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2016 Investment Trend Monitor Report: Product Usage

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Value Over Growth

After years of growth outperforming value, advisors are starting to shift client assets toward value

Advisors appear divided on the outlook for domestic equities. Many plan to add domestic stocks to clients' portfolios over the next 12 months, while others expect to reduce their clients' holdings of the asset class. In this environment, advisors appear to be finding value stocks more attractive than their growth counterparts. This was one of the findings of a recent WealthManagement.com and FUSE Research Network survey of 915 advisors and financial professionals about their product usage.

Among the study's additional findings:

- Mutual funds are the most commonly cited vehicle for investing client funds, with more than half of advisors reporting that at least 40% of their clients' assets are invested in mutual funds.
- Actively managed mutual funds and ETFs are more popular than passive strategies across a broad range of asset and sub-asset classes. This preference for an active management style is most popular among advisors from large firms, although they expect to decrease their exposure over the coming years.
- When choosing active strategies, advisors typically focus most on the reputation of the fund firm and the fund's expense ratio—factors that were much more important to independent advisors than to advisors in other channels.
- For advisors weighing index strategies, the main driver is low costs. A desire to index the entire portfolio was the least commonly cited reason for choosing index funds.

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Seeking value—at the expense of growth

Advisors appear to be shifting away from growth stocks toward value positions—perhaps in response to the strong outperformance of growth stocks ever since the recent financial crisis. In fact, nearly 4 in 10 (39%) advisors say adding domestic large-cap value stocks to client holdings is one of their top two expected portfolio shifts over the next 12 months. This was the most commonly cited addition. Meanwhile, nearly 3 in 10 advisors (28%) named domestic large-cap growth equities as one of their top two expected portfolio decreases over the same time frame—the most commonly cited decrease.

The shift may already be underway: 44% of advisors report that large-cap value equities currently represent a meaningful or significant part of client holdings, while just 36% say the same for large-cap growth. This outlook—favoring value over growth—holds true for advisors from large firms as well as advisors from independent firms. That said, independent advisors expect to make a more dramatic move away from growth stocks than other advisors. Among this group, 24% expect that they will see the greatest decreases in domestic large-cap growth stocks over the next 12 months, compared with just 15% among large firms.

Advisors' top choices for asset increase and decrease over the next 12 months

	ALL FIRMS →	Large firms	Independent firms
Greatest expected increase	27% domestic large-cap value	25% domestic large-cap value	27% domestic large-cap value
Greatest expected decrease	20% domestic large-cap growth	15% domestic large-cap growth	24% domestic large-cap growth

Advisors are not planning to abandon growth stocks completely, however. For instance, 16% of advisors at independent firms expect that their second greatest increase in assets over the next 12 months will be in domestic large-cap growth stocks.

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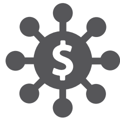


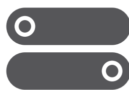
Mutual funds over ETFs

When asked about their preferences for investment types, advisors overwhelmingly point to mutual funds as their preferred investment vehicle for client funds. Overall, 57% of advisors said they invested a meaningful (40%-50%) or significant (over 75%) portion of client assets in mutual funds. ETFs were advisors' second most preferred investment vehicle. About 26% of advisors reported that a meaningful or significant portion of their clients' assets is invested using ETFs.

Percent of advisors with 40% or more of assets invested in mutual funds and ETFs

	ALL FIRMS →	Large firms	Independent firms
Mutual funds	57%	62%	55%
ETFs	26%	22%	29%

The strength of this trend favoring mutual funds varies by advisor channel, however. For instance, the gap between the use of mutual funds and ETFs is much smaller among advisors from independent firms, who favor mutual funds less than do advisors from large firms. Meanwhile the gap is pronounced among advisors at large firms, to the point where these advisors are just as likely to keep 40% or more of client assets in separately managed accounts (21%) as they are in ETFs (22%). The difference in preference may be partly a result of the fact that advisors at large firms tend to prefer active management styles more than do independent advisors.



Active over passive

When considering all client assets under management, advisors across channels strongly favor active strategies over passive. That said, advisors at large firms report a higher average percentage of client assets invested in active strategies (68%) than the percentage reported by advisors at independent firms (57%). However, while advisors from independent firms expect their preferences to remain roughly the same over the next two years, advisors from large firms expect to slightly decrease their use of active strategies while increasing their use of passive strategies.

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Average percent of overall assets under management in active and passive strategies

		Currently →	Two years from now
Active	Large firms	68%	65%
	Independent firms	57%	56%
Passive	Large firms	24%	30%
	Independent firms	38%	40%

The trend favoring active strategies is consistent when only considering assets invested in mutual funds and ETFs, as well as across a broad range of asset and sub-asset classes. Perhaps not surprisingly, the preference for an active strategy approach is strongest when investing in alternatives.

Choosing an active strategy

When ranking the relative importance of various investment characteristics when choosing an actively managed fund, advisors are most likely to focus on the fund's expense ratio and the fund firm's reputation. These preferences were not consistent across all advisor channels, however. In particular, advisors from large firms ranked a fund's upside/downside capture (61%), relative return (59%) and risk-adjusted return measures (57%), along with a number of other factors, ahead of expense ratio (43%) and firm reputation (53%). Meanwhile, advisors from independent firms said expense ratio (55%) and firm reputation (51%) were the most important factors when considering an active strategy.

Most commonly cited concerns when considering an active strategy overall

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Indexing strategies

Despite a preference for active strategies, many advisors still find a place for passive strategies in their client portfolios. When they do opt for a passive strategy, lower costs tend to rank as the most important rationale among advisors polled; lower costs are very important according to 6 in 10 (61%) advisors. The next most important characteristic is exposure to unique asset classes, such as emerging markets (35%).

Percent of advisors who cite the following characteristics as very important when deciding to use index offerings

	ALL FIRMS	Large firms	Independent firms
Lower cost/ low cost beta	61%	53%	63%
Exposure to unique asset classes	35%	40%	35%
For the tactical piece	29%	34%	29%
Index the entire portfolio	12%	7%	14%
Active management is out of favor	14%	14%	14%

While low costs were the most important characteristic for all advisor channels, advisors from independent firms were more likely (63%) than those from large firms (53%) to highlight low costs as very important. This mirrors the findings tied to the selection process for active strategies, where independent advisors were more focused on an active fund's expense ratio than were advisors from large firms.

One characteristic that held a consistent, albeit lower, level of support across all advisor channels was the belief that active management is out of favor (14% of advisors cited this reason for indexing). Says one RIA with 19 years of experience: "We don't believe active management adds value above its costs, over time." ■

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