2002 General Membership Meeting: Chairman's Report

ICI Chairman's Report at the 2002 ICI General Membership Meeting

by

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Good morning. It is a pleasure to address you today at our General Membership Meeting.

Before I begin, I'd like to recognize and thank John Carifa and his planning committee, as well as Matt Fink and the Investment Company Institute staff, for developing an exceptional program.

It should be of little surprise that the theme of this year's meeting touches upon both the challenges we face as a nation and as an industry and on what is perhaps our industry's strongest asset—our tradition of integrity.

At our luncheon this afternoon, Pulitzer Prize-winning author and historian David McCullough will explore the life of John Adams, our second president and a man with a reputation as an intelligent and courageous statesman. I am reminded that Adams once said, "People and nations are forged in the fires of adversity." This perceptive remark is as applicable now as it was in our nation's early days.

Without a doubt, the past year was difficult and demanding for our nation, especially for people in New York and here in Washington, and for mutual funds and their shareholders. The tragic events of September 11 touched people across our nation, and indeed the world, including the mutual fund industry, which, unfortunately, did not escape unharmed that crisp, clear morning.

At 8:41 a.m., Pete Frank sent an e-mail from his office at Alger Funds on the 93rd floor of the World Trade Center's north tower reminding the groomsmen in his wedding to get measured for their tuxedos. Within minutes, the north tower was aflame as the first plane struck. All 35 people who were in their offices at Alger were lost, including all but five of Alger's 30-person investment team and the firm's chief executive, David Alger.

In offices near the top of the south tower, John Hart, a technology specialist at Franklin Templeton, was preparing for a seminar at his firm's Fiduciary Trust subsidiary when the second hijacked airliner struck. Hart had flown to New York from his San Francisco home and looked forward to September 13, when his wife was to join him for a long weekend of plays and restaurant dinners. Hart and nearly 90 Fiduciary Trust employees perished.

Marsh & McLennan, the corporate parent of Putnam Investments, lost 295 employees from offices in both towers. Morgan Stanley, the World Trade Center's largest tenant, lost 12 of its employees. Another member of our industry, OppenheimerFunds, was miraculously spared a loss of life, but its headquarters were destroyed when the south tower crashed to the ground at 10 a.m. Later in the day, the collapse of 7 World Trade Center destroyed the offices of Citigroup's asset-management division, including the Smith Barney family of funds. On a personal note, Merrill Lynch's headquarters across from the World Trade Center did not escape damage and 9,000 of our employees were relocated to other offices in Manhattan, Connecticut, and New Jersey—and we lost three of our colleagues.

The events of September 11 affected us all. Hundreds of businesses were disrupted, thousands of people were lost. And, fortunately, tens of thousands more were able to say "I'm okay," thanks to the efforts of countless rescue workers who selflessly answered the call and brought so many to safety.

We are all indebted specifically to those individuals and generally to the policemen, the firemen and members of our armed forces who serve us every day, often without adequate recognition. And, of course, we will miss our friends and colleagues.

As millions of mutual fund shareholders watched history unfold and waited for our silenced markets to reopen, fund companies across the country established hotlines and extended service hours to answer investors' questions about their funds and the markets. In addition, many firms telephoned customers who had entered orders after 4 p.m. on September 10 to ask if they wanted to carry out their orders or cancel them. Most opted to keep their orders open.

In other efforts throughout our industry, information specialists made sure that backup systems were ready to safeguard mutual fund shareholder records. Technicians checked communications systems to ensure clear transmissions to the exchanges. And portfolio managers who had lost their own offices worked from makeshift facilities and trading rooms.

After the markets reopened, major mutual fund companies uniformly reported that the volume of client calls to their service lines was remarkably light. This led Barron's to conclude that the measured response of mutual fund investors "further belies the common image of the retail investor as a slave to emotion … and eager to act."

Headlines from one week in September tell part of our story.

The English poet Ben Jonson wrote: "He knows not his own strength that has not met adversity." The events of the past year gave each of us an opportunity to realize our strengths both as a nation and individually. The same can be said of the mutual fund industry and our shareholders.

I would like to express my gratitude to each of you for your efforts. They were consistent with our history and our cherished tradition of integrity.

This morning, I would like to make some general observations and comments on the state of our industry. Then, I want to focus on the many reasons why investors turn to mutual funds to reach their long-term financial goals in eras of adversity as well as periods of prosperity. And finally, I would like to offer some personal thoughts.

The State of Our Industry

Since we last met one year ago, I am pleased to report that more Americans own mutual funds than ever before. Overall, mutual fund ownership has reached 93 million individual shareholders.

The mutual fund industry continues to be attractive to long-term investors. One out of every three individuals and more than half of all American households now own mutual funds. Those of you who have been in our industry only a decade or two may have grown accustomed to the mutual funds' unparalleled success story. However, for those of us who have been in this business for 30 years, those numbers are breathtaking. More than half of the households in the United States and 93 million shareholders have entrusted their money to you and this industry.

Furthermore, the mutual fund industry continues to see strong growth in ownership among younger households who are getting an early start on investing for their financial security.

Today, mutual fund investors have more than 8,000 investment choices delivered through literally hundreds of thousands of points of sale. This vibrant competition has produced substantially lower mutual fund costs, and has helped make saving and investing in mutual funds simpler and more accessible to millions of Americans.

As 2001 closed, mutual fund assets stood at $6.97 trillion dollars, virtually unchanged from the year before. Record inflows of new cash offset negative equity performance throughout much of last year, the market's second consecutive down year, and a year in which an average bear market developed into one of the most severe since World War II.

Even as our nation's economy appeared poised to plunge deeper into a recession, mutual fund shareholders had a measured response to the uncertainty that gripped the markets. For the year, mutual funds reported a record net inflow of $505 billion dollars, up from $389 billion dollars in 2000 and ahead of the previous record of $477 billion dollars in 1998. During the year, all fund categories, that is all fund categories—stock, hybrid, bond, and money market—reported inflows.

Bond and hybrid mutual fund flows turned positive for the first time since 1998, with inflows of $88 billion dollars and $9.5 billion dollars, respectively. Stock mutual funds also realized net inflows of $32 billion dollars.

Money market mutual fund inflows reached a record $376 billion dollars last year. Institutional money funds attracted most of the net new cash, totaling a record $339 billion dollars for the year, nearly three times greater than in 2000. Open market short-term interest rates were below money market yields throughout much of the year, and businesses and other institutional investors responded to the yield advantage of institutional money funds by shifting short-term assets into these funds.

Although much of the increase in net new cash to institutional money market funds was attributable to falling interest rates, the underlying growth in demand for these funds showed no signs of slowing. Net new cash flows to institutional money market funds have averaged 23 percent of assets since 1994, as businesses and other institutions increasingly have turned to money funds for cash management in order to benefit from the economies of scale, the liquidity, and the diversification provided by mutual funds.

Despite the market's downturn, American households have increased their reliance on mutual funds as a way of investing in stocks and bonds. At the same time, households are decreasing their direct holdings of stocks and bonds held outside of mutual funds. This shift to mutual funds occurs despite the expansion in recent years in alternatives to traditional mutual funds, such as exchange-traded funds and separately managed accounts. These products so far appear to have had very modest effects on the demand for mutual funds.

Long-Term Investors Shun Short-Term Solutions

Last year I outlined several facts about mutual funds and mutual fund shareholders. Little did I know then that one of those facts would be tested so severely.

You may recall I stated, as a fact, that "panic" is not a word one would associate with mutual fund shareholders. Granted, the historical record showed this to be the case. The Institute had conducted a number of studies, including an analysis of equity fund flows since World War II, all of which showed that fund investors have never responded to sharp market breaks by redeeming shares en masse. And no evidence had been found to indicate that this long-established pattern of behavior would change—and it didn't change in 2001.

Often when I think of all that has changed since we last met, I'm reminded also of what has held fast and true.

First, the tremendous benefits and protections enjoyed by mutual fund shareholders remain intact. Mutual funds continue to be attractive to investors for the same reasons that have driven the growth of the industry for decades—an unsurpassed combination of professional oversight, diversified portfolios, risk and volatility management, affordability, and innovative account services.

And, unlike other pooled investment products, the mutual fund industry has been untainted by major scandal for more than 60 years. This is a wonderful testament to you, to your predecessors, and to the people responsible for regulating funds.

Second, mutual fund shareholders continue to maintain their long-term investment horizon. Institute research shows that shareholder reaction to last year's market downturn, in general, and the events of September 11, in particular, were muted. For example, the pace of outflows from domestic equity funds after the attacks rose modestly compared to outflows during the first 10 days of September. The outflow was largely the result of a drop in new sales, which was expected given past shareholder behavior. And for the year, as I mentioned a few moments ago, all fund categories reported inflows.

Historically, shareholder response to market movements tends to be spread over time. Over the course of a typical cycle in stock prices, investors do tend to buy more when stock prices are increasing and buy less when they are decreasing—a pattern that continues today.

It has been said, "prosperity is a great teacher, adversity even greater." With that in mind, we may be able to gain significant insights by looking at how the markets have reacted following some of the past century's most alarming national and global crises, including the Cuban Missile Crisis, the Gulf War, Pearl Harbor, and the 1993 bombing of the World Trade Center.

An analysis by Ned Davis Research of the market's reaction to 14 historic events found that, in general, markets tended to fall immediately after they reopened. Following these events, the median first-day decline in the Dow Jones Industrial Average was 1.4 percent and slipped further to 4 percent after about a month. But after three months, the industrials had recovered all their losses to show a 2 percent gain, which widened to nearly 7 percent after six months.

At the closing bell on September 17, the first full day of trading following the terrorist attacks, the Dow had dropped 7 percent. One week later, the loss widened to 14 percent; however, after one month, the Dow was down only 5 percent. And, six months later, the Dow had climbed nearly 11 percent.

During this time, mutual funds shareholders looked beyond the headlines, and refused to turn to short-term solutions to reach their long-term investment goals. Research shows the vast majority of mutual fund shareholders are long-term investors. In fact, 83 percent of fund shareholders indicate they are not overly concerned with short-term market fluctuations. This investment discipline continues to reward mutual fund investors—and I suspect always will.

The Benefits of Investor Awareness and Education

The 17th Century statesman and philosopher Francis Bacon said, “The virtue of prosperity is temperance; the virtue of adversity is fortitude.” This philosophy could apply to our investor awareness efforts today.

Some of you will recall the full-page advertisements the Institute placed in national newspapers a few years ago at the height of the bull market. The ad’s message may have seemed a bit out of step with the times. Simply put, we sought to temper unrealistic expectations amid a period of extraordinary investment returns.

The fortitude shown by mutual fund shareholders during last year’s market downturn demonstrates the value of educating investors. Two of the key messages of the Institute’s longstanding Investor Awareness program are the importance of diversification and the need for a long-term investment horizon. Events even more recent than September 11, have shown the wisdom of both of these themes.

Preserving and enhancing public confidence in mutual funds through investor awareness programs is a crucial element of our industry’s continued success. I’m pleased to tell you that we have expanded the ICI Education Foundation’s successful Investing for Success partnership with the National Urban League and the Coalition of Black Investors–Investment Education Fund.

This partnership is strengthening investor awareness among middle-income African-Americans through a series of free regional and online workshops. We are introducing a bilingual version of our Investing for Success online workshop to expand the program’s reach into the Hispanic community. You will hear more about this later in our conference.

Investor education will continue to be important especially in light of the fact that greater responsibility for retirement planning and saving for higher education is being placed on individuals. These areas represent two of the Institute’s key initiatives going forward.

In closing, if you would permit, I would like to make a personal observation. As many of you know, this will be my final General Membership Meeting as chairman, although my final one-year term won’t end until October. It has been my honor and privilege to serve as your Chairman for the past two years. Working closely with our industry’s leaders and the outstanding staff of the Institute has been a rewarding chapter of my career.

I’d like to take this occasion to thank Matt Fink, Julie Domenick, Craig Tyle, Larry Maffia, and the rest of the ICI staff, and my fellow Board members for their professionalism and their support. I also appreciate your own broad-based support of the Institute’s many efforts. I respect your ability to put individual opinions aside for the best interests of our industry and our shareholders. Your active participation enables our industry to continue to speak with a single, united voice before legislators, regulators, and the public.

United we are more than 8,000 mutual funds, closed-end funds, and unit investment trusts managing nearly $7 trillion dollars in shareholder assets.

United, we help shepherd the hopes and dreams of more than 93 million shareholders as they confidently look ahead to sending their children to college, retiring in financial security, and caring for their parents.

We are united by our long-standing tradition of integrity—and in our moral and legal obligation to serve shareholders responsibly following the principles established under the Investment Company Act of 1940. This fiduciary culture is ably embodied by the ICI, which has been instrumental over the years in fostering its growth.

Everything we do to hold true to our tradition and culture allows us to retain the respect of our regulators and, most importantly, the trust of our shareholders.

In the months before the end of the Second World War, Winston Churchill said, “A love for tradition has never weakened a nation, indeed it has strengthened nations in their hour of peril.” Just as our nation’s traditions of freedom and democracy continues to strengthen American resolve, I believe our industry’s precious tradition of integrity provides mutual fund shareholders with a measure of confidence in adverse, as well as, prosperous times.

The shared success of our industry and our shareholders is a direct result of your efforts, and those of your predecessors. What we do for a living—both in times of prosperity and adversity—directly benefits our neighbors, our community, and our nation. I hope you are as proud of what you are doing as I am.

Please enjoy the rest of the conference and thank you for your attention.