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2015 Investment Trend Monitor Report: Advisor Use Of Financial Products

Mutual Funds Still on Top

Despite the breadth of available products, mutual funds remain the top product advisors use in client portfolios

Mutual funds are the most popular investment product with advisors industrywide, with large-cap domestic equity funds topping the list of tools advisors use to address clients' goals. Perhaps not surprisingly, advisors reported that hedge funds, private equity and limited partnerships accounted for the smallest portions of clients' portfolios. These are the findings of a recent study by WealthManagement.com and FUSE Research Network, which surveyed more than 680 advisors on their product usage.

Among the study's other findings:

- ETFs were far less popular than mutual funds with advisors, which mirrors advisors' tendency to favor active investments over passive investments across both equity and fixed income investments.
- Client portfolios tended to use more equity funds than fixed income funds, and when advisors seek to add international exposure, they tend to do so through international rather than global funds while avoiding region-specific funds.
- Within alternative investments, tactical allocation investments were most favored, while currency-related alternative investments and managed futures were least popular.
- Over the next 12 months, advisors are split on the direction of domestic equity markets. Nearly a quarter of advisors plan to increase their clients' exposure to large-cap domestic equities, while close to a fifth of advisors expect to decrease their clients' exposure over the coming year.

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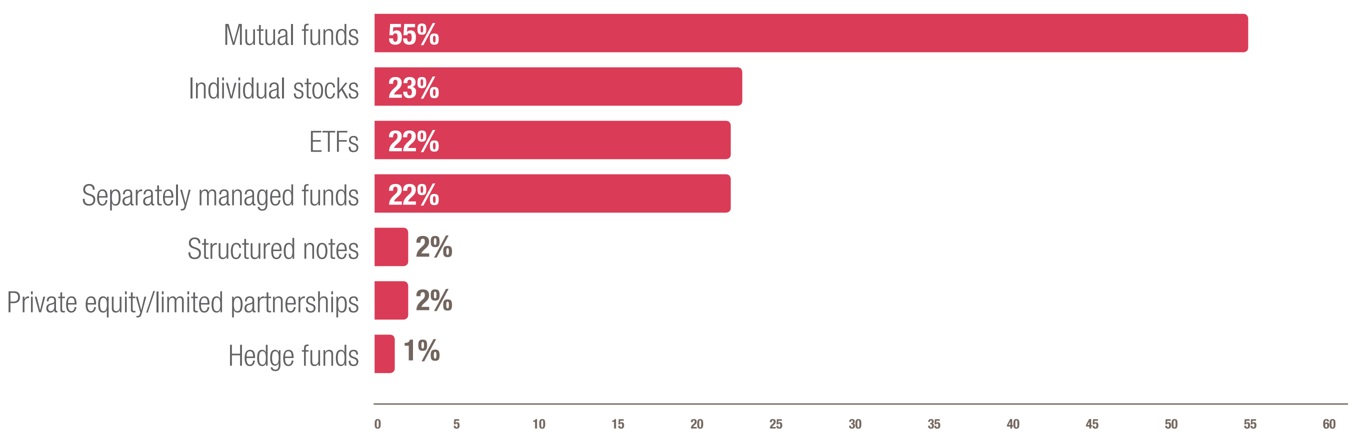
Mutual funds over ETFs

More than half (55%) of advisors reported that mutual funds represented a meaningful portion (defined in the survey as between 40% and 50%) or a significant portion (more than 75%) of client portfolios. This trend was stronger for advisors at large firms (63%) than it was for independent RIAs (45%). Individual stocks were a distant second in terms of popularity, with ETFs and separately managed accounts tied for third just below stocks. At the same time, more than a quarter of advisors (27%) reported modest use (between 20% and 30%) of ETFs, while just 15% of advisors reported modest use of separately managed accounts.

Structured notes, private equity and limited partnerships, and hedge funds were the least likely products to account for a meaningful or significant portion of client assets—perhaps unsurprisingly given the specific and supporting role these products typically play.

Meaningful and significant use of products



Advisors' tendency to favor mutual funds over ETFs aligns with results showing that advisors tend to favor active management strategies. Advisors were far more likely to select active over passive strategies in both equity funds (52% versus 17%) and fixed income funds (55% versus 21%). When selecting active strategies, advisors listed risk-adjusted return measures and expense ratios as the factors they valued the most.

Index funds still have an important role to play, however. Three in four advisors said they used index strategies because of the lower costs. One advisor, who has 15 years of experience in the industry and under $200 million in AUM, said index funds make it "easier to diversify smaller accounts."

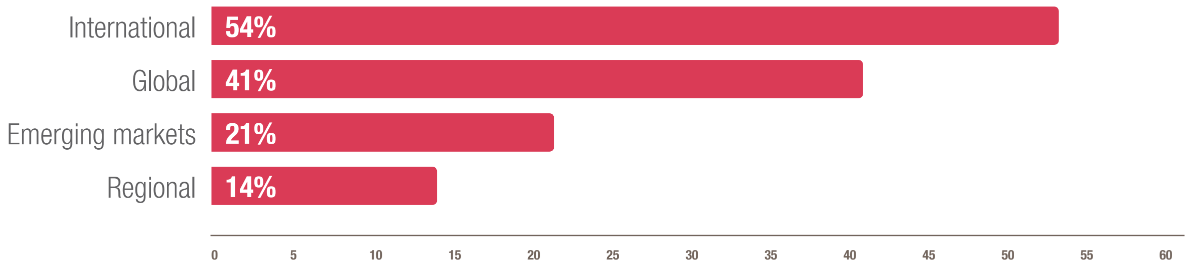
Equities over bonds

Domestic large-cap funds were the most popular sub-asset class, with 54% of advisors reporting meaningful or significant use. Large-cap funds were more popular than either mid-cap (19%) or small-cap funds (12%). Large-cap stock funds also handily beat the sub-asset classes in fixed income, perhaps reflecting the recent strong gains in equities relative to the low yields available in fixed income markets.

The most popular bond funds among advisors were municipal bond funds (13%), followed closely by core corporate bond funds (10%). Emerging market bonds were the least favored by advisors at only 1%, reflecting concerns about how a Federal Reserve interest rate hike may affect emerging markets debt.

Advisors looking to provide their clients' portfolios with modest exposure or more to investments outside of the U.S. tend to slightly favor international funds over global funds, while the popularity of either of those strategies exceeds that of a more regional approach or seeking exposure to emerging markets.

Adding modest international exposure

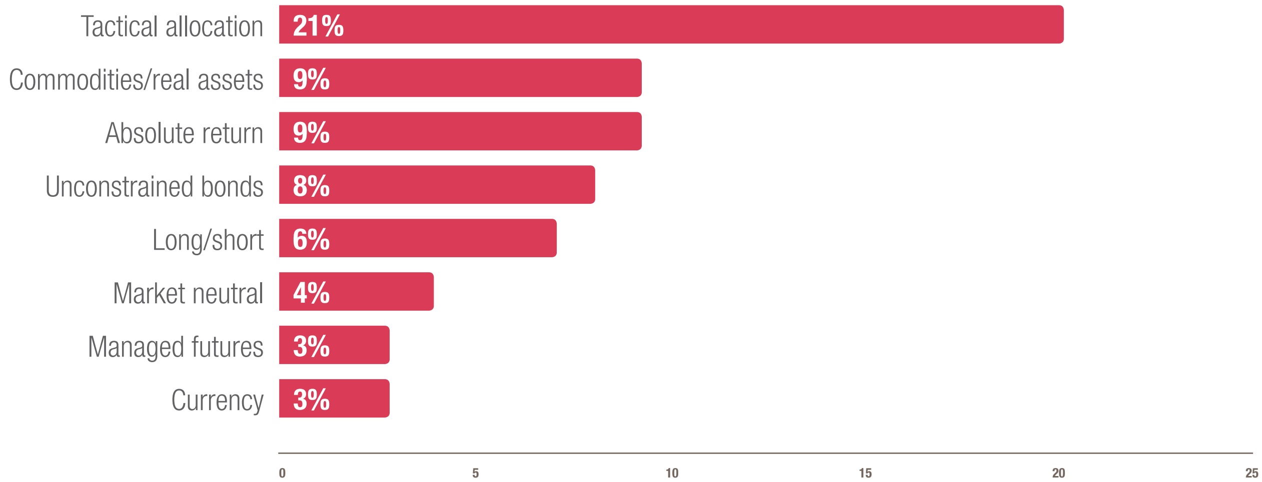


There's really only one alternative

Not surprisingly, alternative investments featured much less prominently in client portfolios than did equities or fixed income investments. Of the various alternative investments described in the survey, tactical allocation investments were the most favored, with one in five advisors (21%) reportedly using them at least modestly in client portfolios. Managed futures were much less popular, with only 3% of advisors reportedly using them at least modestly.

Currency-related alternative investments, meanwhile, were also only used modestly by 3% of advisors. However, that strategy lags managed futures when considering the percentage of advisors who avoided either strategy entirely—82% avoid currency alternatives while just 75% avoid managed futures.

Leaning lightly on alternatives (advisors who use alternatives modestly or greater)

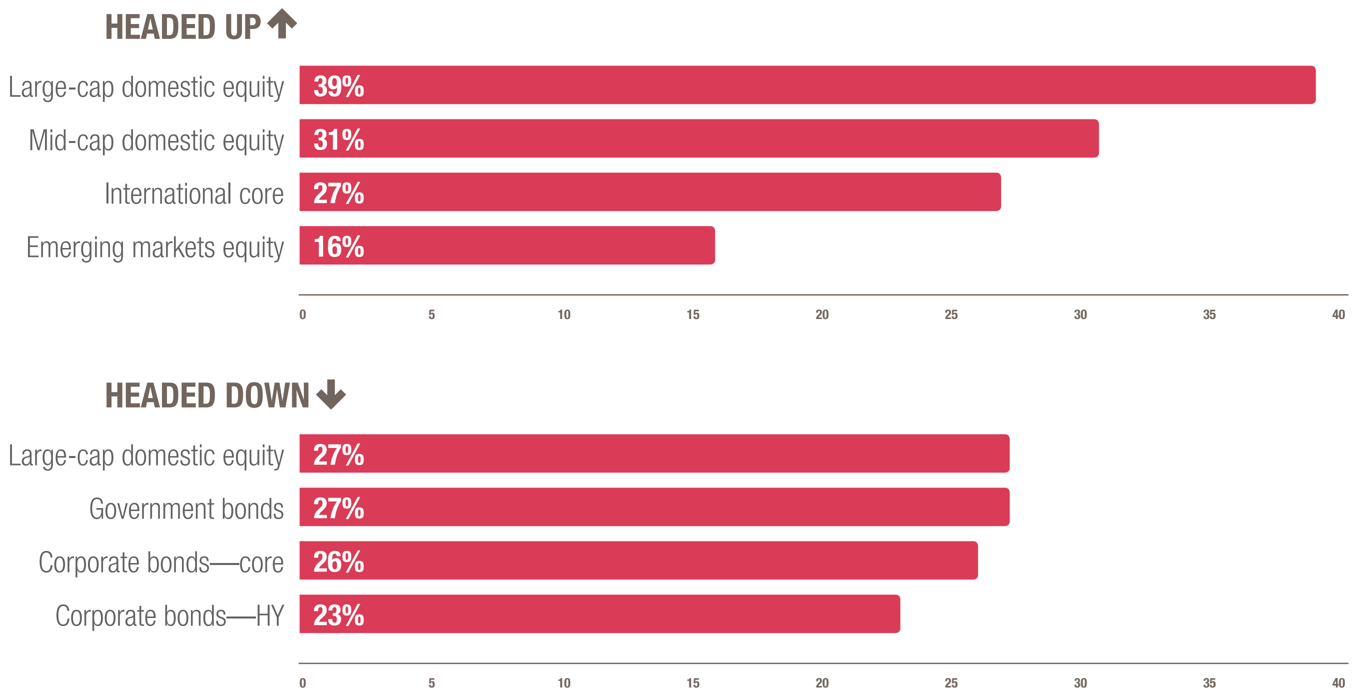


Advisors across the industry reported a strong preference for active strategies in alternative investments. Across all alternative investments, an average of 61% of advisers preferred an active strategy versus just 19% for passive. The remainder reported using both.

Looking at the year ahead

Advisors appear divided on the direction domestic equity markets will take over the next 12 months. Nearly a quarter of advisors plan to increase their clients' exposure to large-cap domestic equities over the coming year, while close to a fifth of advisors expect to decrease their clients' exposure. Government bonds topped the list of assets where advisors expected to decrease exposure.

Expected shifts in asset allocation (advisors' first and second choices)



When considering a change in allocation strategy, 8 in 10 (82%) advisors view changes in clients' goals and risk profile as the most important drivers of their decisions. Market outlook was the next most highly ranked driver, with half (51%) of advisors saying it was a very important driver. Third-party models were the least relevant consideration, reported as not important by 41% of advisors.