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Money Still Pours Into Stock Funds

Despite Industry Scandals, New Investment in October Totaled Nearly $24 Billion

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DOW JONES NEWSWIRES

Allegations of wrongdoing in the mutual-fund industry didn't discourage investors last month.

While some individual mutual-fund companies saw large withdrawals, nearly $24 billion of new money went into stock mutual funds overall in October, according to estimates by Lipper Inc.

Lipper senior analyst Don Cassidy, noted, however, that some of the more disturbing allegations of improper trading of mutual-fund shares came late in the month and in early November. "The depth and severity of the disclosed malfeasance ratcheted up in November," he said. "We believe November will prove to be more challenging in light of the added recent disclosures and because stocks so far have spent the month in a decline."

October's equity-fund inflows were estimated at $23.8 billion, while bond funds had an outflow of $3.1 billion. A net $29.8 billion was redeemed from money-market funds.

Outflows from eight companies that have either been named in allegations or have admitted to some sort of special-trading arrangements were about $3 billion in October, Lipper said, down from $7.9 billion in outflows in September from four companies originally associated with the scandal. "Two prominent firms saw significant outflows, while results for the others were mixed," the report said, without naming the companies. Lipper also noted "significant moves of assets" by institutions and intermediaries "away from some of the fund families that have been accused or admitted wrongdoing."

The fund tracker said it expects such moves to continue through at least the end of 2003.

Because investors have made money in stocks during the past year, "their perception is of minor damage" to their known gains, the report said. Also, investors don't know yet whether their losses were material, which damps their inclination to flee "in response to the distasteful revelations."

The report also said fund investors don't see better alternatives. "For many, the path of least resistance seems to be to do nothing or at most to shift from funds in a tarnished brand to those in one not (at least yet) caught up in the vortex of charges," the report said.

The Investment Company Institute, the industry's largest trade group, is expected to report October fund assets within the next few days.

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CONCENTRATION PAYS?: Actively managed mutual funds with concentrated holdings -- typically defined as funds that invest a majority of their assets in one to three industries -- tend to post higher returns than actively managed funds with more diversified portfolios, new research suggests.

"Our results say it might be optimal to have several mutual funds that are concentrated," said Clemens Sialm, an assistant finance professor at the University of Michigan Business School, Ann Arbor, Mich. He cowrote the research paper "Do Skilled Fund Managers Diversify Less?" along with Lu Zheng, an assistant finance professor, and Marcin Kacperczyk, a doctoral student in finance, both at the University of Michigan.

The study found that managers of more concentrated funds tend to overweight growth and small stocks, whereas managers of more diversified funds typically hold portfolios that resemble the market portfolio. Mutual funds investing primarily in small-growth, small-value and large-growth stocks tended to have higher returns; funds investing in large-value stocks tended to underperform.

Index funds, which passively match the makeup of market or industry benchmarks, are still a good choice for those who are risk-averse and have only a modest amount to invest, Prof. Sialm said.

Funds with the most diversified positions typically have annual expenses of about 1%, while those with higher concentrations have annual fees of about 1.5%, he said.