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The Passive Vs. Active Fund Monitor

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→ Summary

In 2021, Canadian passive funds increased their market share from 13.5% to 14.5% on the back of a record inflow of \$33 billion. Meanwhile, Canadian active funds attracted \$114 billion. Passive funds represent \$280 billion of roughly \$2 trillion in total AUM. We estimate that Canadian passive funds posted a weighted average Management Expense Ratio of 0.26%, compared to 1.55% for active funds. In the US, passive funds increased their market share from 40% to 42%. US passive funds attracted a record \$881 billion, while active funds attracted a \$329 billion inflow. For the world excluding North America, the market share of passive funds increased from 18% to 20% in 2021. For the world as a whole, the passive market share amounted to 31% at the end of 2021, up from 28% in the previous year.

Since 2012, Canadian passive funds have increased their market share from 9.6% to 14.5%. During that time, passive funds attracted a cumulative \$135 billion in net new money compared to \$190 billion for active funds. During the same period, US passive funds have increased their market share from 23% to 42% and attracted a net money flow of \$4.5 trillion, compared to a \$129 billion outflow for active funds. Worldwide, passive funds have increased their market share from 15% to 31%. Over ten years, passive and active funds had similar cumulative inflows of \$6.9 trillion and \$7.3 trillion, respectively.

In short, passive funds dominate asset gathering in the United States. Interestingly, the big winner of this trend is the Vanguard Group, a firm that does little (if any) advertising. In Canada and elsewhere in the world, the trend towards passive is healthy, but not nearly as strong as in the United States. This is perhaps explained by a more competitive investment industry and a stronger culture of passive investing south of the border. Lagging the US market is costing Canadian investors as passively managed funds remain on average 83% less expensive than their active counterparts. The extra cost of active funds does not provide much benefit, as they generally lag their passive counterparts in performance. But glimmers of hope are appearing, with passively managed funds increasing market share in six consecutive years in Canada. In recent years, we're even observing that traditionally active money management firms such as Franklin Templeton and MacKenzie have launched serious offerings of low-cost passive funds. We think this is a sign that with increasing investor awareness, the trend towards passive funds will be there for years to come.

¹ The data for the Canadian market is in CAD; while figures for the U.S. and World markets are in USD.

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

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Introduction

This report describes the competitive landscape for passively and actively managed retail funds from 2012 to 2021 in Canada, the United States and worldwide.

Section 1 describes the methodology that serves as a backbone to this study.

Section 2 describes the Canadian retail fund market. We review the dollar amount, market share and flow of funds of passive and active funds. We review the types of passive funds offered on the Canadian market, classifying them into three categories: market-capitalization weighted, factor funds and others. We also look at the Management Expense Ratios of passive and active funds in Canada.

Sections 3, 4 and 5 review the dollar amount, market share and flow of funds of passive and active retail funds for the US, the world ex-US and the world overall.

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, the United States and the world. 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. The Canadian mutual fund data excludes segregated funds sold by life insurance companies.

The data for Canada and the US excludes all money market funds because they are not at the core of the competition between active and passive funds. The data excluding money market for world markets funds was not available. Funds of funds are also excluded in all markets to avoid double counting. We made an exception for Canadian ETFs, for which we excluded only the funds of funds that hold Canadian-listed ETFs. A lot of Canadian ETFs hold US ETFs which do not result in double counting of passive assets in the Canadian market. This change in our methodology is likely responsible for the greater market share of Canadian passive funds compared to previous editions of this report.

To determine the composition of Canadian passive funds, we reviewed each individual passive fund and we classified them manually into three categories: “Market-cap weighted”, “Factor” and “Others”.

When estimating the MERs for Canadian funds, we encountered an issue with new funds which aren't allowed to post MERs before operating the fund for a full fiscal year. Occasionally, some funds gather large assets before their first anniversary. An example of that was observed in 2021 with the few blockbuster cryptocurrency ETFs. To overcome this problem, we estimated the MER of each fund

as the highest of the latest annual MER, the latest semi-annual MER and the management fee. In this edition, we document distinctly the weighted average MERs for three sub-categories of mutual funds: “Commission-Based”, “Do-It-Yourself” and “Fee-Based Advice”.

2. Canadian Market

2.1 Market Share

In 2021, the market share of passive funds increased 1%, from 13.5% to 14.5%. This represents the sixth consecutive annual increase in market share. The data for Canada displays a positive trend in favor of passively managed funds, with their market share increasing from 9.6% in 2012 to 14.5% currently. Correspondingly, the market share of actively managed funds has slipped from 90.4% of the market to 85.5%.

The Canadian data shows not only an upwards trend in the market share of passive funds, but also a strong growth rate for these funds between the years 2012 and 2021. Passive funds experienced an impressive 346% growth rate during this period, compared to 181% for active funds. In other words, passive funds grew almost twice as fast as active funds during the period. However, passive fund gains in market share have not been steady, as periods with solid gains (2012-2013 and 2016-2021) alternated with a period of decline (2013-2015).

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

	PASSIVE	ACTIVE
2012	63	590
2013	73	649
2014	84	775
2015	94	906
2016	111	988
2017	136	1092
2018	138	1045
2019	176	1212
2020	216	1391
2021	280	1659
2012-21	346%	181%

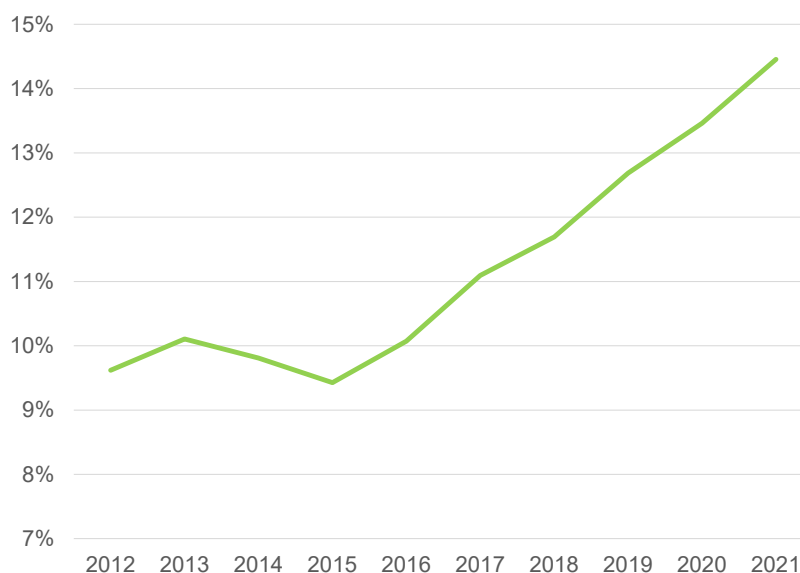
Source: Morningstar

Table 2: Market Share—Canada

	PASSIVE	ACTIVE
2012	9.6%	90.4%
2013	10.1%	89.9%
2014	9.8%	90.2%
2015	9.4%	90.6%
2016	10.1%	89.9%
2017	11.1%	88.9%
2018	11.7%	88.3%
2019	12.7%	87.3%
2020	13.5%	86.5%
2021	14.5%	85.5%

Source: Morningstar

Chart 1: Passive Fund Market Share in Canada



Source: Morningstar

2.2 Flow of Funds

Chart 2 shows the flow of money into passive and active Canadian funds between 2012 and 2021. In 2021, passive funds collected a record \$33 billion, compared to \$114 billion (also a record) for active funds. As regards multi-year trends, the net flow into passive funds has been positive every year since 2012, with a total inflow of \$135 billion over the period.

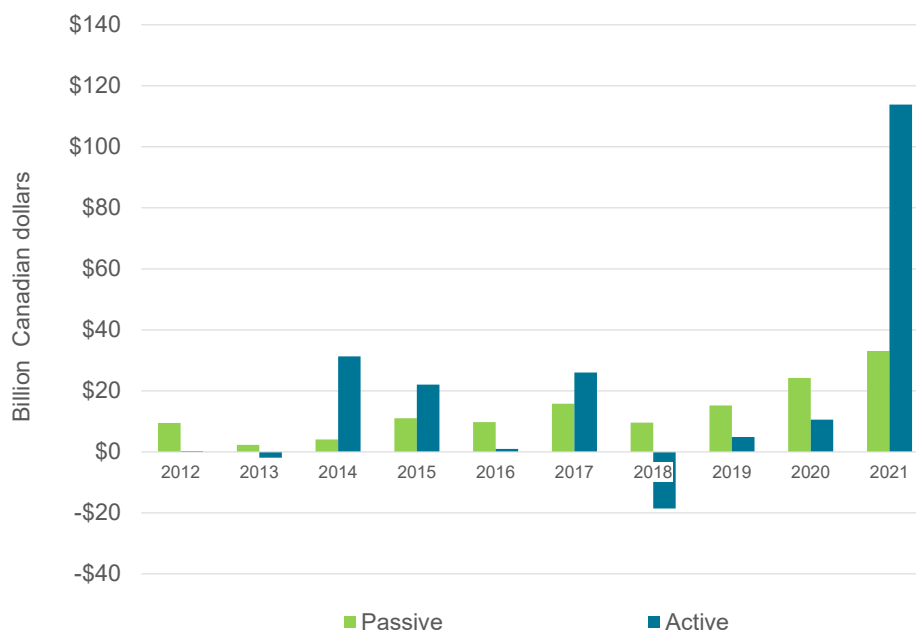
Over that same period, the flow of money in and out of active funds has been more volatile. In fact, Canadian active funds faced net withdrawals in 2013 and 2018. However, during the 2012-2021 period, net inflows totaled \$190 billion, thus surpassing the inflows towards passive funds.

Table 3: Canadian Flow of Funds (CAD Billions)

	PASSIVE	ACTIVE
2012	9.5	0.3
2013	2.3	-1.9
2014	4.1	31.3
2015	11.0	22.1
2016	9.8	1.0
2017	15.8	26.0
2018	9.6	-18.5
2019	15.2	4.9
2020	24.2	10.6
2021	33.1	113.9
2012-2021	134.6	189.6

Source: Morningstar

Chart 2: Canada Flow of Funds

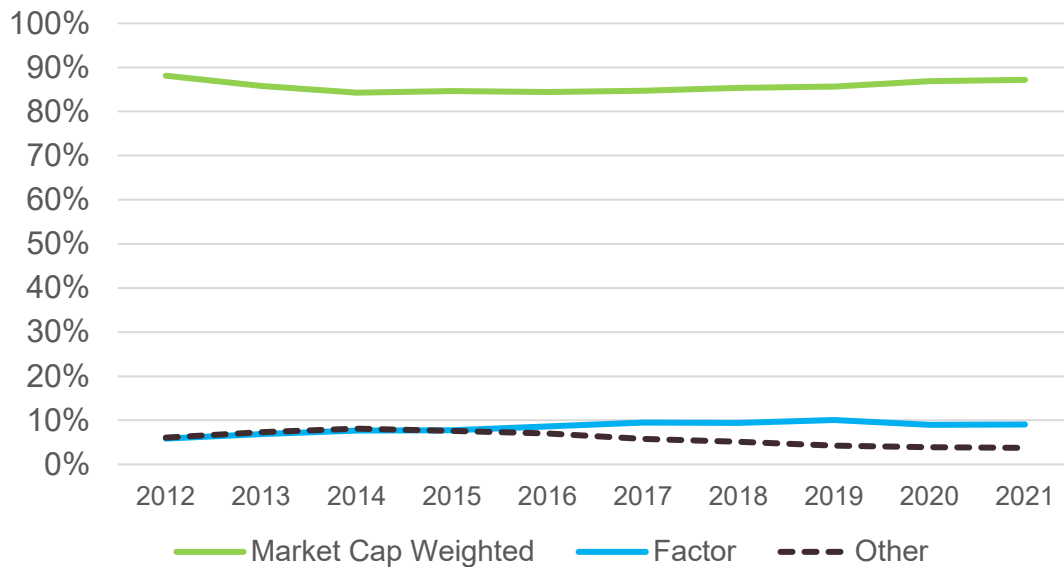


Source: Morningstar

2.3 Composition of Passive Funds

It is important to note that all the funds that are labelled as “passive” may have different characteristics. First, the “Market Cap Weighted” category is the purest type of passive fund, which are constructed using broad-based, market cap weighted indices. This category includes broad-based ESG index funds as well. The “Market Cap Weighted” category currently makes up 87% of the Canadian passive funds. A second category is “Factor” passive funds, which includes both single factor (value, growth, dividend, low volatility, etc.) and multi-factor index funds. This category represents 9% of passive funds. Finally, the “other” category, representing 4% of passive funds, includes mostly thematic and other non-market cap weighted index funds. Chart 3 below depicts the evolving composition of Canadian passive funds since 2012. We observe that despite the increasing abundance of new “innovative” ETF offerings, the share of market cap weighted passive funds has been stable through time.

Chart 3: Composition of Passive Funds 2012-2021



Source: Morningstar

2.4 Management Expense Ratios

We estimate the weighted average management expense ratio (MER) for Canadian active ETFs at 0.71%, compared to 0.21% for passive ETFs, resulting in a 0.51% difference. We separate mutual funds in three categories: “Commission-Based” funds pay a monthly trailer fee to the advisor, “Do-it-Yourself” funds charge lower fees but are sold without advice, and “Fee-Based Advice” funds also charge lower fees because the advisor who recommends them charges his fees directly to the client in addition to the product fee. Active mutual funds labelled as “Commission-Based” by Morningstar cost an average MER of 2.00% compared to 0.82% for passive mutual funds, a 1.18% difference. Active mutual funds labelled as “Do-it-Yourself” cost 1.14% compared to 0.38% for their passive equivalent, a difference of 0.76%. Lastly, active mutual funds labelled as “Fee-Based Advice” (also known as “F Class”) cost 0.93% compared to 0.49%, a difference of 0.44% in favor of passive funds.

All-in-all, we estimate the weighted average MER at 1.55% for active mutual funds and ETFs, compared to 0.26% for their passive counterparts, resulting in a 1.28% difference between the cost of active and passive funds. If we combine only ETFs and mutual funds that are structured for fee-based advice, active funds display a weighted average MER of 0.90%, compared to 0.21% for passive products, a net difference of 0.68%.

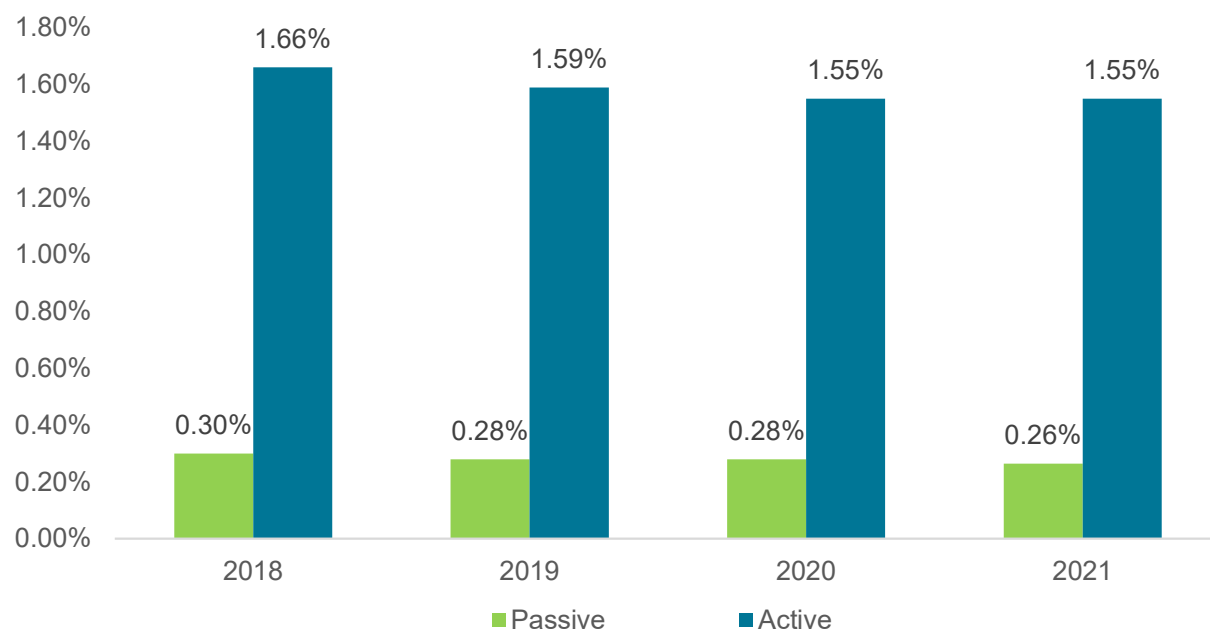
Table 4: Management Expense Ratios in 2021

	ACTIVE	PASSIVE	DIFFERENCE
ETFs	0.71%	0.21%	0.51%
Mutual Funds (Commission-Based)	2.00%	0.82%	1.18%
Mutual Funds (Do-It-Yourself)	1.14%	0.38%	0.76%
Mutual Funds (Fee-Based Advice)	0.93%	0.49%	0.44%
ETFs + Mutual Funds	1.55%	0.26%	1.28%
ETFs + Mutual Funds (Fee-Based Advice)	0.90%	0.21%	0.68%

Source: Morningstar

As shown in Chart 4, the MERs of passively managed ETFs and mutual funds have declined by 0.02% in 2021 while the MERs of actively managed ETFs and mutual funds are unchanged.

Chart 4: Weighted Average MERs for Passive and Active Mutual Funds and ETFs in Canada



Source: Morningstar

3. US Market

3.1 Market Share

In 2021, the market share of passive funds in the US increased by two percentage point, from 40% to 42%. Over ten years, the data shows a significant increase in market share for passively invested funds, from 23% to 42%. The market share of active funds, on the other hand, declined from 77% to 58% over the same period. Passive funds also experienced an astonishing 385% growth rate in 2012–2021, compared to only 98% for active funds. The growth rate of passively managed funds outpaced that of active ones by an almost 4:1 ratio. In dollar terms, passive funds increased their assets under management (AUM) by \$9.4 trillion compared to \$8.1 trillion for active funds. Active funds increased their AUM only on the back of the market gains, having recorded a net outflow during the 2012-2021 period. By contrast, passive funds have attracted a huge amount of money in the last 10 years (details in Section 3.2).

Table 5: Assets Under Management in the US (USD Trillions)

	PASSIVE	ACTIVE
2012	2.4	8.2
2013	3.1	9.7
2014	3.7	10.3
2015	3.9	9.9
2016	4.7	10.3
2017	6.2	11.8
2018	6.2	10.8
2019	8.0	12.7
2020	9.4	14.3
2021	11.8	16.3
2012-2021 Growth	385%	98%

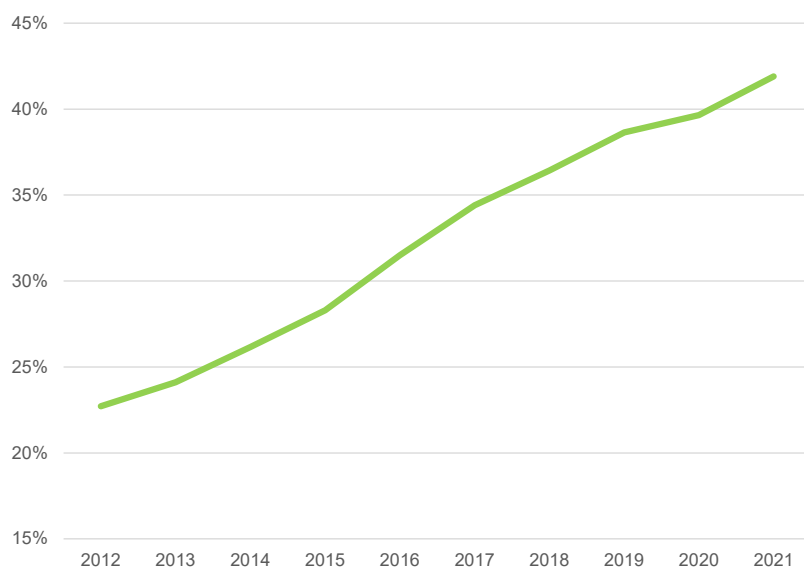
Source: Morningstar

Table 6: Market Share — US

	PASSIVE	ACTIVE
2012	23%	77%
2013	24%	76%
2014	26%	74%
2015	28%	72%
2016	31%	69%
2017	34%	66%
2018	36%	64%
2019	39%	61%
2020	40%	60%
2021	42%	58%

Source: Morningstar

Chart 5: Passive Fund Market Share in the US



Source: Morningstar

3.2 Flow of Funds

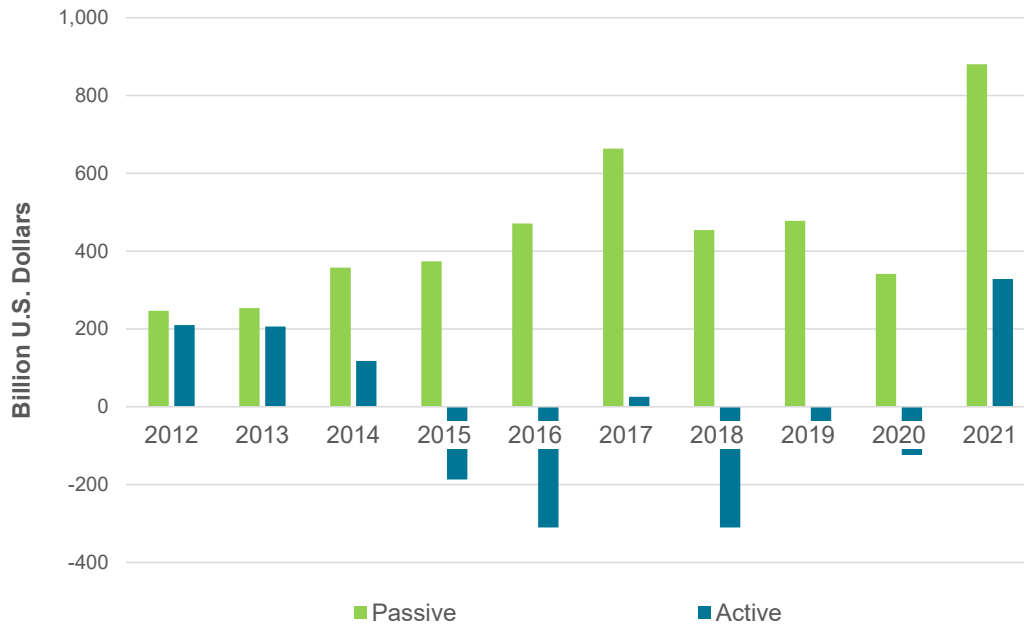
Chart 6 illustrates the flow of US money into passive and active funds between 2012 and 2021. In 2021, passive funds attracted a record \$881 billion in new money, whereas active funds attracted \$329 billion. Active funds were hit by negative cash flows in five of the last seven years. From 2012 to 2021, passive funds attracted \$4.5 trillion in net new money, compared to a \$129 billion net outflow for active funds.

Table 7: US Flow of Funds (USD Billions)

	PASSIVE	ACTIVE
2012	247	210
2013	254	206
2014	358	118
2015	374	-187
2016	471	-310
2017	664	26
2018	454	-310
2019	478	-87
2020	342	-124
2021	881	329
2012-2021	4,522	-129

Source: Morningstar

Chart 6: US Flow of Funds



Source: Morningstar

4. World Markets excluding North America

4.1 Market Share

Chart 7 depicts the evolution of the passive market share for the world excluding North America (Canada and the US) during the last 10 years. In 2021, the market share of passive funds increased by two percentage points, from 18% to 20%. Over ten years, the market share for passively invested funds has more than doubled, from 8% to 20%. Passive funds also experienced an astonishing 330% growth rate in 2012–2021, more than five times the 62% growth rate of active funds. In dollar terms, passive funds increased their assets under management (AUM) by \$3.8 trillion compared to \$7.7 trillion for active funds. Active funds increased their AUM mostly only on the back of net inflows, as market gains were modest.

**Table 8: Assets Under Management
World ex-North America (USD Trillions)**

	PASSIVE	ACTIVE
2012	1.1	12.3
2013	1.4	13.2
2014	1.6	13.3
2015	1.6	12.6
2016	1.8	13.1
2017	2.5	15.9
2018	2.5	14.8
2019	3.3	16.9
2020	4.1	19.1
2021	4.9	20.0
2012-2021 Growth	330%	62%

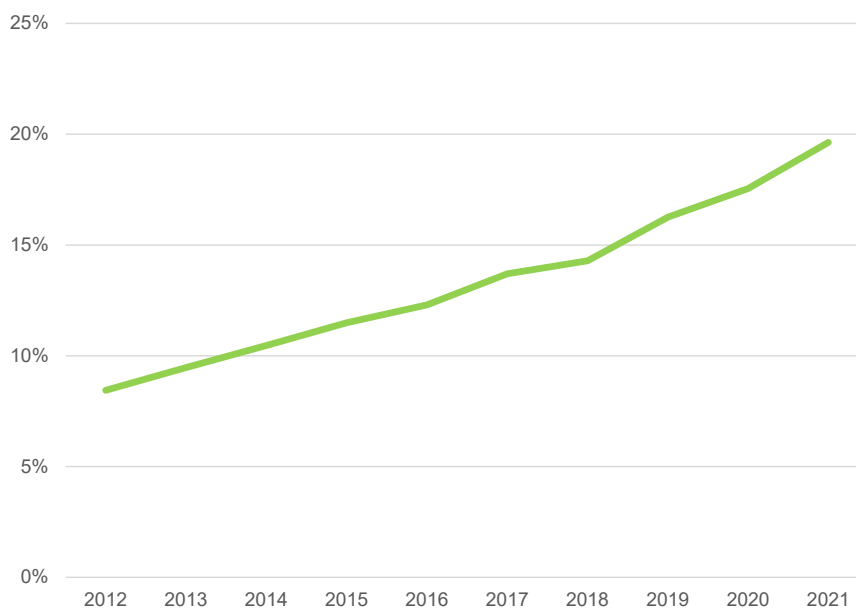
Source: Morningstar

**Table 9: Market Share —
World ex-North America**

	PASSIVE	ACTIVE
2012	8%	92%
2013	9%	91%
2014	10%	90%
2015	11%	89%
2016	12%	88%
2017	14%	86%
2018	14%	86%
2019	16%	84%
2020	18%	82%
2021	20%	80%

Source: Morningstar

Chart 7: Passive Fund Market Share — World ex-North America



Source: Morningstar

4.2 Flow of Funds

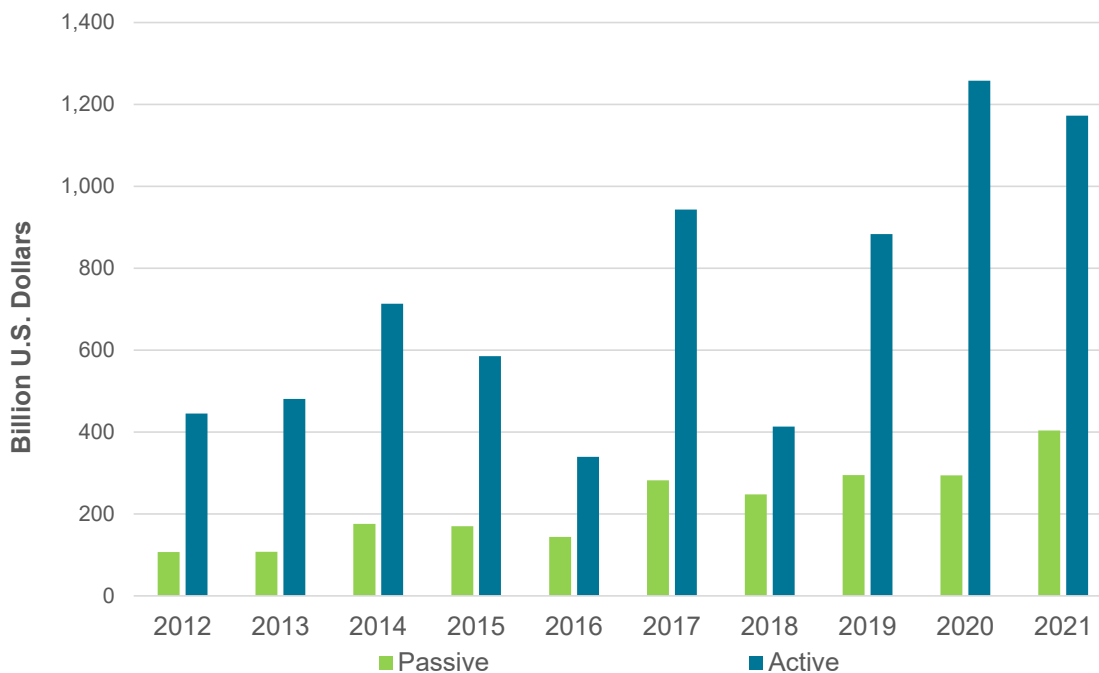
Table 10 and chart 8 illustrate the flow of funds into passive and active funds for the world excluding North America. Passive and active funds experienced inflows of \$404 billion and \$1.173 trillion in 2021. Over ten years, passive funds gained \$2.2 trillion in net new assets, compared to \$7.2 trillion for active funds. Both passive and active funds experienced positive flows every year since 2012.

Table 10: Flow of Funds - World ex-North America (USD Billions)

	PASSIVE	ACTIVE
2012	107	446
2013	108	481
2014	176	714
2015	171	585
2016	144	339
2017	282	943
2018	248	413
2019	295	884
2020	295	1,258
2021	404	1,173
2012-2021	2,230	7,236

Source: Morningstar

Chart 8: Flow of Funds — World ex-North America



Source: Morningstar

5. World Markets

5.1 Market Share

In 2021, the market share of passive funds in world markets increased by three percentage points, from 28% to 31%. Over ten years, the data shows a sharp increase in the market share of passive investments, which climbed from 15% to 31%.

Worldwide, passive fund assets have experienced spectacular growth of 367% since 2012, compared to only 79% for active funds. In dollars, assets under management for passive funds grew by \$13.3 trillion compared to \$16.8 trillion for their active counterparts. Globally, passively managed funds have increased their market share steadily since 2012; however, actively managed funds have attracted significant inflows (see section 5.2).

Table 11: Assets Under Management — World (USD Trillions)

	PASSIVE	ACTIVE
2012	3.6	21.1
2013	4.6	23.6
2014	5.3	24.4
2015	5.7	23.5
2016	6.7	24.4
2017	8.9	28.8
2018	8.8	26.6
2019	11.5	30.9
2020	13.7	34.8
2021	16.9	37.9
2012-2021 Growth	367%	79%

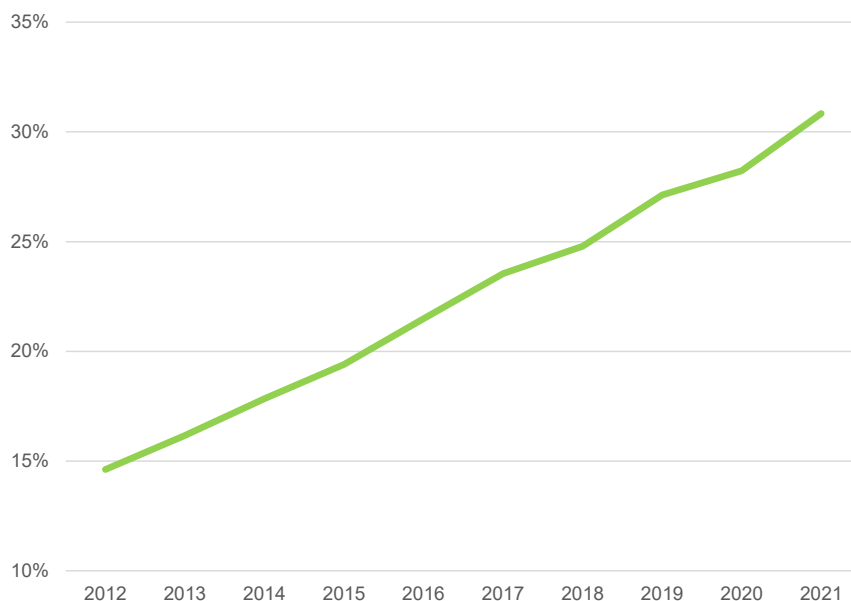
Source: Morningstar

Table 12: Market Share — World

	PASSIVE	ACTIVE
2012	15%	85%
2013	16%	84%
2014	18%	82%
2015	19%	81%
2016	21%	79%
2017	24%	76%
2018	25%	75%
2019	27%	73%
2020	28%	72%
2021	31%	69%

Source: Morningstar

Chart 9: Passive Fund Market Share — World



Source: Morningstar

5.2 Flow of Funds

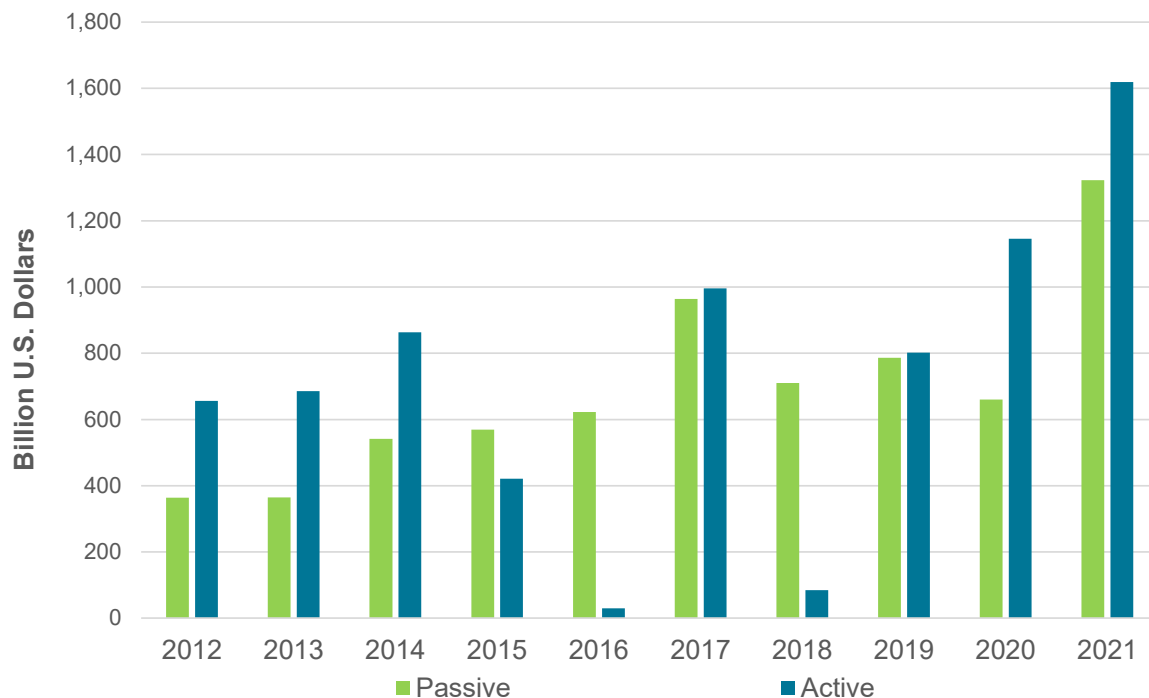
Chart 10 illustrates contributions to passive and active funds globally between 2012 and 2021. In 2021, passive funds raised \$1.3 trillion in new money, compared to contributions totaling \$1.6 trillion for active funds. In particular, the latter have posted positive cash flows in each of the last ten years, although these contributions have been much less stable than those of passively managed funds. From 2012 to 2021, passive funds raised \$6.9 trillion in new money, compared to \$7.3 trillion for active funds. Thus, on a global scale, the competition between passive and active funds to attract capital is very tight.

Table 13: Flow of Funds — World (USD Billions)

	PASSIVE	ACTIVE
2012	364	656
2013	365	686
2014	541	863
2015	570	421
2016	622	30
2017	964	996
2018	710	85
2019	787	802
2020	660	1,145
2021	1,322	1,619
2012-2021	6,905	7,303

Source: Morningstar

Chart 10: Flow of Funds — World



Source: Morningstar

Conclusion

Since 2012, passive funds have consistently attracted positive net amounts in Canada, the United States and around the world. In Canada, passive funds increased their market share for a sixth consecutive year, with the 2021 inflow beating their previous record by a landslide. Nonetheless, despite their substantial progress, passive funds still represent a modest market share of 14.5% in Canada.

The story is very different in the United States: passive funds dominate actively managed funds in terms of inflows. Active funds have experienced nice inflows in 2021, however passive funds attracted a lot more money. Since 2012, active funds have recorded a net outflow while passive funds flourished.

For the world ex-North America and the world overall, passive funds have increased their market share substantially while active funds managed to attract very large flows since 2012. Passive funds are growing faster as a percentage, but active funds are attracting the most net new money.

Overall, passive funds are clearly gaining acceptance with retail investors worldwide. While the 31% market share of passive funds is impressive, this number heavily influenced by the US market. In the last decade, the US has been experiencing a cultural revolution. Since the turn of the 2010's, passive funds have dominated inflows, only leaving crumbs to active funds. Even more remarkable is the fact that the market leader for passive funds, the Vanguard Group, is grabbing market share every year without resorting to heavy advertising. Legions of US investors are quitting actively managed funds every year. They have good reasons to do so. Broad-based passive funds beat the median mutual fund almost every year. It's no secret why. While it is very difficult to beat the market steadily before fees, the very high fees charged by active funds make it almost impossible to compete with their passive equivalent after fees. This explains why the past outperformance of passive funds is likely to repeat in the future: it is just simple arithmetic. No rocket science here.

In Canada and in the rest of the world, passive funds are moving up in ranks. Yes, things are slower than in the US, but progress is made steadily. In Canada, if it weren't for the massive inflows in favor of active funds in 2021, passive funds would have attracted more assets for the ten years since 2012. Passive funds have increased market share for six years in a row now; the world ex-North America has seen its passive market share increase every year since 2012. Passive funds have also attracted positive net flows every year since 2012 in Canada, the US and the world excluding North America.

Why are passive funds so dominant in the United States and not in Canada? Several hypotheses come to mind. In particular, the US has a well-established culture of passive management, which may have resulted in greater public awareness. Passive funds have existed in the US since 1975, while the first index fund in Canada was launched in 1990. This corresponds well to the US being 15 years ahead of Canada in terms of passive fund market share. I also wonder whether Canadians have as easy an access to passive funds than their US neighbors. Maybe more Canadian financial institutions prefer not actively proposing passive funds to their clients than is the case in the US because it would be detrimental to their bottom line. But all-in-all, the adoption of passive funds by Canadian investors is progressing steadily.

Appendix A: Canadian ETF Data

Source: Morningstar

Table 14: Assets Under Management (CAD Billions)

	PASSIVE	ACTIVE
2012	42	13
2013	48	13
2014	57	18
2015	66	21
2016	81	30
2017	104	40
2018	107	43
2019	138	56
2020	172	67
2021	227	96

Table 15: Market Share

	PASSIVE	ACTIVE
2012	76%	24%
2013	78%	22%
2014	76%	24%
2015	76%	24%
2016	73%	27%
2017	72%	28%
2018	71%	29%
2019	71%	29%
2020	72%	28%
2021	70%	30%

Table 16: Flow of Funds (CAD Billions)

	PASSIVE	ACTIVE
2012	8.0	2.0
2013	3.6	0.7
2014	5.5	3.7
2015	11.5	4.5
2016	10.2	5.1
2017	16.2	8.5
2018	9.5	5.0
2019	16.0	6.6
2020	22.3	11.6
2021	31.4	19.4
2012-21	134.2	67.1

Appendix B: Canadian Mutual Fund Data

Source: Morningstar

Table 17: Assets Under Management (CAD Billions)

	PASSIVE	ACTIVE
2012	21	576
2013	25	636
2014	27	758
2015	28	886
2016	29	958
2017	32	1,051
2018	31	1,002
2019	38	1,156
2020	44	1,324
2021	54	1,563

Table 18: Market Share

	PASSIVE	ACTIVE
2012	3%	97%
2013	4%	96%
2014	3%	97%
2015	3%	97%
2016	3%	97%
2017	3%	97%
2018	3%	97%
2019	3%	97%
2020	3%	97%
2021	3%	97%

Table 19: Flow of Funds (CAD Billions)

	PASSIVE	ACTIVE
2012	1.5	-1.7
2013	-1.3	-2.6
2014	-1.4	27.6
2015	-0.5	17.6
2016	-0.4	-4.1
2017	-0.5	17.5
2018	0.1	-23.5
2019	-0.7	-1.7
2020	1.9	-1.0
2021	1.7	94.4
2012-21	0.4	122.4

Appendix C: U.S. ETF Data

Source: Morningstar

Table 20: Assets Under Management (USD Billions)

	PASSIVE	ACTIVE
2012	1.2	0.1
2013	1.5	0.2
2014	1.7	0.3
2015	1.9	0.3
2016	2.2	0.3
2017	3.0	0.4
2018	3.0	0.4
2019	3.9	0.5
2020	4.8	0.7
2021	6.2	1.1

Table 21: Market Share

	PASSIVE	ACTIVE
2012	89%	11%
2013	87%	13%
2014	86%	14%
2015	87%	13%
2016	88%	12%
2017	88%	12%
2018	88%	12%
2019	89%	11%
2020	87%	13%
2021	85%	15%

Table 22: Flow of Funds (USD Billions)

	PASSIVE	ACTIVE
2012	178	12
2013	142	47
2014	210	35
2015	219	24
2016	265	4
2017	420	45
2018	279	30
2019	318	14
2020	386	119
2021	740	169
2012-21	3,157	497

Appendix D: U.S. Mutual Fund Data

Source: Morningstar

Table 23: Assets Under Management (USD Trillions)

	PASSIVE	ACTIVE
2012	1.2	8.1
2013	1.6	9.5
2014	1.9	10.0
2015	2.1	9.7
2016	2.5	10.0
2017	3.2	11.4
2018	3.2	10.4
2019	4.1	12.2
2020	4.6	13.6
2021	5.6	15.2

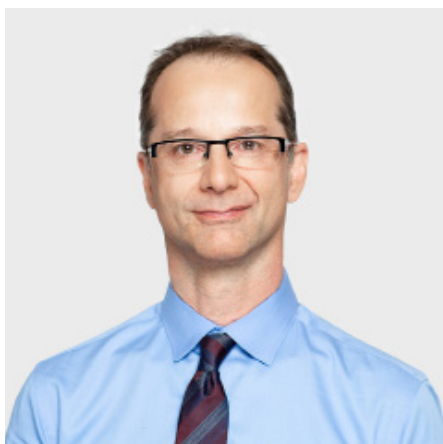
Table 24: Market Share

	PASSIVE	ACTIVE
2012	12%	88%
2013	13%	87%
2014	14%	86%
2015	15%	85%
2016	17%	83%
2017	18%	82%
2018	20%	80%
2019	22%	78%
2020	24%	76%
2021	26%	74%

Table 25: Flow of Funds (USD Billions)

	PASSIVE	ACTIVE
2012	69	198
2013	113	160
2014	152	83
2015	169	-210
2016	203	-314
2017	246	-18
2018	174	-340
2019	158	-100
2020	-45	-242
2021	145	164
2012-21	1,384	-620

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