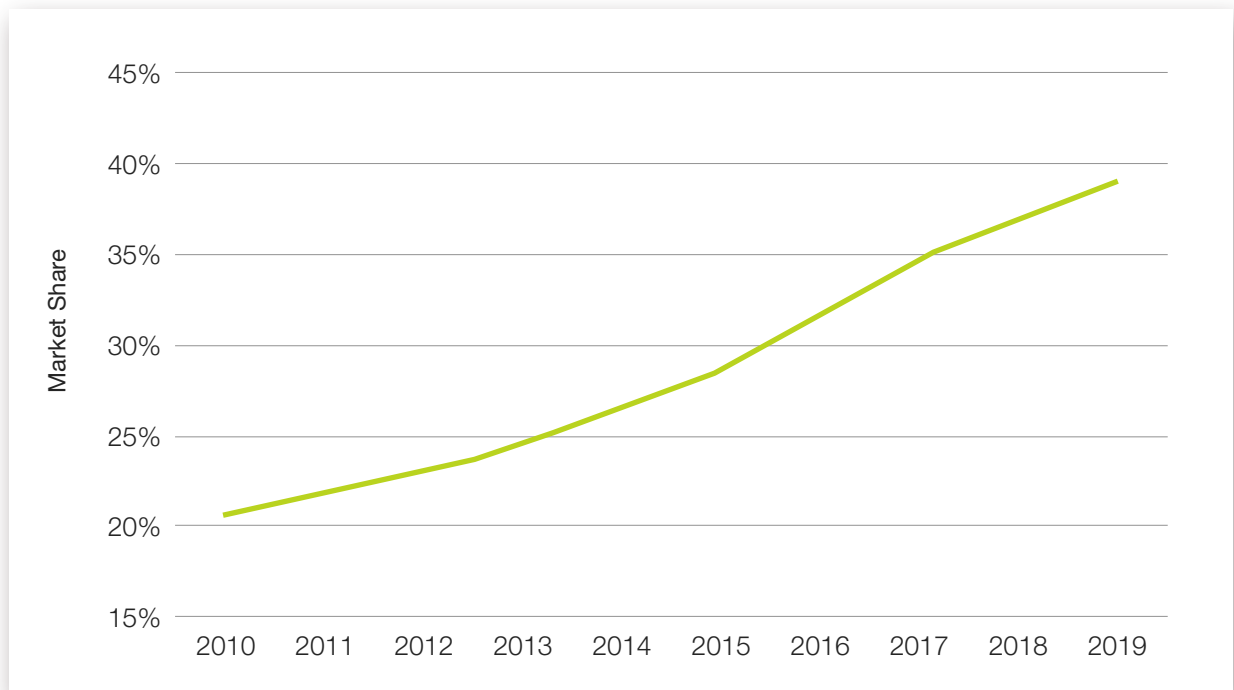
Source: Morningstar

Table 6: Market Share—U.S.

	PASSIVE	ACTIVE
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%
2019	39%	61%

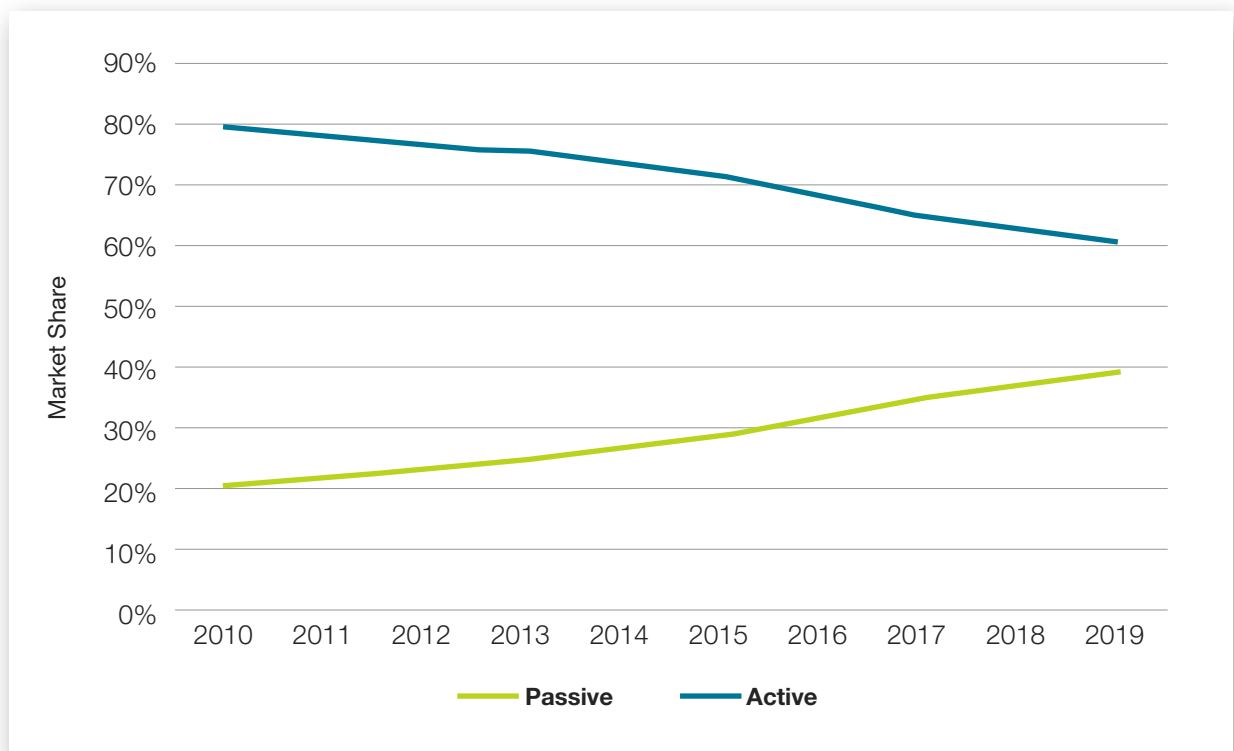
Source: Morningstar

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

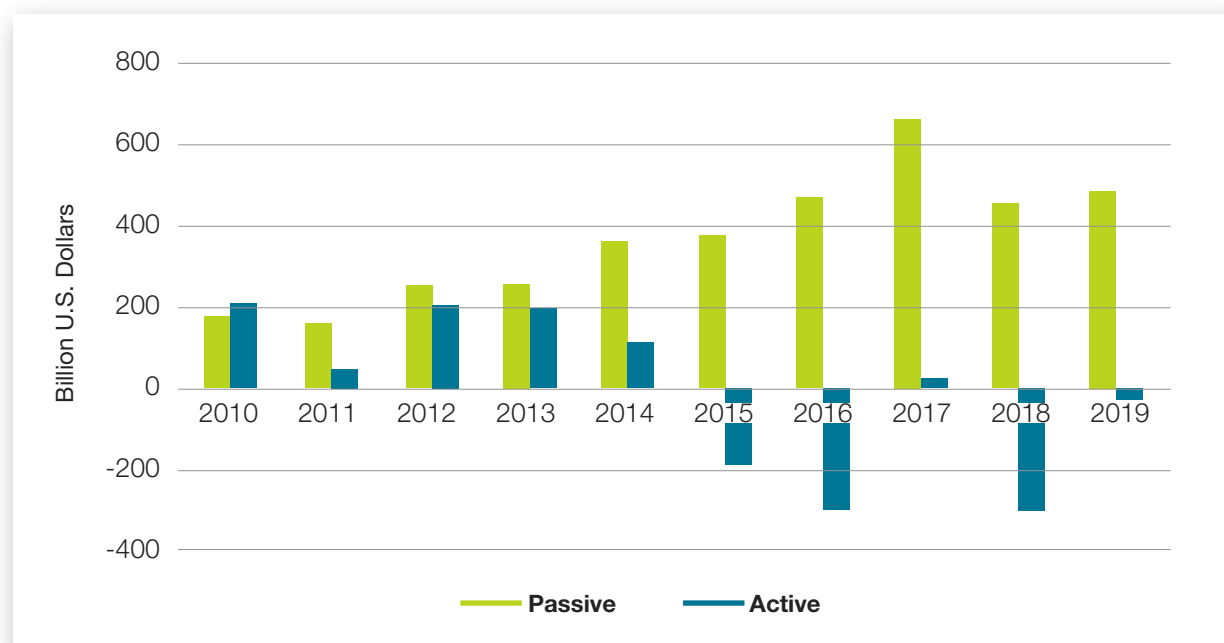
Chart 6 illustrates the flow of U.S. money into passive and active funds between 2010 and 2019. In 2019, passive funds attracted \$488 billion in new money, whereas active funds suffered outflows of \$75 billion. Active funds were hit by negative cash flows in four of the last five years. The negative flow of funds out of active funds stands in stark contrast to the steadily positive figures for passive fund investments, which have attracted more than \$350 billion in new money in each of the last five years. From 2010 to 2019, passive funds attracted \$3.7 trillion in net new money, compared to a net outflow of \$79 billion for active funds.

Table 7: U.S. Flow of Funds (USD Billions)

	PASSIVE	ACTIVE
2010	173	211
2011	160	47
2012	252	205
2013	256	196
2014	360	110
2015	375	-190
2016	471	-302
2017	663	23
2018	453	-304
2019	488	-75
2010-2019	3,651	-79

Source: Morningstar

Chart 6: US Flow of Funds



Source: Morningstar

4 Conclusion

Since 2010, both Canadian and U.S. passive funds attracted positive net new money steadily, whereas the flow of funds toward active management has been more volatile. Passive funds have substantially increased 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 over \$8 trillion (USD) in assets under management, the U.S. completely dwarfs Canada's tiny \$163 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 six 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 2010, U.S.-domiciled active funds managed \$4 for every dollar managed by passive funds. Nowadays, this ratio has fallen to than \$1.5 for \$1. Meanwhile, in Canada, this ratio of actively to passively managed funds is still at more than \$8 for \$1.

We also highlight the substantial savings realized by the Canadian investors who choose passive investing. Considering the 1.31% fee difference between active and passive fund MERs, we estimate this net saving to \$1.9 billion dollar in 2019. In our opinion, an 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
2010	26.5	8.6
2011	30.0	9.8
2012	40.9	11.5
2013	46.0	11.7
2014	54.5	15.7
2015	62.1	18.4
2016	76.2	26.7
2017	95.9	36.3
2018	99.5	39.9
2019	128.6	51.1

Table 9: Market Share

	PASSIVE	ACTIVE
2010	75.4%	24.6%
2011	75.3%	24.7%
2012	78.0%	22.0%
2013	79.8%	20.2%
2014	77.7%	22.3%
2015	77.1%	22.9%
2016	74.1%	25.9%
2017	72.5%	27.5%
2018	71.4%	28.6%
2019	71.6%	28.4%

Table 10: Flow of Funds (CAD Billions)

	PASSIVE	ACTIVE
2010	2.7	0.7
2011	4.6	1.6
2012	9.3	1.6
2013	3.5	0.6
2014	5.6	3.6
2015	10.0	2.3
2016	9.7	4.5
2017	14.0	7.5
2018	9.5	5.4
2019	16.5	5.6

Appendix B: Canadian Mutual Fund Data

Source: Morningstar

Table 11: Assets Under Management (CAD Billions)

	PASSIVE	ACTIVE
2010	16	482
2011	18	525
2012	21	573
2013	25	632
2014	27	751
2015	27	876
2016	29	946
2017	32	1,038
2018	30	995
2019	35	1,142

Table 12: Market Share

	PASSIVE	ACTIVE
2010	3.3%	96.7%
2011	3.3%	96.7%
2012	3.5%	96.5%
2013	3.8%	96.2%
2014	3.5%	96.5%
2015	3.0%	97.0%
2016	3.0%	97.0%
2017	3.0%	97.0%
2018	2.9%	97.1%
2019	2.9%	97.1%

Table 13: Flow of Funds (CAD Billions)

	PASSIVE	ACTIVE
2010	1.0	-5.6
2011	1.0	8.1
2012	1.7	1.3
2013	-1.2	1.5
2014	-1.4	33.2
2015	-0.5	24.6
2016	0.1	4.2
2017	0.1	26.2
2018	-0.8	-11.3
2019	-1.3	13.6

Appendix C: U.S. ETF Data

Source: Morningstar

Table 14: Assets Under Management (USD Billions)

	PASSIVE	ACTIVE
2010	887	127
2011	936	126
2012	1203	145
2013	1476	225
2014	1736	269
2015	1859	277
2016	2245	311
2017	3036	404
2018	3009	392
2019	3935	493

Table 15: Market Share

	PASSIVE	ACTIVE
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%
2019	89%	11%

Table 16: Flow of Funds (USD Billions)

	PASSIVE	ACTIVE
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
2019	320	12

Appendix D: U.S. Mutual Fund Data

Source: Morningstar

Table 17: Assets Under Management (USD Trillions)

	PASSIVE	ACTIVE
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
2019	4.2	12.2

Table 18: Market Share

	PASSIVE	ACTIVE
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%
2019	26%	74%

Table 19: Flow of Funds (USD Billions)

	PASSIVE	ACTIVE
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
2019	168	-87

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