July 2, 2004

Monthly Mutual Fund Report

Statistics for May-June 2004

Mutual Funds and Retirement Savings

Retirement savings significantly propped up net new cash flows into long-term mutual funds in 2003, according to the Investment Company Institute's annual report[1] on the retirement market. Unlike 2002, where the "automatic" inflow from employer-sponsored defined contribution and individual retirement accounts spared equity funds from worse net outflows, equity fund inflows were strong in 2003, enhanced by the contributions of IRA's and 401k's. However, due to the large outflow in the money market funds, as investors and fund managers came back to the equity market, total net flows were negative in 2003, despite the inflows from retirement accounts. For the second straight year, the net cash inflow to mutual funds in retirement accounts declined, from $135 billion in 2001 to $85 billion in 2003, due to the sharp decline in flows to bond funds and money market accounts. Still, retirement accounts hold 36 percent of total mutual fund assets (up from 33 percent in 2002), and 22 percent of U.S. retirement assets are invested in mutual funds (up from 20 percent in 2002). (Figure A)

Sales and Redemptions

Total assets for all funds decreased in May by $32.8 billion, or 0.4 percent, to $7.51 trillion. Money market funds had a net cash inflow, its first since June 2003, of $6.5 billion compared to an outflow in April of $46.3 billion. Other funds (equity, hybrid, and bond) had a net cash outflow of $13.3 billion, compared to an inflow of $19.8 billion in April. New sales of non-money market funds, the purchase of new shares excluding reinvested dividends, were $101.1 billion in May, down from $127.8 billion in April. The value of non-money market assets appreciated by $34.3 billion in May, following a depreciation of $135.5 billion in April.

Total assets of **equity funds** increased by $43.1 billion, or 1.1 percent, to $3.85 trillion. There was a $0.6 billion net cash inflow to equity funds in May, compared with an inflow of $23.0 billion in April. The market value of assets appreciated by $42.1 billion in May. The year-to-date inflow is $108.3 billion, compared to an inflow of $16.9 billion in the first five months of 2003.

Total assets for **hybrid funds**, which invest in a mix of stocks and bonds, increased 1.0 percent, or $4.5 billion, to $456.9 billion. In May, there was a $2.3 billion net cash inflow for these funds, compared to an inflow in April of $4.6 billion. Hybrid funds have experienced an inflow of $22.1 billion thus far in 2004, compared to an inflow of $7.7 billion to this point in 2003.

Bond funds experienced a cash outflow of $16.2 billion, while their total assets decreased by $23.2 billion, to $1.22 trillion. The market value of bond funds assets decreased by $9.8 billion, after adjusting for net sales and reinvested dividends. The assets of taxable bond funds decreased by 1.8 percent, while the assets of tax-exempt bond funds decreased by 2.0 percent. The 2004 outflow is $14.9 billion, compared to an inflow of $62.4 billion through May 2003.

Assets of taxable and tax-exempt **money market funds** increased $8.4 billion, to $1.97 trillion, increases of 0.2 percent for taxable money market funds and 1.6 percent for tax-exempt funds. The year-to-date outflow of $91.1 billion is less than the outflow for the first five months of 2003, $145.0 billion.

Liquidity Ratio

The liquidity ratio for bond and hybrid funds decreased from 6.00 to 5.85 percent, while the ratio for equity funds decreased from 4.33 to 4.16 percent (figure 4).

Weekly Flows

In June, there were outflows from equity funds of 0.1 percent of total assets, with returns of 1.3 percent (figure 6a). Though this outflow is less than May's 0.4 percent, equity fund flows have been negative for four consecutive months. Bond funds had outflows of 0.1 percent and returns of 0.2 percent.[2]

Index funds had monthly inflows of 0.5 percent and returns of 2.2 percent. Aggressive growth funds had outflows of 0.2 percent and returns of 1.8 percent. Small-cap funds had an inflow of 0.03 percent and returns of 3.0 percent.

Technology funds had an outflow of 0.7 percent and returns of 0.8 percent (figure 6b). There was an inflow to real estate funds of 0.9 percent and returns of 3.6 percent.

There were inflows to international funds in June of 0.5 percent of assets and returns of 0.8 percent. Latin American funds had outflows of 0.7 percent and losses of 1.0 percent. Japan funds had inflows of 0.5 percent and returns of 5.5 percent of assets for the month of June. Pacific funds that do not invest in Japan had outflows of 0.9 percent and losses of 2.5 percent of assets. Emerging Markets funds had outflows of 0.6 percent, its 28th straight negative month, and returns of 1.5 percent.

Capital Market Returns and Volatility

The S&P 500 ended June at 1140.84, an increase of 1.8 percent from the beginning of the month. The 12-month gain was 18.4 percent at month-end. The annualized volatility for the daily return on the S&P 500 was 12.1 percent.

The 12-month average return on the Citigroup Bond Index was -0.4 percent for May. Volatility decreased to 5.73 percent (figure 8).

Price-Earnings Ratio

The macro projections for the growth of earnings of the Standard and Poor's 500 index over the next two years have increased in the second quarter to 2.5 percent from current levels. The trailing price-earnings ratio decreased from 22.6 in the fourth quarter of 2003 to 21.4 for the first quarter of 2004, while Thomson Financial/First Call's forward price-operating earnings was 16.9 in the second quarter of 2004, down from 17.1 in the first quarter. During the second quarter the price-earnings ratio for the Standard and Poor's Small-Cap 600 Index fell to 29.0 from 30.7 (figure 9).

The Monthly Mutual Fund Report is available online at http://www.bos.frb.org/economic/mmfr/mmfr.htm.

Also, the Stock Market Report is now available to the general public. The current issue, as well as previous editions, can be found at our public website, http://www.bos.frb.org/economic/smr/smr.htm.

Please contact Matthew S. Rutledge for questions and comments at Matthew.S.Rutledge@bos.frb.org, or by phone at (617) 973-3198.

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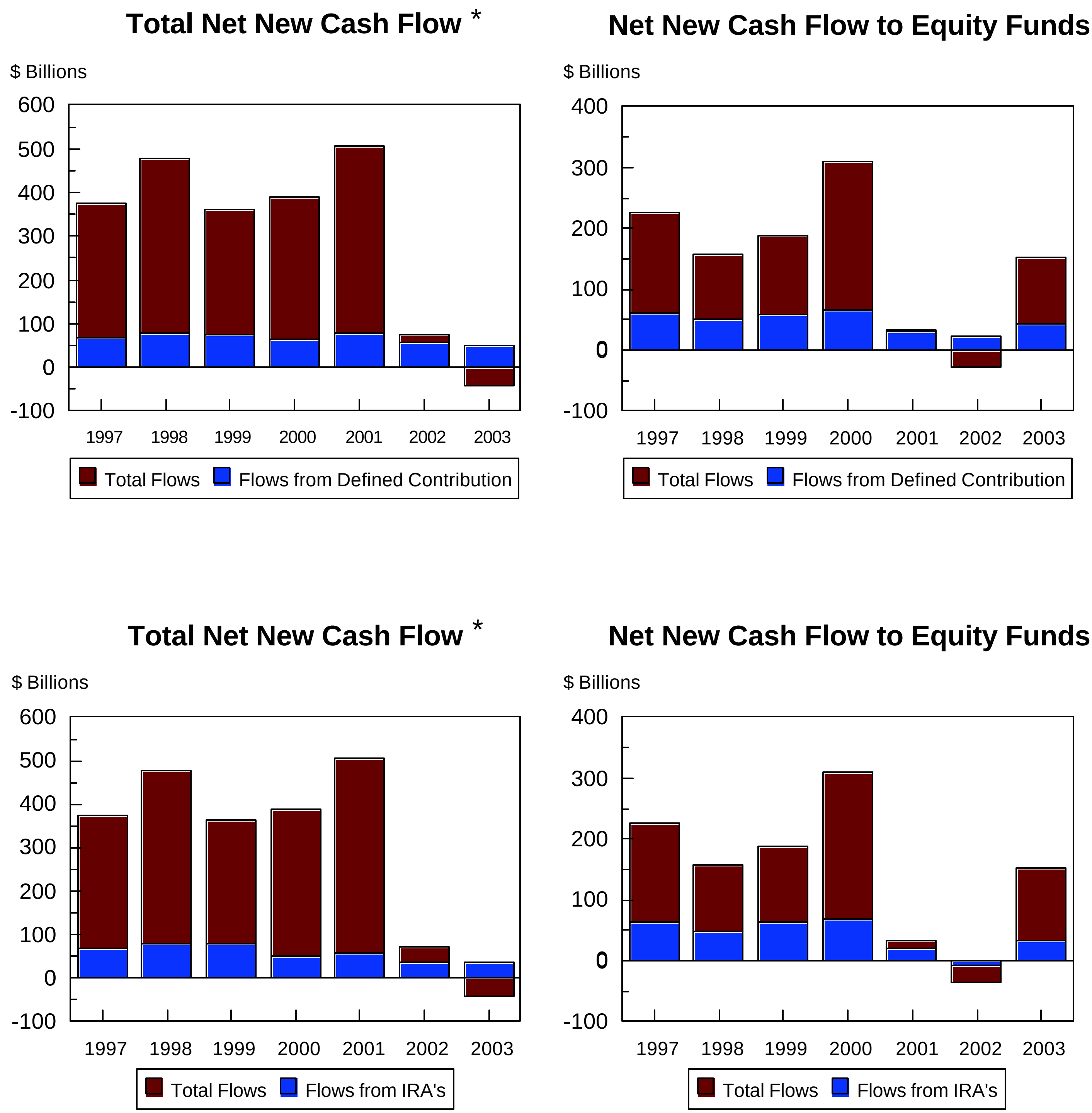
[1] "Mutual Funds and the U.S. Retirement Market in 2003," Fundamentals, Investment Company Institute, Vol. 13, No. 2 (June 2004), p. 5.

[2] Due to a small error, we have refined the formula used to calculate monthly flows and returns. For past results using the new formula, please contact the author.

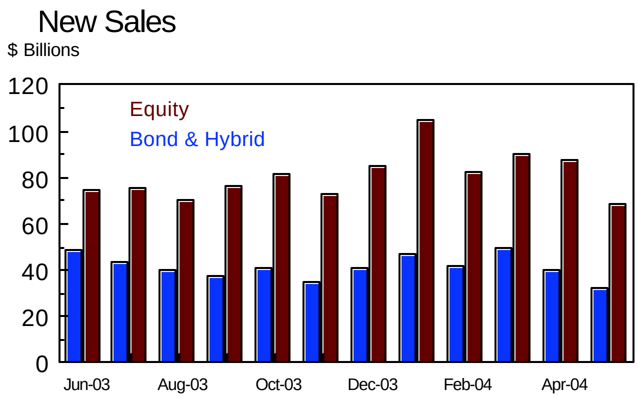
Figure A
Mutual Funds and the U.S. Retirement Market

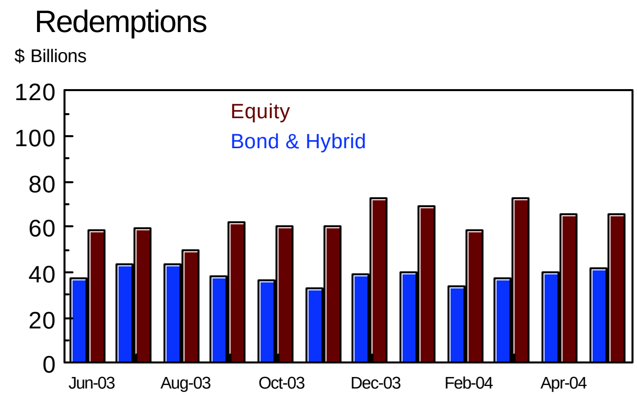


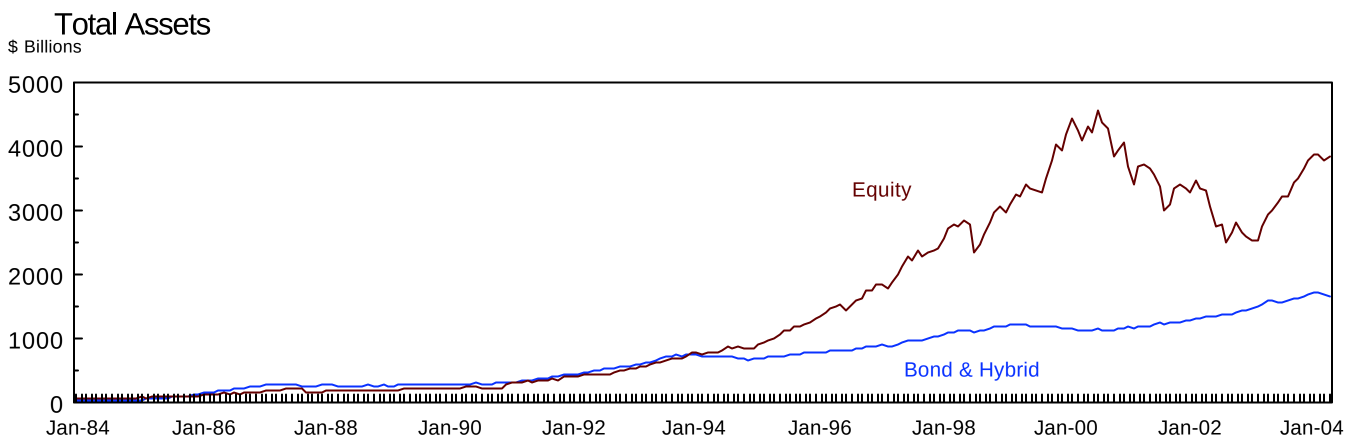
* Flows into all U.S. mutual funds, including equity, hybrid, bond and money market funds.

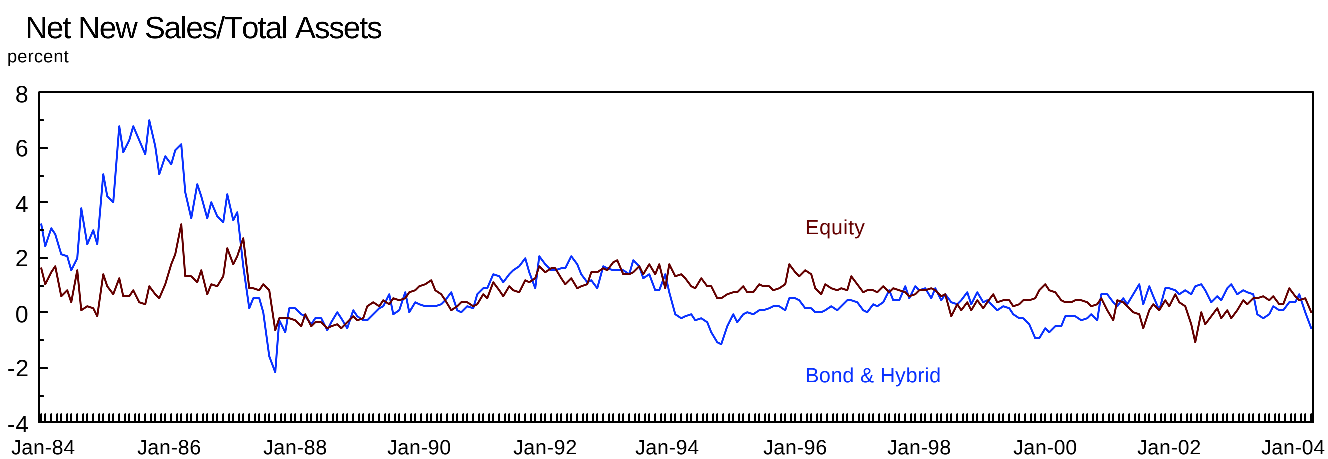
Source: Investment Company Institute

Figure 1
Sales of Mutual Funds







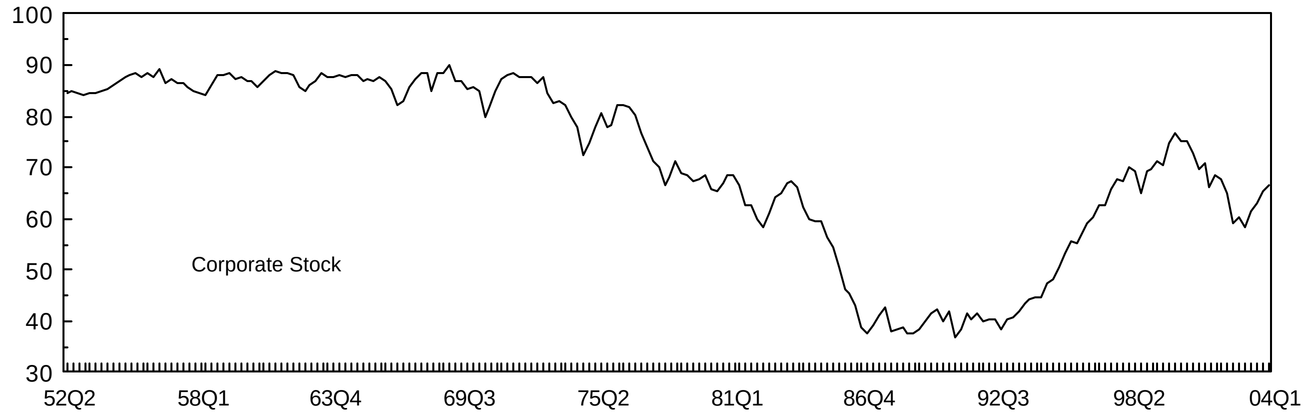


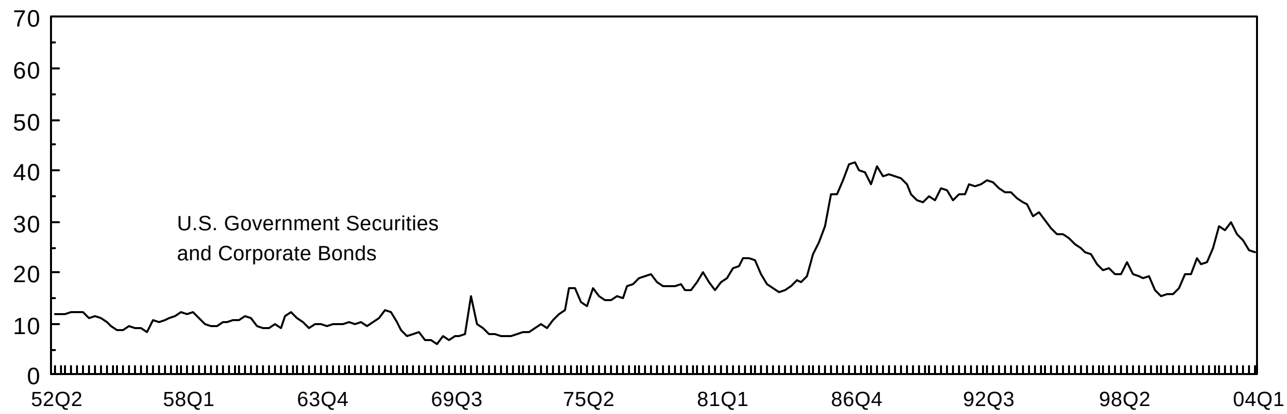
Source: Investment Company Institute

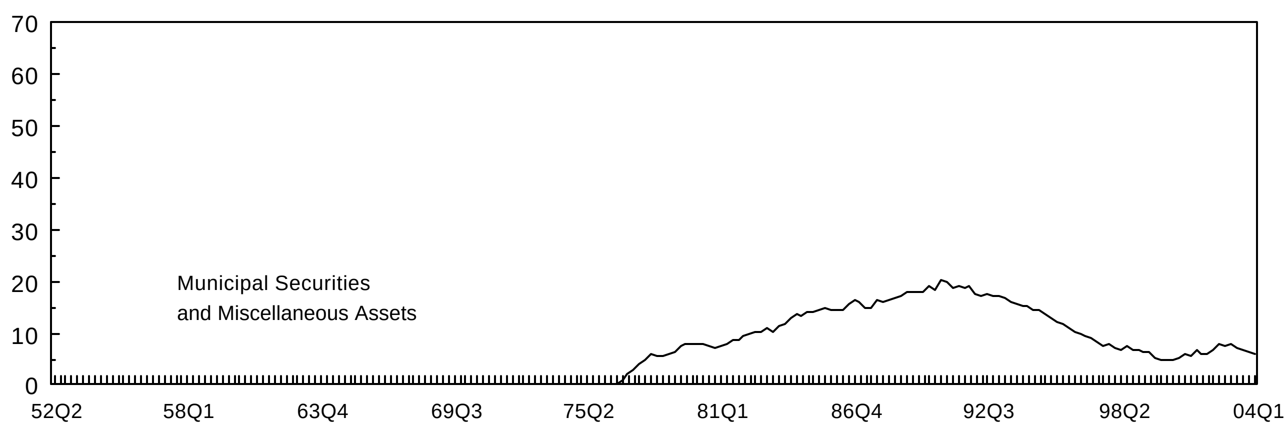
Figure 2

Composition of Mutual Funds' Financial Assets

(percent of Total Financial Assets)







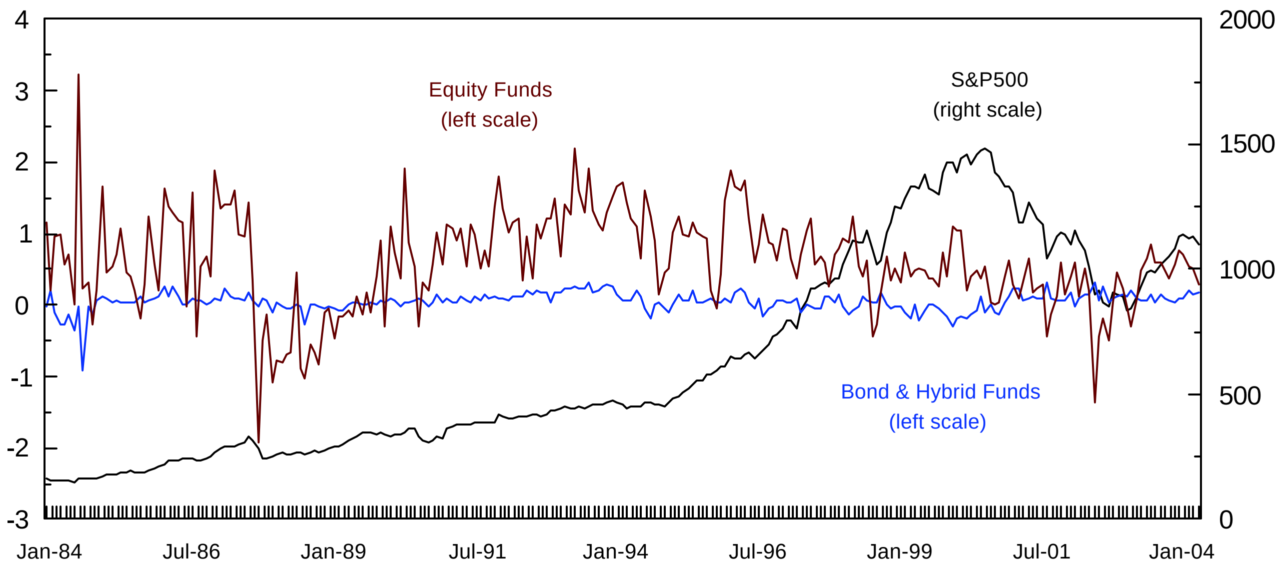
Source: Flow of Funds, Haver Analytics

Figure 3

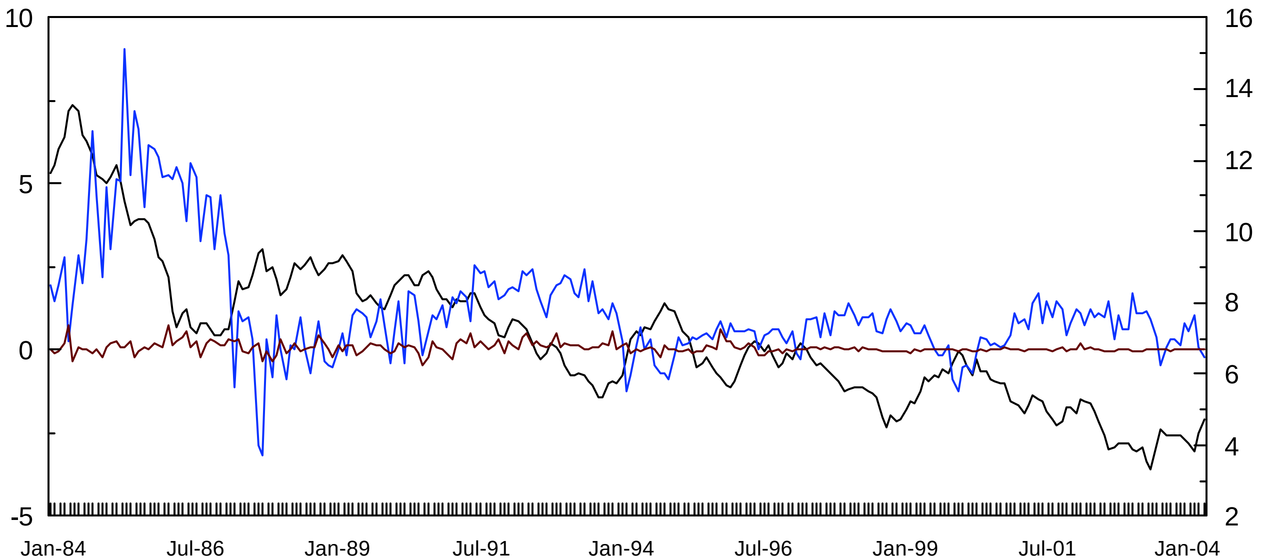
Net Portfolio Purchases

(percent of Total Assets)

Net Common Stock Purchases



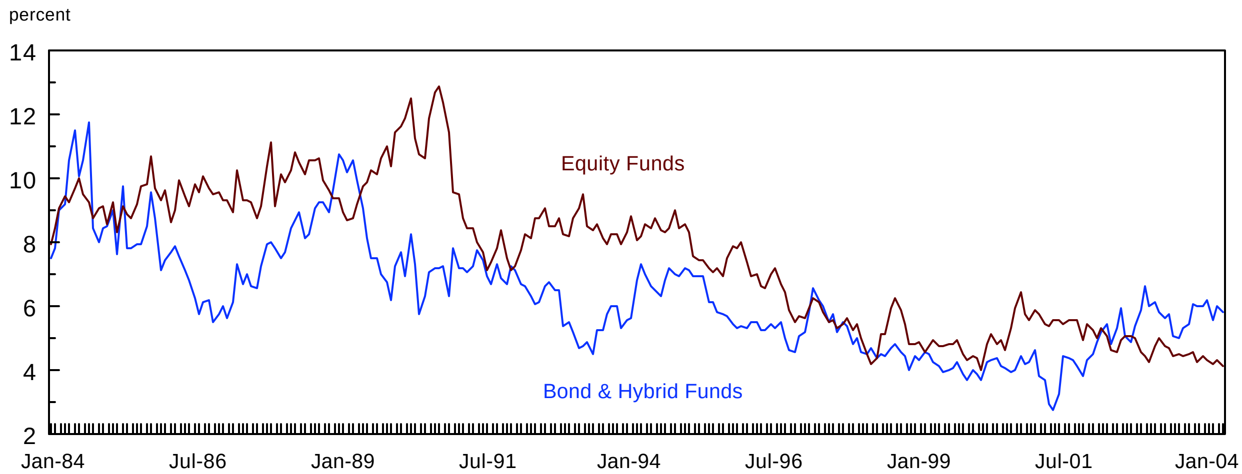
Net Purchases of Other Assets

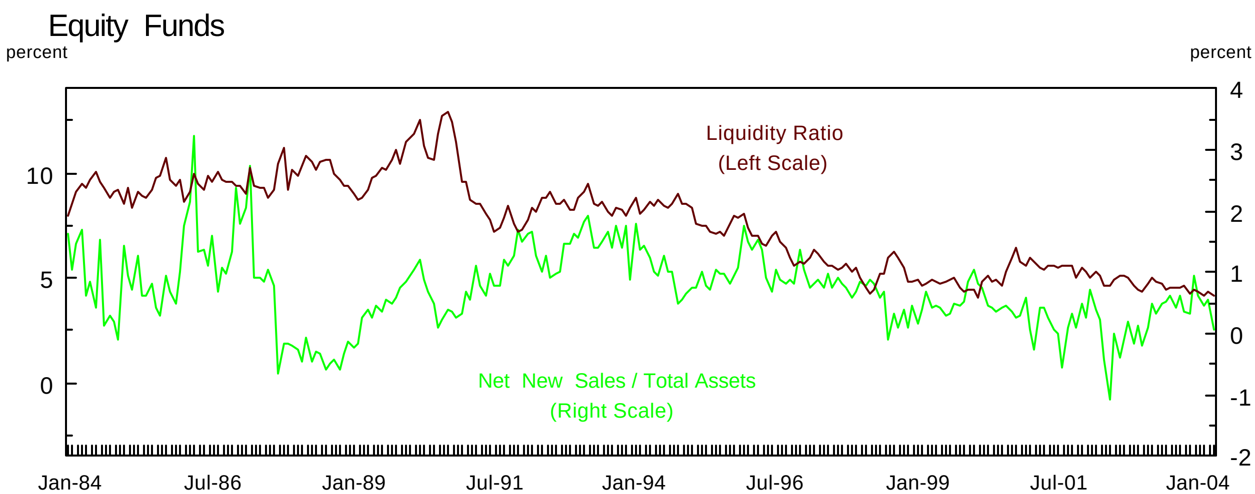


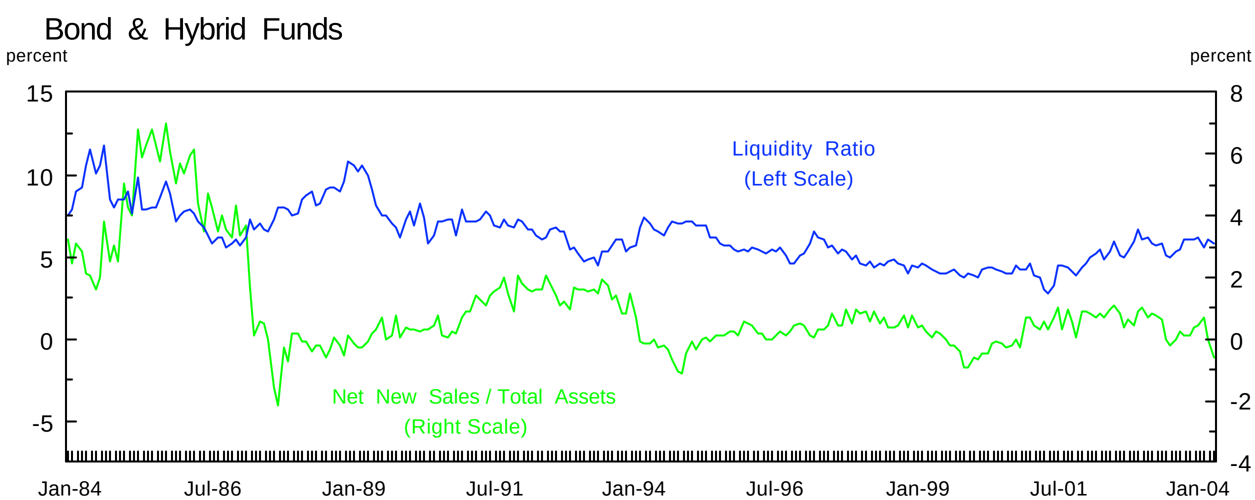
Source: Investment Company Institute

Figure 4

Liquidity Ratio*



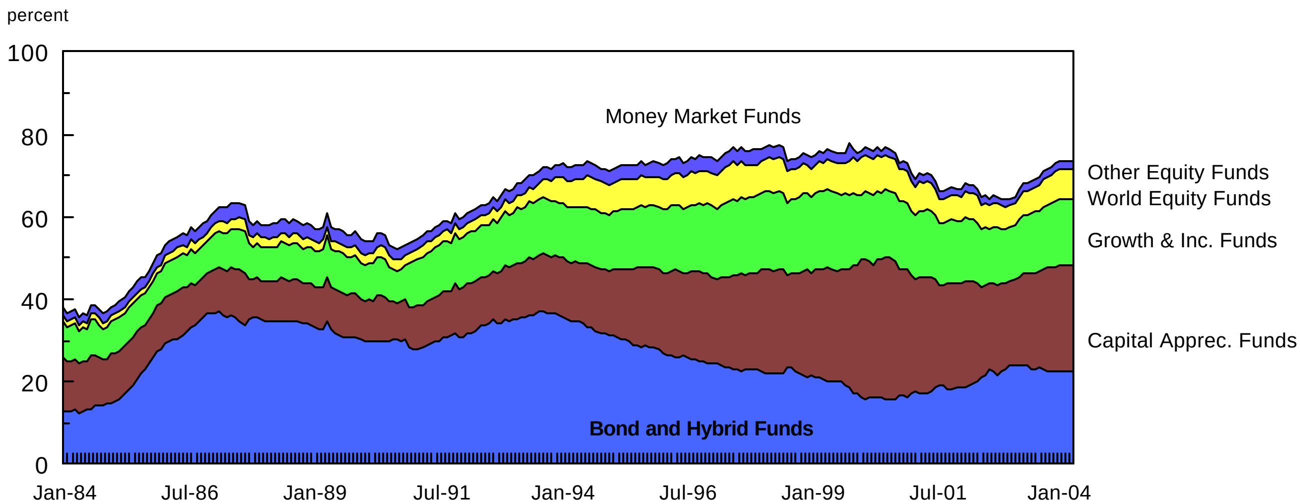




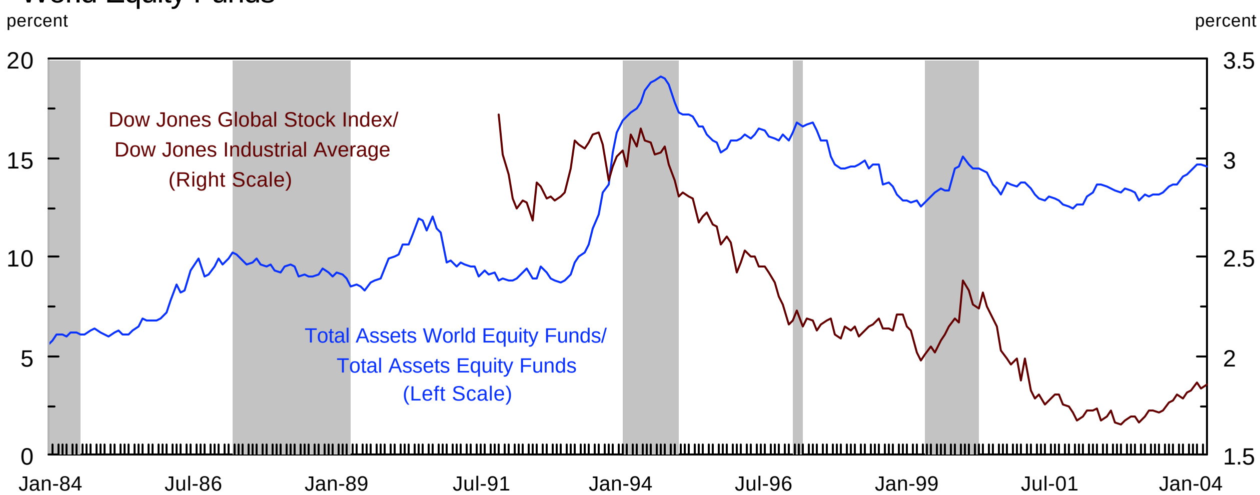
*The Liquidity Ratio is the Percent of Total Assets held in Cash and Short-Term Securities.

Source: Investment Company Institute

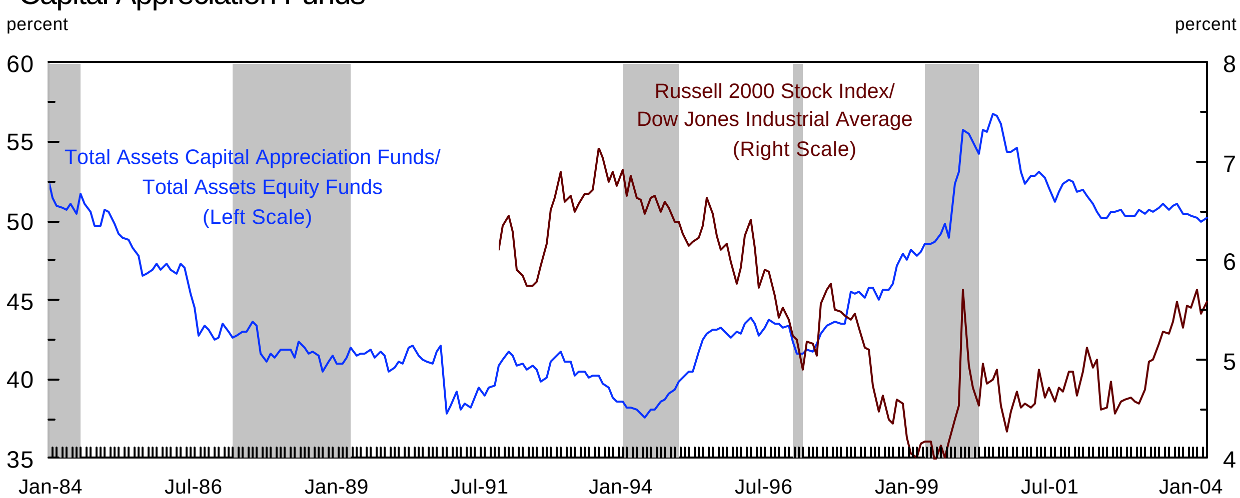
Figure 5
Industry Composition
(Shaded Regions Indicate Periods of Rising Fed Funds Rate)



World Equity Funds



Capital Appreciation Funds

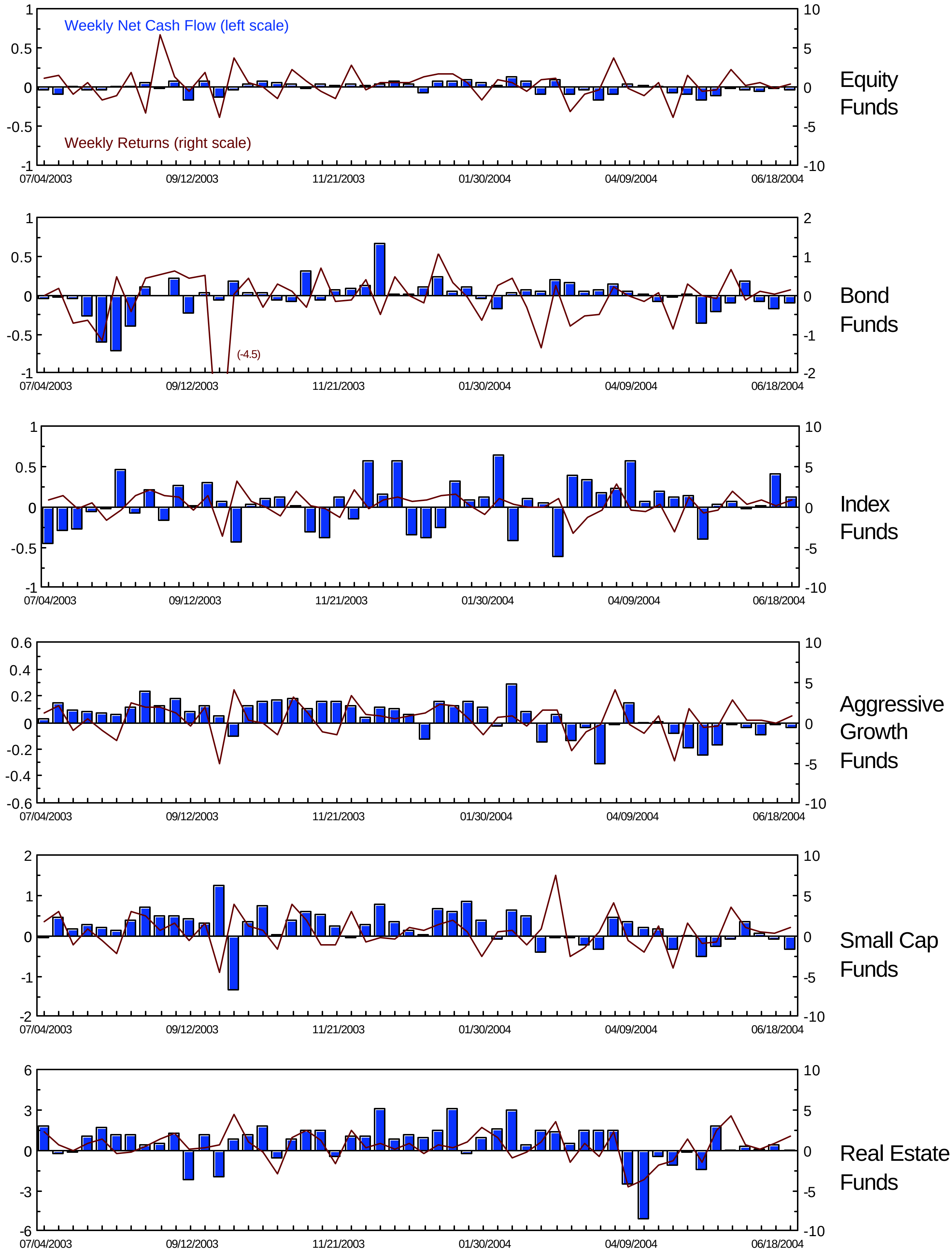


Source: Investment Company Institute

Figure 6a

Weekly Flows into Mutual Funds

(percent of Total Assets)

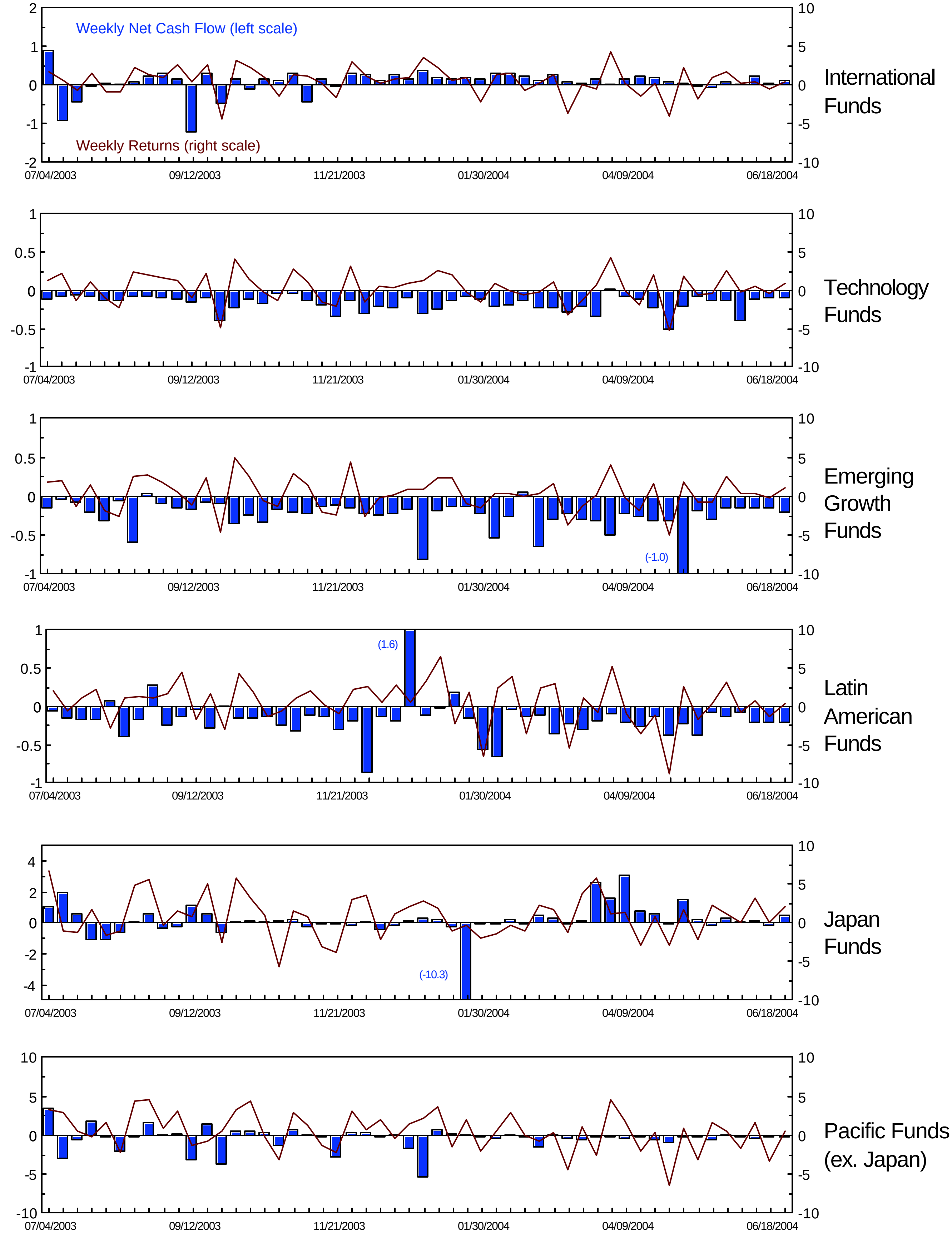


Source: Mutual Fund Trim Tabs

Figure 6b

Weekly Flows into Mutual Funds

(percent of Total Assets)

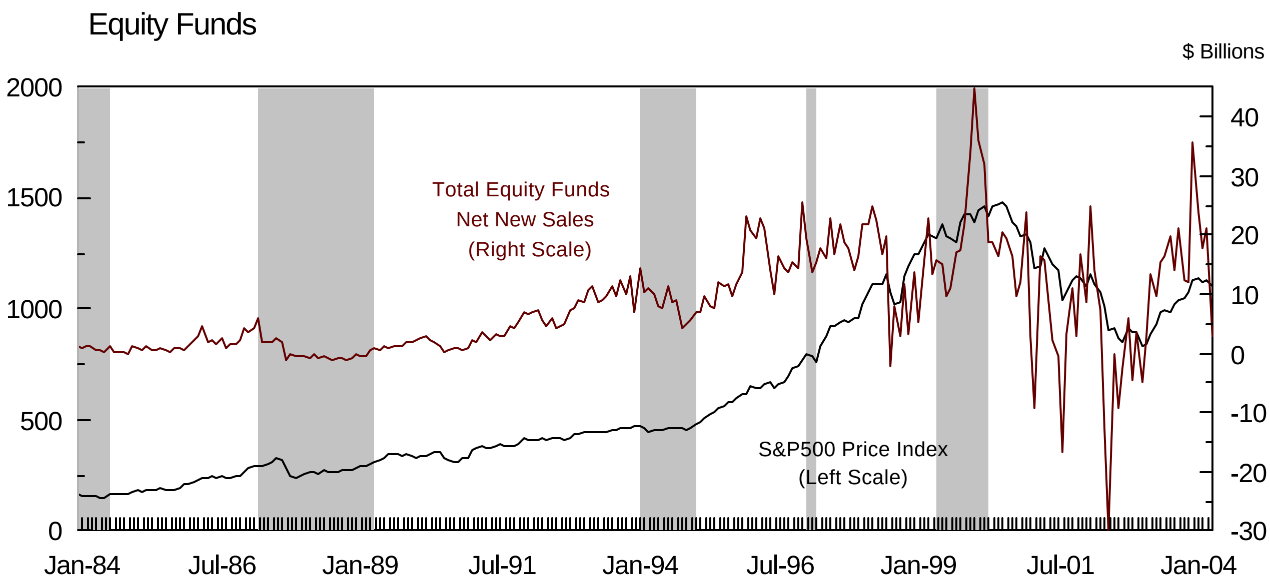


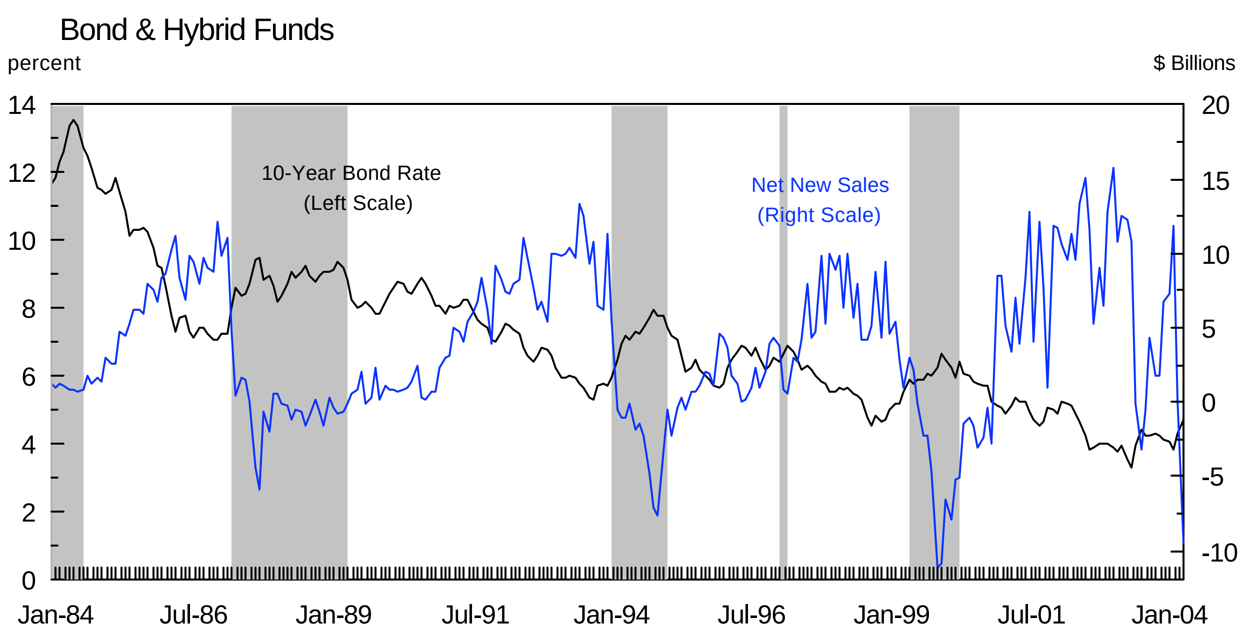
Source: Mutual Fund Trim Tabs

Figure 7

Net New Sales By Investment Objective

(Shaded Regions Indicate Periods of Rising Fed Funds Rate)

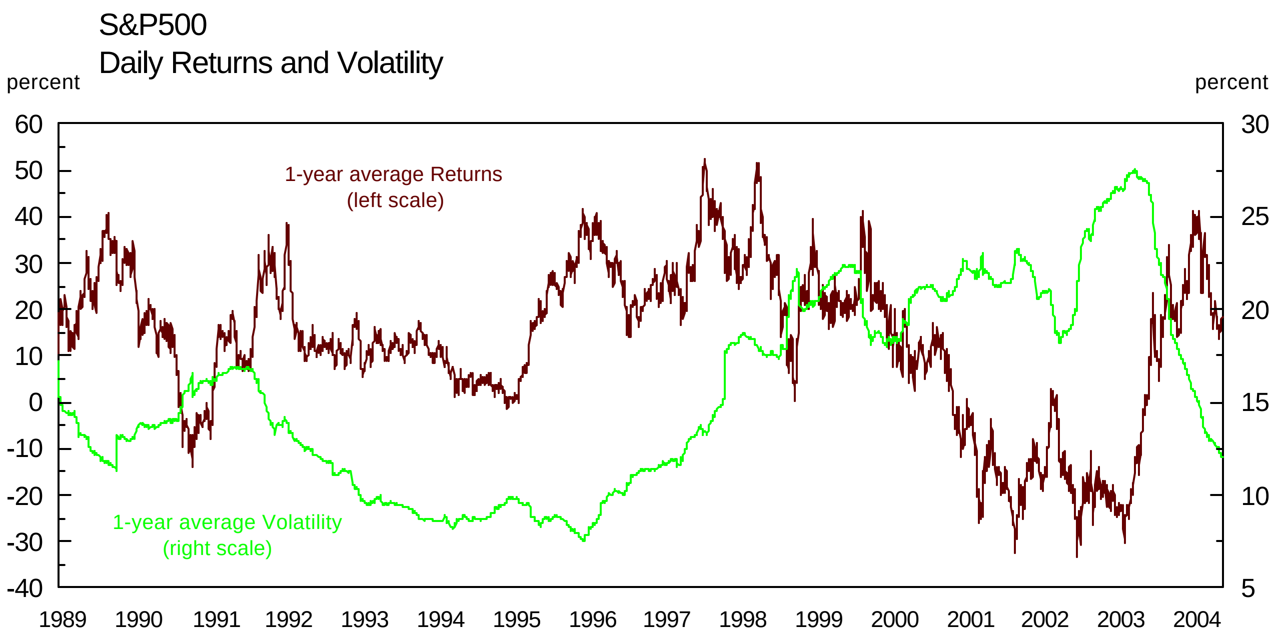


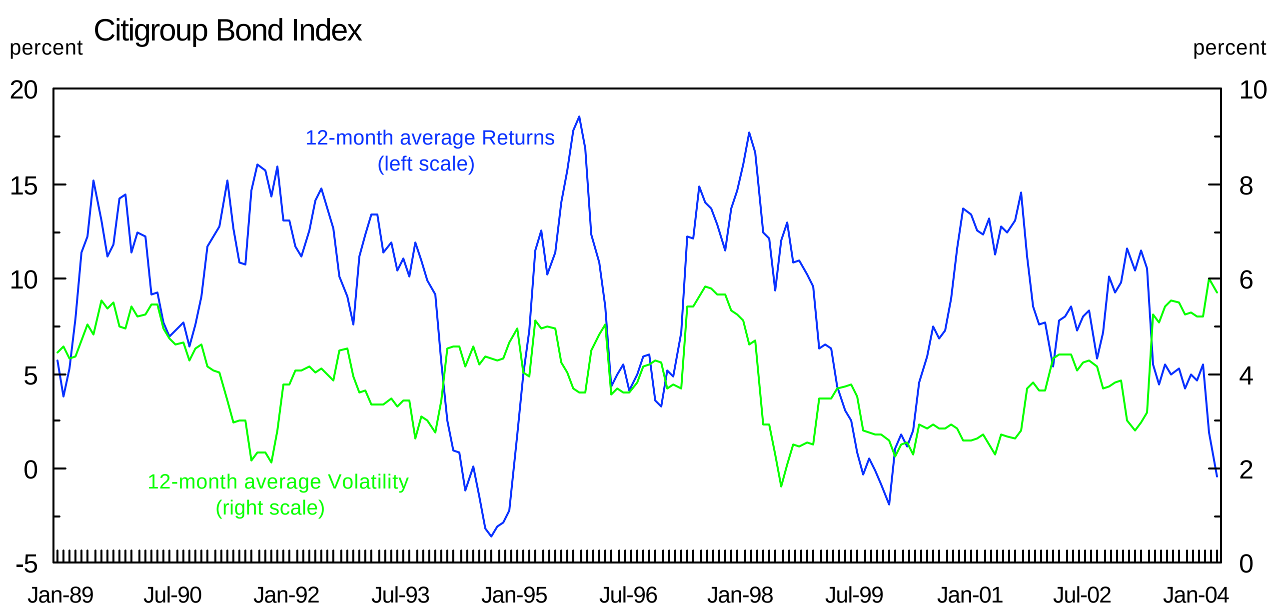


Source: Investment Company Institute

Figure 8

Capital Market Returns and Volatility

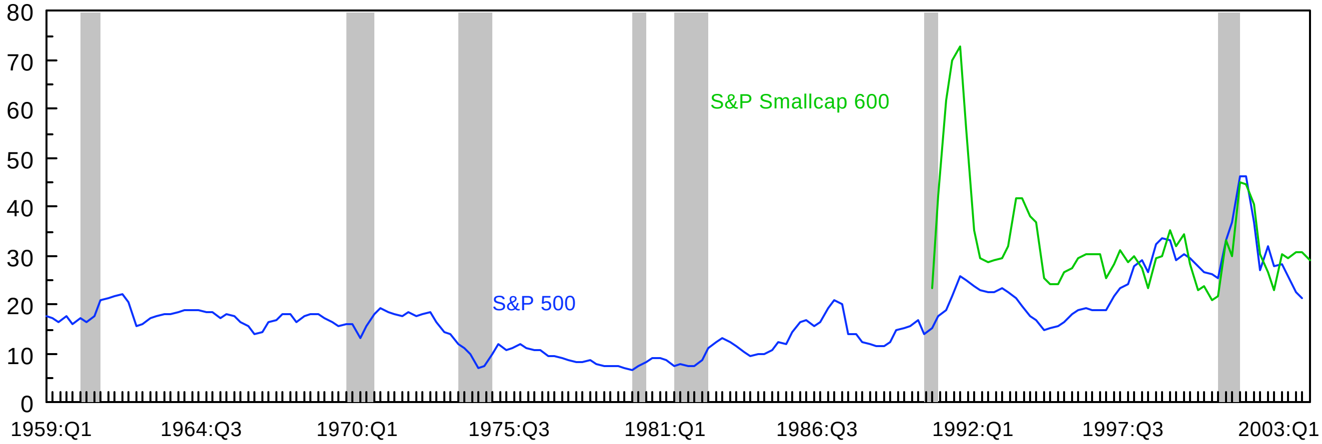




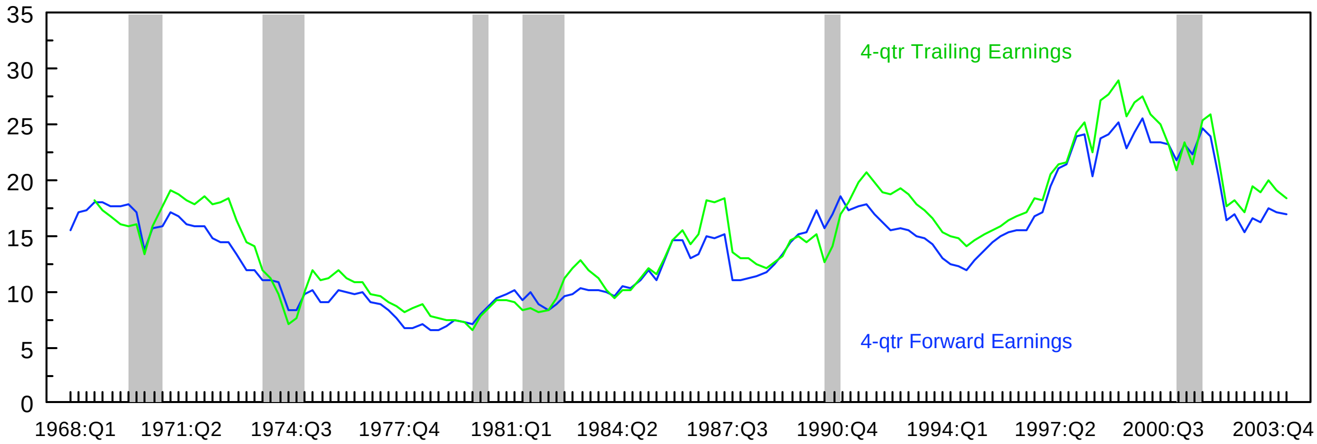
Source: FAME Database, Citigroup

Figure 9

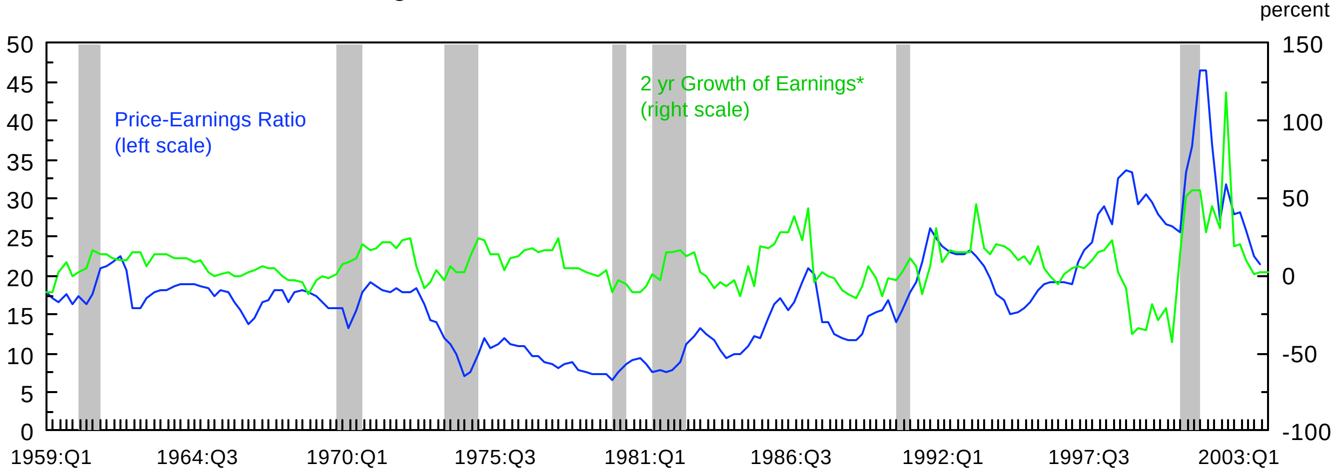
S&P Price-Earnings Ratios



S&P500 Price-Operating Earnings Ratio



S&P500 Price Earnings Ratio
and the Growth of Earnings

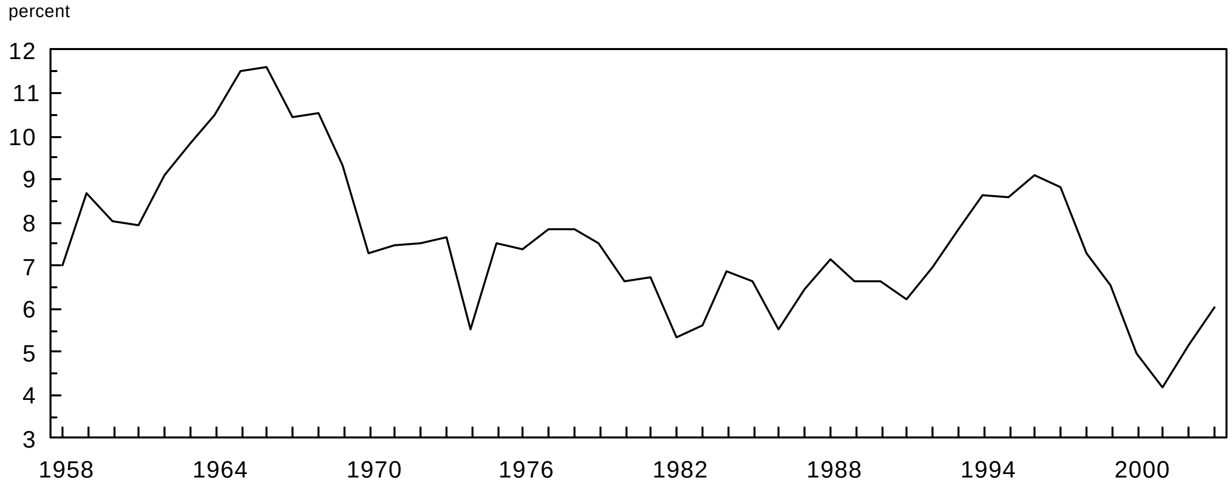


* Growth of earnings over subsequent 8 quarters. Current observations use forecast of earnings from macro projections.

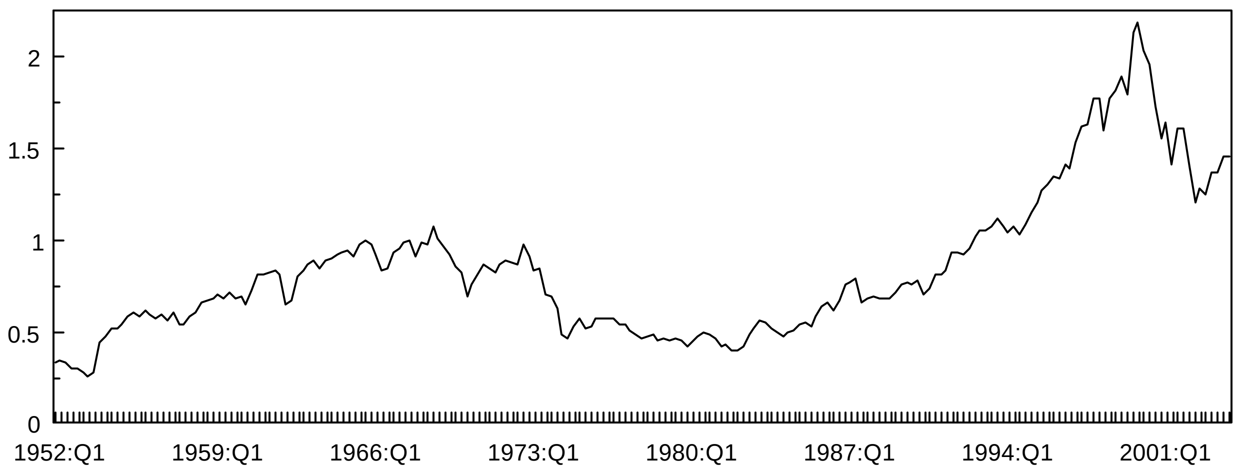
source: Thomson Financial/First Call, Global Exchange (formerly DRI), Bloomberg

Figure 10

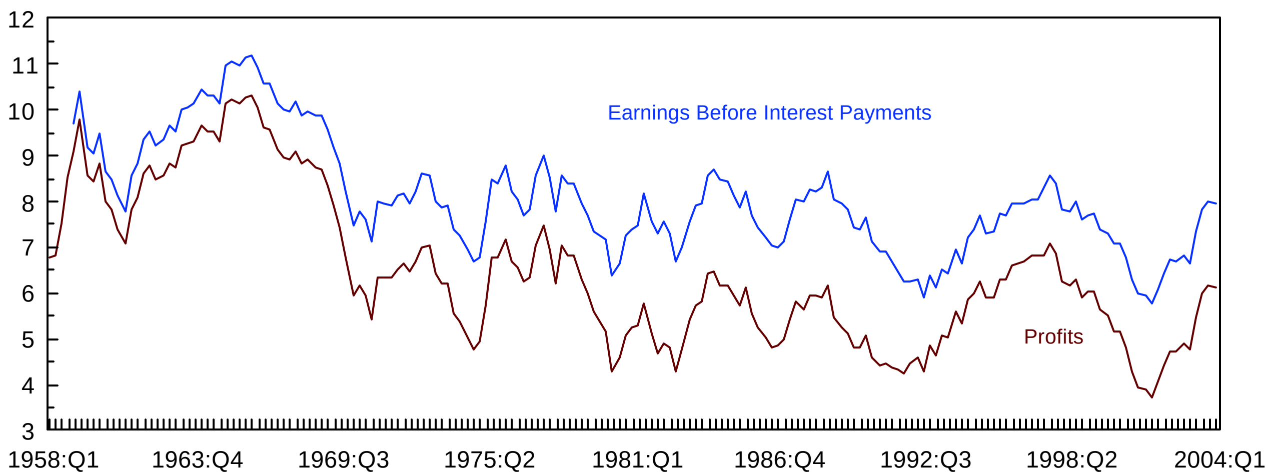
Real Rate of Return on Nonfinancial Corporate Equity
(from National Income and Flow of Funds Accounts)



Tobin's Q*



Profits of Nonfinancial Corporations
(percent of GDP)



* Market Value of Equity plus Net Interest Bearing Debt / Current value of Land, Inventories, Equipment, and Structures

Source: Flow of Funds, Haver Analytics