



The Great Purge: Liquidations to Dominate 2009

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Financial advisors will have far fewer mutual funds to pick from next year.

Distressed market conditions and a battered banking system have forced fund managers to trim their lineups in an attempt to alleviate some of the pain from an industrywide profit squeeze.

In fact, mutual funds are poised to shatter the all-time record for liquidations, set back in 2001 in the wake of the tech wreck. Through Nov. 25 there have been 560 liquidations of fund share classes in 2008, according to **Lipper**. That puts total liquidations on pace to surpass the 581 liquidations in 2001. That compares to 498 liquidations in 2007 and 460 liquidations in 2006.

Morgan Stanley Investment Management and its **Van Kampen** subsidiary have folded 60 fund share classes this year, followed by John Hancock, which has ditched 27 share classes. **Lehman Brothers** and **JPMorgan** liquidated 24 and 20 share classes, respectively.

Touchstone Investments has scuttled 15 fund share classes, while **First Investors** and **Munder** each have scrapped a dozen. **Allianz** dumped 11 fund share classes in 2008. Meanwhile, exchange-traded fund providers **XTF Advisors**, **Healthshares** and **Claymore** have liquidated a combined 42 of their fund share classes.

Next year the carnage is going to be even worse, analysts say. "With far lower assets due to performance, we're going to see a sizeable number of firms merge or liquidate their funds in 2009," says Jeff Tjornehoj, senior analyst at Lipper. Newer retail mutual funds that ape institutional strategies such as absolute return funds and 130/30 funds are likely to be the first to disappear, Tjornehoj says. "Those could be the first to bite the bullet."

Russ Kinnel, director of research at **Morningstar**, agrees. "There are a lot of funds that have small asset bases and not-so-great prospects of drawing assets in the near future," he says. He sees BRIC funds as one of the most vulnerable fund categories when it comes to tightening up a stable of funds. "A lot of the first funds to go are the ones that came out of the gate and flopped," he says.

For most fund professionals, a period of contraction is anticipated, but the extent of that retrenchment is difficult to gauge. "The product rationalization is going to be huge," says Lisa Cohen, CEO and principal of **Momentum Partners**, a consulting firm in Medfield, Mass. "You could lose one third of the funds."

Other industry observers see a much deeper cut. "I wouldn't be surprised to see the number of funds shrink from 8,000 to about 2,000 by the time the market bottoms," says Robert Ellis, managing director of wealth management at **Celent**, a research and consulting firm.

Product innovation will also suffer. Burt Greenwald, a mutual fund consultant at **BJ Greenwald & Associates**, sees very few new products hitting the shelves next year, with the exception of funds aimed at generating retirement income

Cohen sees a shrinking universe of funds as a positive development in that the more useful funds will survive the purge while so-called "hobby products" will fall by the wayside. And the increased economies of scale will likely lead to lower fund expenses for fund shareholders.

"Just because you have the capability doesn't mean it should be offered. If you're not the best in a particular discipline, get out if it," she says. The funds that have "a very clear reason for existing" will succeed in the long run despite having to muddle through a period of redemptions, she says.

Deciding which funds must be relegated to the scrap heap is not an easy task but a necessary exercise, especially for fund companies that have a series of vanilla, mediocre funds. "If you're not a chart topper, you can't compete," Cohen says.

Still, there is an opportunity to change a negative perception of a manager's products by snipping funds that are outside the firm's bailiwick and crafting a new, narrowly focused message to advisors about what the firm stands for. "A really intelligent product lineup pruning can be an effective marketing story," she says.

The flip side to that argument is that funds that are killed off might have succeeded in a different market and therefore firms could be handicapping their potential for gathering assets. Plus, offering funds that are outside a firm's expertise can be an effective way to keep assets under one roof when that particular style or strategy is out of favor. "Being able to offer investors an alternative stabilizes some of the hot money that is out there," Tjornehoj says. "A feast-or-famine approach won't work."

Another factor worth considering: Trimming a fund lineup can be more costly than anticipated. Winning shareholder approval for a liquidation through the [proxy process](#) can be expensive and time consuming, attorneys say.