Balanced Fund Landscape for Canadian Fund Investors
2023

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Objective of Landscape

Target allocation funds, or balanced funds, present a one-stop strategy for Canadian retail investors and make up a significant portion of retail assets in Canada. This report investigates trends in product development, fund flows, fees, and performance of balanced funds in Canada. Notable emerging trends, which we will continue to monitor in future iterations of this research, appear at the end.

Key Takeaways

- As of the end of March 2023, retail assets in balanced funds totaled over CAD 740 billion. This represents a growth—through flows and capital appreciation—of roughly CAD 140 billion over the last five years ended March 31, 2023.

- Canadians continue to prefer global exposure in their balanced funds. Global balanced funds (those holding more than 70% of assets outside of Canada) grew substantially, while Canadian balanced funds (those holding more than 70% of assets within Canada) lost ground.

- Bank-owned asset managers Royal Bank, Toronto-Dominion, Bank of Montreal, Scotiabank, CIBC, and National Bank manage most of the balanced assets; market share, as defined by total assets, changed little (51% to 52%) over the last five years ended March 31, 2023.

- Investors pulled out of balanced funds during the recent market turbulence, with net outflows of CAD 26 billion from the start of 2022 through to the end of March 2023. Commission-based advice share classes drove this exodus, with net outflows of CAD 36 billion over the same period. Meanwhile, fee-based advice share classes saw CAD 7 billion of inflows over the same period.

- We estimate that 683 balanced funds opened and 456 closed from the start of 2012 through the end of March 31, 2023. Fund firms responded to investor interest by offering more global strategies and fewer Canadian strategies.

- Balanced exchange-traded funds have taken off, especially after Vanguard entered the market. The number of balanced ETFs more than doubled to 58 from 24, and their assets sextupled to CAD 12 billion from CAD 2 billion over the five years ended March 31, 2023.

- Fees for balanced funds have declined over 15% over the last 10 years. Balanced ETFs and fee-based share classes have declined the most, with reductions of 28% and 17%, respectively. Increased competition from low-cost entrants contributed to this trend.

- The historical premium investors pay for global balanced funds declined. Today, the average fee for global equity balanced funds is only 2 basis points—0.02%—more than Canadian equity balanced funds. Global neutral balanced funds are on average 1 basis point less than Canadian neutral balanced funds.

- Every Morningstar Canada balanced benchmark lost money in 2022 for the first time since 2008 as rising interest rates pressured all asset classes and increased correlations. Longer time frames still show a strong case for the diversification benefit of balanced funds.

- Over the last 10 years, cheaper funds typically outperformed their expensive counterparts. This reinforces the importance of fees as the most reliable predictor of performance over time.

Introduction

Balanced funds are the second largest broad category in Canada in terms of total assets. The balanced cohort comprises 1,000 unique funds with an estimated CAD 740 billion of retail investor assets at the end of March 2023. They provide straightforward, diversified portfolios for many investors.

New funds, investor flows, and general market appreciation have bolstered growth in the broad category over the last 10 years. Two main trends emerge over the last five years: Canadian investors are going more global and cheaper. In response, fund companies offered more global strategies for lower fees. The balanced ETF space, for example, grew more than sixfold in the last five years as investors embraced the strategies that charged one fifth the cost of the average traditional balanced mutual fund.

It has been more than a year since the full implementation of the Client-Focused Reforms in Canada—a series of changes to the investment advisor landscape including an assessment of suitability, greater fee transparency, and know-your-client requirements, among others, that aimed to help the overall retail investor experience. Asset-management arms of the big six banks (Royal Bank of Canada, Toronto-Dominion, Bank of Montreal, Scotiabank, CIBC, and National Bank) hold an advantage over competitors with their strong in-house distribution network. Since the full implementation of the CFRs on Dec. 31, 2021, we notice only minimal but encouraging changes to this dynamic.

A volatile 2022—in which rising interest rates pressured both bonds and stocks—may have called the traditional 60/40 portfolio approach into question. Last year was only the second calendar year since 2007 that all six Morningstar Canada allocation benchmarks recorded a loss; the other was 2008. Despite these short-term setbacks, patient investors were rewarded if they held their funds. The last 15 years saw the benchmarks produce an annualized return between 4.0% and 6.6%.

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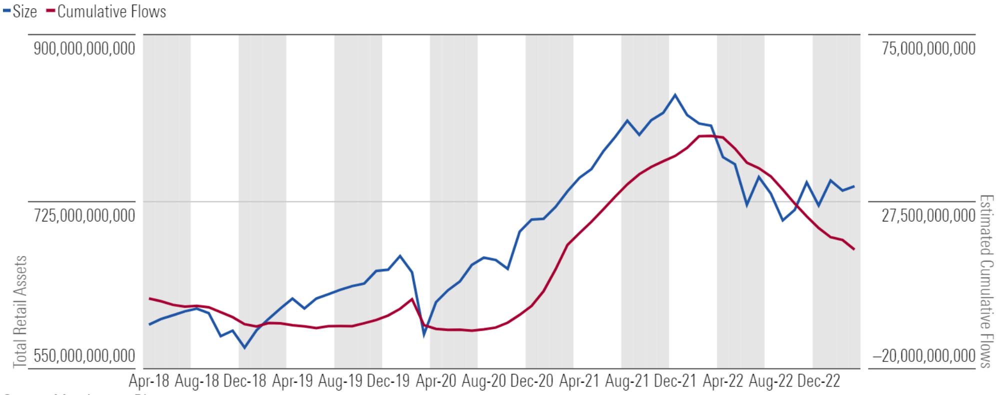
Growth of Balanced Funds Over Time

Balanced funds are popular with Canadian retail investors. Exhibit 1 shows their assets and cumulative flows over the last five years. Inflows were steady from April 2020 until they turned to outflows from April 2022 through March 2023, when roughly CAD 32 billion left the broad category as global markets grew volatile and investors conservative. Over the full five years, though, balance funds had nearly CAD 14 billion in inflows.

Exhibit 1 Size and Cumulative Flows for Balanced Funds



Source: Morningstar Direct

Largest 15 Balanced Fund Managers

Exhibit 2 ranks the 15 Canadian firms managing the most retail balanced assets. The asset-management arms of the big six banks, which have strong distribution networks through in-house advisors, dominate. They manage more balanced assets than the rest of their competitors combined.

Exhibit 2 Largest Balanced Fund Managers by Retail Assets

Branding Name	Total Size ($M)
RBC	146,730
TD	82,151
Fidelity International	77,449
Scotiabank	60,821
Investors Group	47,390
BMO	42,346
Desjardins	33,917
CIBC	33,144
CI Investments	30,978
Mackenzie	23,707
National Bank	21,726
Manulife	17,181
ATB Financial	11,957
EdgePoint	10,548
Vanguard	7,416

Scotiabank includes 1832 Asset Management and Dynamic Funds, National Bank (Canada) includes National Bank Trust. Estimated retail assets in balanced funds by organization. Ex-institutional share classes and funds with exactly one underlying holding excluded.

Source: Morningstar Direct

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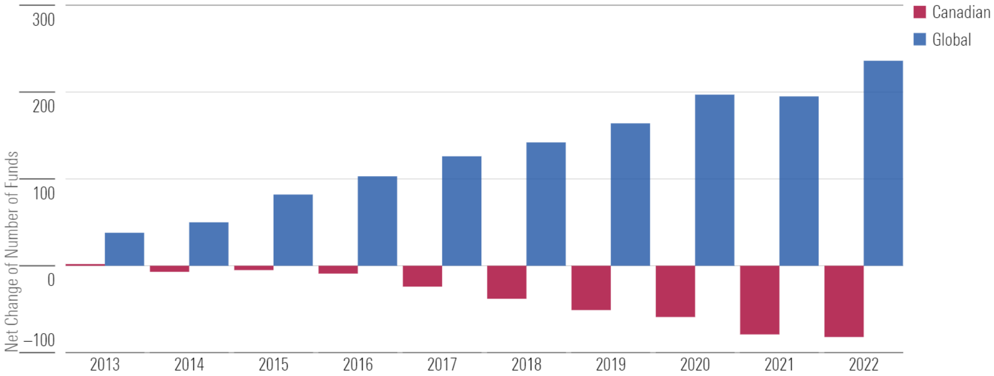
Fund Launches

Firms launched 683 balanced funds while merging or liquidating about 456 since the start of 2012. The number of global balanced funds (or those with more than 70% of assets outside of Canada) grew by 230, while the quantity of Canadian balanced offerings (or those with more than 70% of assets in Canada) shrank by 81. Exhibit 3 looks at the cumulative change in the number of two types of funds.

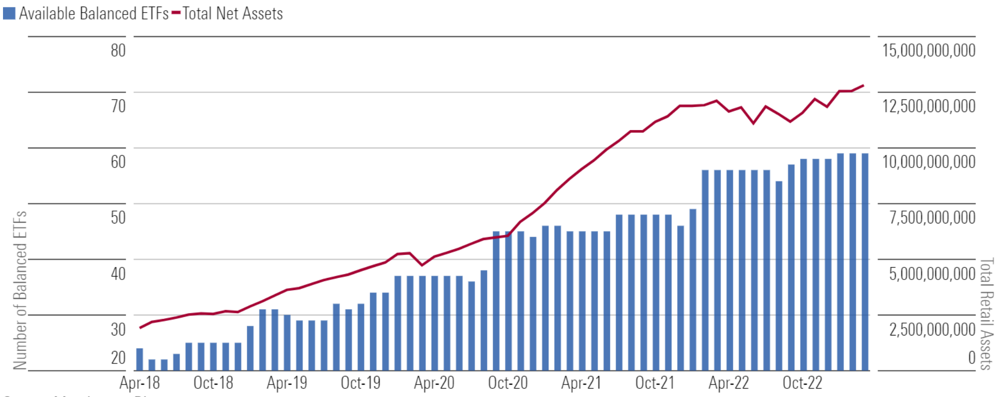
Exhibit 3 Difference in Number of Funds since Year-End 2012 - Canadian Balanced vs. Global Balanced



Source: Morningstar Direct

Although smaller in size and number, balanced ETFs offer investors a cheaper and more flexible alternative to mutual funds. Some of the biggest balanced ETF strategies own a static mix of index ETFs and charge just 20 basis points (0.20%). Exhibit 4 shows the significant growth in both assets and number of balanced ETF strategies in Canada. It is still small compared with balanced mutual funds, but its growth over the last five years warrants close attention. From April 2018 through March 2023, assets grew to CAD 12.8 billion from CAD 1.9 billion, and the number of unique balanced ETFs grew to 59 funds from 24.

Exhibit 4 Size and Number of Balanced ETFs



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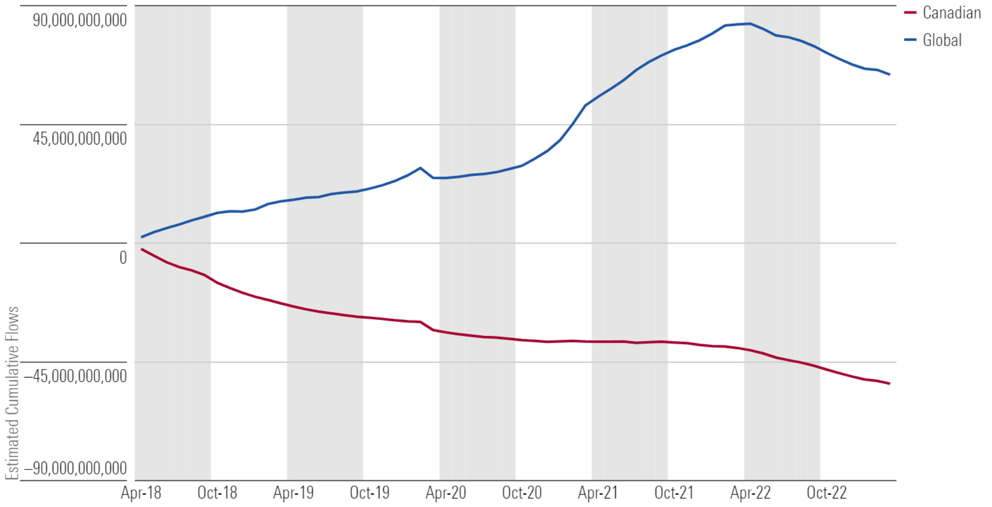
Flows

Investors Moved Away From Canadian and Into Global Balanced Funds

Canadian investors preferred global portfolios over domestic ones, part of a longer-term trend toward greater geographic diversification. Investors poured in a net CAD 13 billion in balanced funds over the five-year period ended March 31, 2023. Global balanced funds accounted for most of the inflows. Global balanced funds saw more than CAD 63 billion of inflows, while Canadian balanced funds saw more than CAD 53 billion of outflows. Target-date funds and tactical balanced funds—balanced funds that aren't restricted to geography exposures — totaled roughly CAD 3 billion of inflows over the same period.

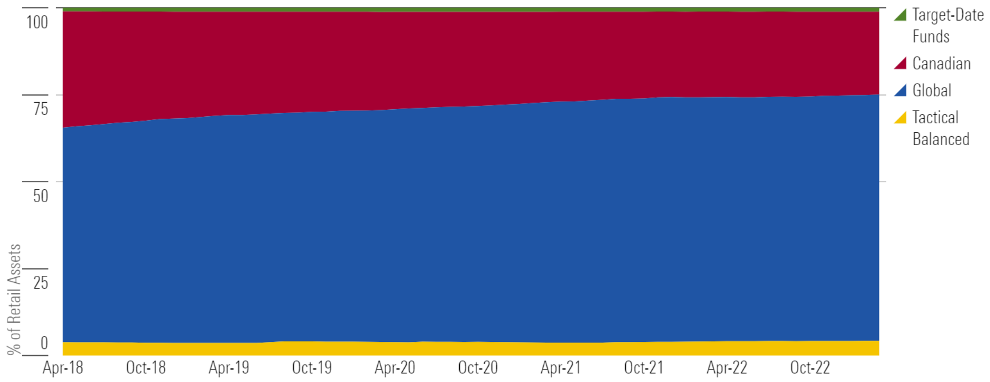
Exhibit 5 Cumulative Net Flows - Canadian Balanced vs Global Balanced



Source: Morningstar Direct

Global balanced funds command nearly three fourths of the balance fund segment's market share. They gained over 9 percentage points of market share and now have 71%, up from 62% five years ago, as shown in Exhibit 6. Canadian balanced funds lost slightly more than 10 percentage points in that time. Target-date funds and tactical balanced funds gained less than 1 percentage point of market share.

Exhibit 6 Market Share (as % of Retail Assets) - Balanced Segments



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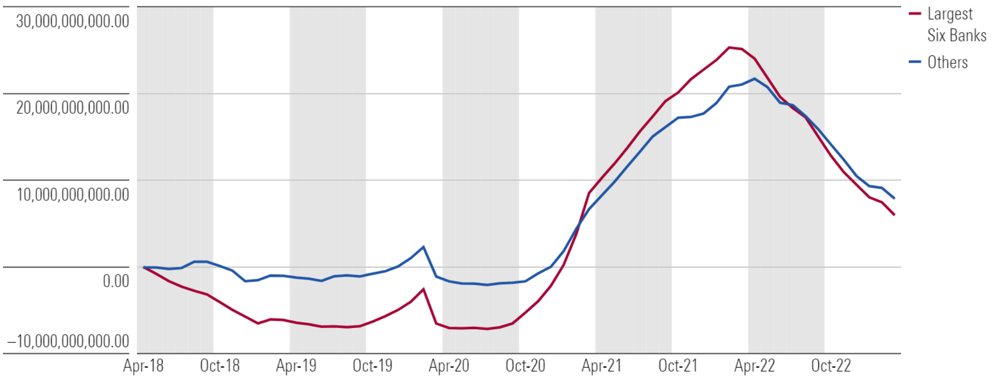
Bank-Owned Asset Managers Vs. Competitors

The asset-management arms of the largest six banks—Royal Bank, Toronto-Dominion, Bank of Montreal, Scotiabank, CIBC, and National Bank—collectively manage a slight majority of assets. This oligopoly led Canadian regulators to implement the Client-Focused Reforms in two phases, with the last phase put into place at the end of 2021. The reforms seek to improve investors' experience through, among other things, pricing transparency and know-your-product rules. Though the CFRs are relatively new, flows into nonbank offerings increased after their implementation. From April 2020 to December 2021, bank balanced funds received more than CAD 29 billion in flows and nonbank balanced funds received CAD 19 billion. From the start of 2022 to the end of March 2023, bank funds saw CAD 13 billion in outflows while their nonbank rivals saw CAD 7 billion leave. This could mean that the CFRs are having an effect.

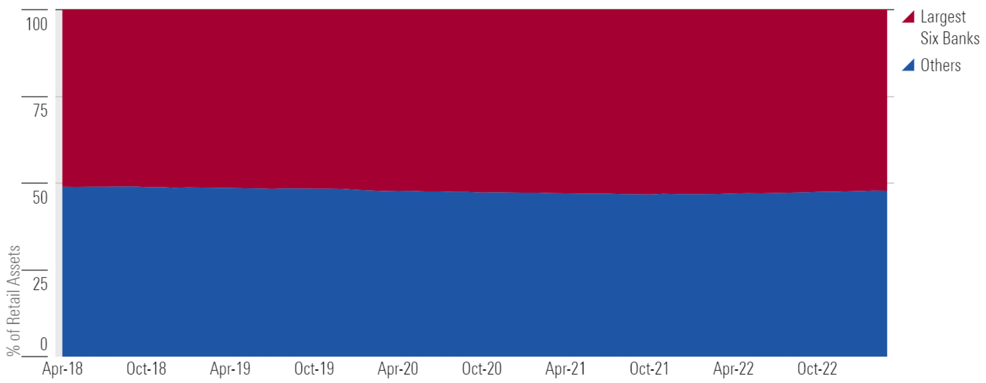
Exhibit 7 Estimated Net Cumulative Flows - Largest Banks vs Others



Source: Morningstar Direct

Exhibit 8 shows the market share between the big six and the rest of the field. It's too early to tell if money will continue to flow away from the asset-management arms of the six major banks, but a wider dispersion of flows among firms would indicate greater competition.

Exhibit 8 Market Share (% of Retail Assets) - Largest Banks vs Others



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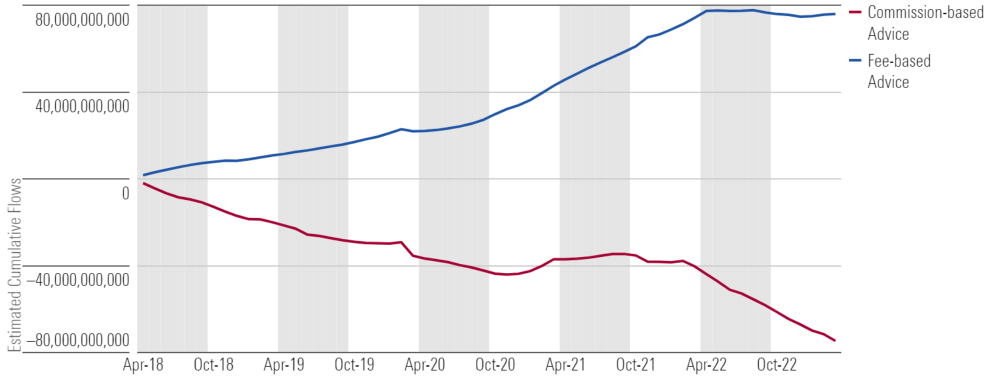
Large Distribution Channel Shift

The largest change in the last five years in balanced funds is the types of share classes that investors buy. Besides choosing cheaper balanced ETFs, investors are opting for lower fee shares of traditional mutual funds. Exhibit 9 shows that outflows in commission-based share classes (where the cost of advice and the distribution cost are bundled into one fee) nearly match the inflows of fee-based share classes (where the cost of advice is separately charged, giving greater transparency to investors). Fee-based share classes have claimed an average of 85% of total estimated quarterly balanced fund inflows, while commission-based share classes have lost an average of 86% total estimated quarterly balanced fund outflows since January 2022.

Exhibit 9 Estimated Cumulative Net Flows - Commission-Based vs Fee-Based



Source: Morningstar Direct

The CFRs, which require advisors to assess if an investment is suitable and in their clients' best interests when evaluating overall costs, may have motivated the increasing shift. Since the reforms took full effect on Dec. 31, 2021, not only have investors preferred fee-based share classes, but asset managers have also launched an increasing number of more-transparent, fee-based shares.

Exhibit 10 Share Class Launch by Distribution Channel

Distribution Channel	2021	Since Jan. 2022
Commission-based Advice	41%	37%
Do-It-Yourself	3%	4%
Exchange-Traded Fund	1%	6%
Fee-based Advice	54%	53%

Source: Morningstar Direct Data as of April 1, 2023.

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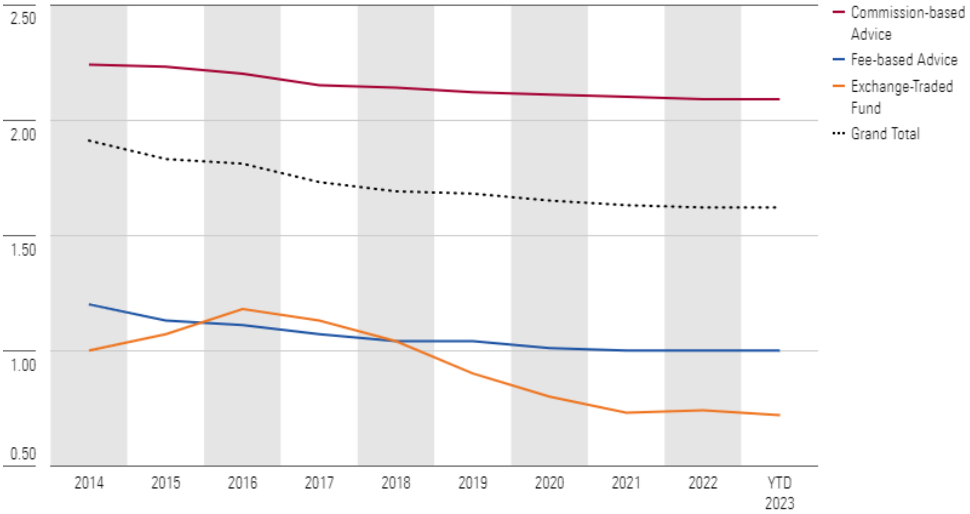
Fees

Things Are Getting Cheaper

A 2022 Morningstar study found that Canadian fund fees have declined in every asset class, including balanced funds. Over the last 10 years, balanced mutual fund and ETF fees have dropped to an average 1.62% from 1.91%. Allocation ETFs fell the most, by more than 28%, while fee-based and commission-based fees fell 17% and 7%, respectively. Exhibit 11 shows the average fee for funds by distribution channel.

Exhibit 11 Average Annual Fee Trend



Source: Morningstar Direct. Data as of April 1, 2023.

A further catalyst occurred in 2018 with the emergence of low-fee balanced ETFs.

The Vanguard Effect

The most significant competition emerged when industry giant Vanguard, a firm renowned for its low fees, launched three balanced ETF strategies in Canada in 2018. The ETFs—Vanguard Growth ETF VGRO, Vanguard Balanced ETF VBAL, and Vanguard Conservative ETF VCNS—offered one-stop portfolios of passive stock and bond ETFs at less than a fourth of the average fund's price at the time.

Local competition responded. Exhibit 12 shows that between 2018 and 2023, fees for all balanced funds dropped over 4%. Once again, ETF fees led the way down, dropping more than 30% while mutual fund fees fell 3.8%.

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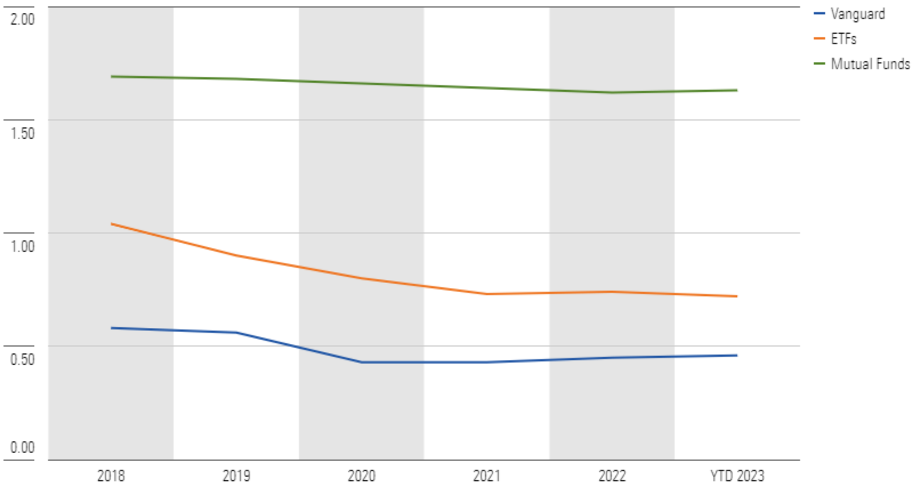
Exhibit 12 The Vanguard Effect: Impact on Fees Since 2018



Source: Morningstar Direct Data as of April 1, 2023.

Vanguard's foray into Canadian balanced ETFs also spurred price competition among asset managers beyond ETFs. On average, individual asset managers decreased their fees by an average of 10% between 2018 and 2023. Exhibit 13 shows that, over the last five years, Guardian Capital, Educators, HSBC, and ATB Financial posted the largest declines among firms that had at least five share classes of balanced funds in 2018 and 2023. Interestingly, 1832 Asset Management (Scotiabank) was the only bank-owned asset manager to decrease fees by more than 10%.

Exhibit 13 Asset Managers with Largest Average Fee Decrease (min. 5 share classes)

Asset Manager	Average of 2018	Average of YTD 2023	% Change
Guardian Capital	1.79	1.31	-26.9%
Educators	1.74	1.30	-25.2%
HSBC	1.56	1.20	-23.3%
ATB Financial	1.15	0.91	-20.9%
AGF	2.20	1.79	-18.7%
NEI Investments	1.77	1.45	-17.9%
EdgePoint	1.64	1.36	-17.1%
Value Partners Investment	1.77	1.51	-15.0%
Capital International Asset Management	1.81	1.54	-14.8%
Desjardins	1.68	1.44	-14.7%
RGP	1.76	1.50	-14.4%
1832 Asset Management	1.81	1.55	-14.4%
Counsel Wealth Management	1.92	1.65	-14.1%
SEI	1.41	1.22	-13.4%
Purpose Investments	1.49	1.29	-13.0%

Source: Morningstar Direct Data as of April 1, 2023.

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The Fee Holdouts

Not all fund companies responded similarly. Average fees for Canada Life, Mackenzie, Fidelity International, and CI Investments either stayed the same or increased. According to Morningstar's data, these four, as well as Sunlife and Manulife, are the only firms that ranked in 2018's 20 cheapest Canadian asset managers that got relatively more expensive in 2023. Exhibit 14 looks at the cheapest Canadian asset managers in 2018 and where they rank today.

Exhibit 14 Asset Manager Fee Rank Change: 2018-2023 (min. 5 share classes)

Asset Manager	Average of 2018	2018 Fee Rank	Average of YTD 2023	2023 Fee Rank
Dimensional	0.96	1	0.88	1
Gestion FERIQUE	1.00	2	0.95	3
MD group	1.07	3	1.00	4
ATB Financial	1.15	4	0.91	2
SEI	1.41	5	1.22	6
RBC	1.46	6	1.32	10
Canada Life	1.46	7	1.53	20
Purpose Investments	1.49	8	1.29	7
Franklin Templeton	1.52	9	1.43	13
BMO	1.54	10	1.43	12
Lysander	1.56	11	1.51	19
HSBC	1.56	12	1.20	5
Mackenzie	1.56	13	1.56	26
TD	1.58	14	1.49	16
Sun Life	1.60	15	1.55	23
Fidelity International	1.63	16	1.80	33
Manulife	1.63	17	1.55	25
EdgePoint	1.64	18	1.36	11
CIBC	1.65	19	1.50	18
CI Investments	1.66	20	1.73	31

Source: Morningstar Direct Data as of April 1, 2023.

Global Strategies Now Similar Cost to Canadian Strategies

Historically, Canadians paid a premium to access strategies with higher international exposure. Today, that is no longer the case. Global neutral balanced, the largest balanced category by both size and fund count, is currently less expensive than its Canada-focused counterpart. The gap between the global equity balanced category decreased notably relative to Canadian equity balanced. Firms chased investor preferences, which led to greater competition, a notable factor that helped this premium compression occur.

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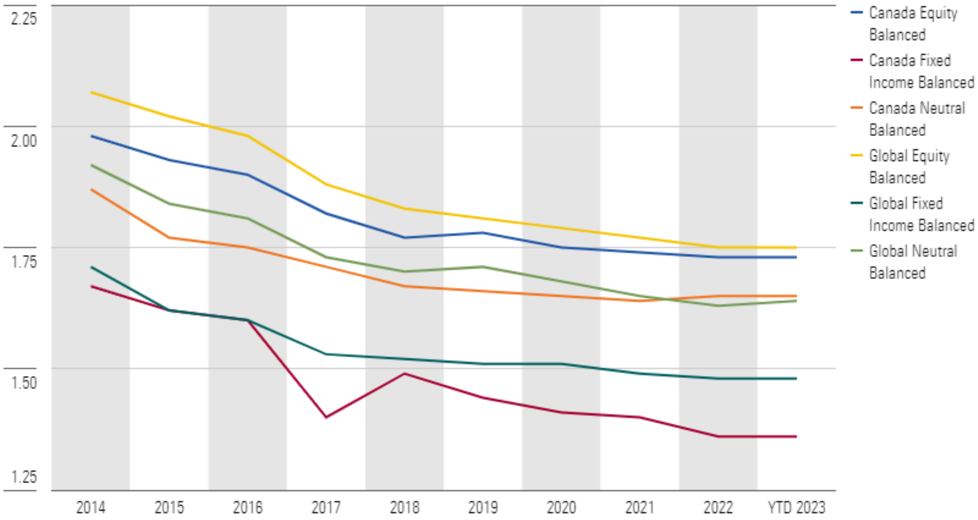
Exhibit 15 Category Fee Trends



Source: Morningstar Direct Data as of April 1, 2023.

Morningstar Benchmarks' Performance Since 2008

Traditional diversification approaches fell short in 2022. Interest rates jumped from the historically low levels that had prevailed since the 2008 global financial crisis and helped push down stocks, bonds, and most other asset classes. Exhibit 16 shows that 2022 was an unusual year. Only twice in the last 15 full calendar years have all six Canada balanced Morningstar Category benchmarks lost money: 2022 and 2008.

Exhibit 16

Calendar Year Returns - Morningstar Canada Allocation Benchmarks

Year	Morningstar Can Equity Tgt Alloc NR CAD	Morningstar Can Neut Tgt Alloc NR CAD	Morningstar Can FI Tgt Alloc NR CAD	Morningstar Can Eq Gbl Tgt Alloc NR CAD	Morningstar Can Neu Gbl Tgt Alloc NR CAD	Morningstar Can FI Gbl Tgt Alloc NR CAD
2007	5.86	4.91	4.10	0.46	1.94	3.23
2008	−22.90	−13.61	−2.50	−20.21	−11.94	−2.14
2009	23.51	16.02	8.40	16.39	12.18	7.59
2010	13.30	10.45	7.68	9.90	8.73	6.96
2011	−3.99	0.33	5.05	−2.76	0.86	4.66
2012	7.47	6.28	4.88	9.86	7.75	5.70
2013	12.88	8.95	3.90	18.60	11.55	5.09
2014	10.70	9.96	9.08	11.09	10.43	9.35
2015	−0.84	1.83	3.24	7.68	6.08	4.18
2016	13.22	8.40	4.34	7.40	5.94	3.96
2017	8.46	6.61	4.50	10.82	7.82	4.70
2018	−4.05	−1.85	0.18	−1.73	−0.41	0.55
2019	18.30	14.21	9.89	17.06	13.65	9.78
2020	8.67	8.72	8.33	10.66	9.64	8.02
2021	16.47	9.76	2.61	13.35	8.27	2.69
2022	−8.23	−9.08	−10.12	−10.01	−10.37	−10.65

Source: Morningstar Direct

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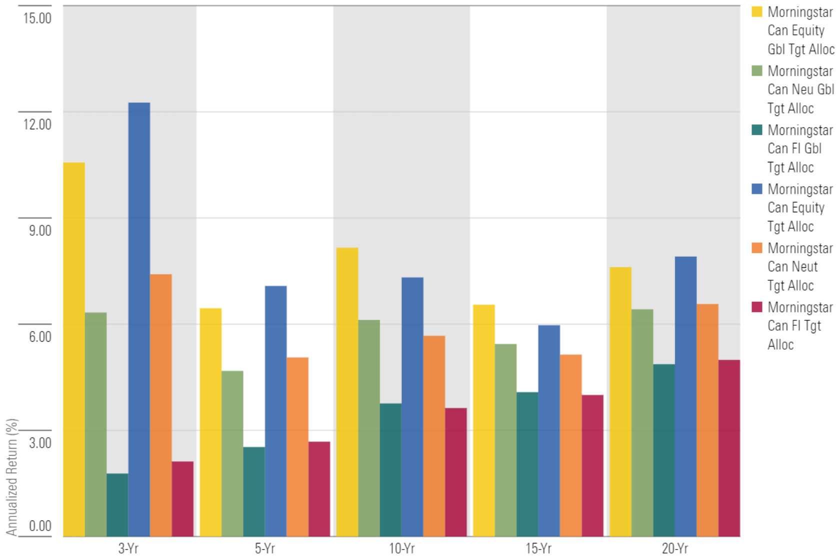
The case for balanced funds and the one-stop diversification they provide remains compelling over periods longer than a year. To better highlight the annualized returns of long-term holders, Exhibit 17 compares the same six allocation Morningstar Category benchmarks on multiple time frames. Generally, the more equity-oriented the benchmark was, the better it did. This matches the additional risks that come with the exposure.

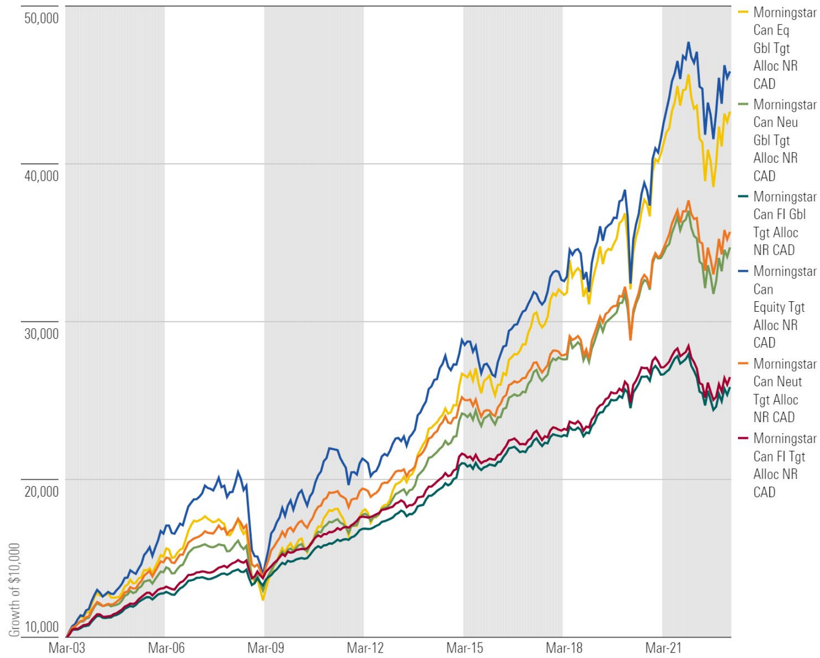
Exhibit 17 Annualized Returns ending March 31, 2023 - Morningstar Canada Allocation Benchmarks



Source: Morningstar Direct

Investors over the last 20 years saw notable growth in all six categories. Exhibit 18 shows what an initial $10,000 would have grown to in all six Morningstar Categories.

Exhibit 18 Growth of $10,000 since March 31, 2023



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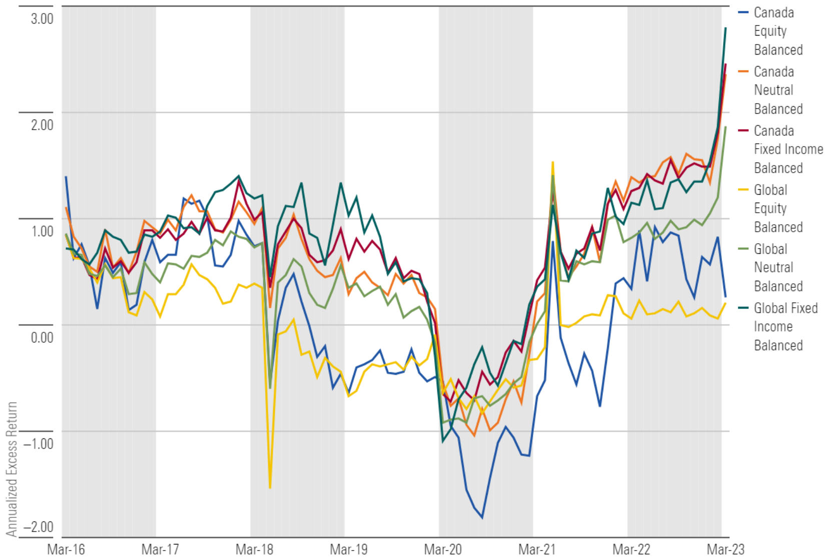
Gross Excess Return

Exhibit 19 looks at the median excess gross returns of balanced funds in Canada on a three-year rolling basis. However, gross outperformance doesn't include the impact of fees; active funds need to outperform by more than the expense ratios they charge to benefit investors. With the median fee north of 1.61%, a fund performing at the 50th percentile would not overcome the added costs.

Exhibit 19 Median 3-Yr Rolling Excess Gross Return by Category - Annualized

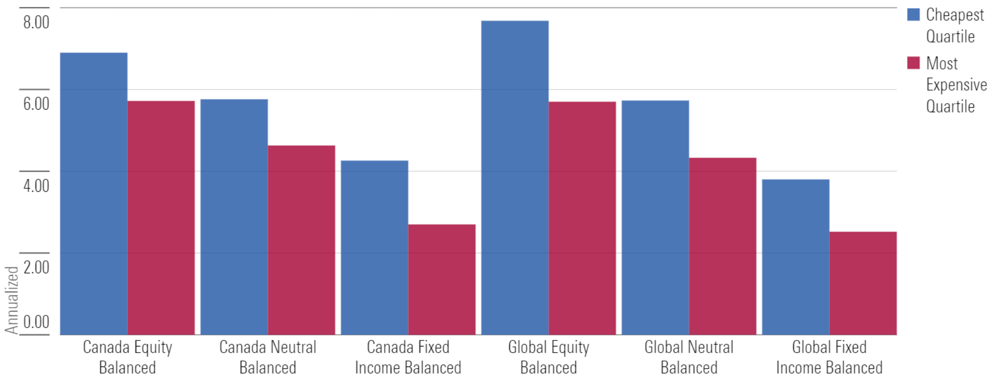


Source: Morningstar Direct

Spread of Fund Performance Study

To highlight the importance of fees, we took 447 retail funds' cheapest share classes with 10 years of performance history and separated the cheapest and most expensive quartiles. Exhibit 20 displays the average performance of the cheapest quartile and most expensive quartile grouped by Morningstar Category. In all six categories, the performance differences were most noticeable in the global categories, where the fee dispersion is wider.

Exhibit 20 Average 10-Yr Performance - Cheap vs Expensive



Source: Morningstar Direct

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Going Forward/Conclusions

Three big trends emerge in the data:

1. Investor preferences are leaning further away from Canadian balanced funds and toward global balanced funds.

2. Market share (as % of retail assets) among bank-owned asset managers and the rest of the field remains steady.

3. Funds are getting cheaper.

Increased competition among balanced funds drives these changes. For example, the balanced ETF space exploded once Vanguard launched three funds at a fourth of the cost of the average fund at the time. A recent regulatory change in the CFRs aimed to improve the transparency of cost and product knowledge, which put downward pressures on fees. We will continue to monitor the impact of the CFRs.

We are also keeping an eye on other developments in balanced fund strategy and design. For example, balanced strategies have increased the use of alternatives, such as bitcoin in Fidelity's All-in-One ETFs and TD Greystone in TD Retirement funds. This could lead to wider options beyond the standard 60/40 portfolio. Sustainable balanced funds are also becoming more prominent as asset managers look to meet demand for strategies following approaches that stress environmental, social, and governance criteria. Lastly, retirement and income-oriented strategies continue to fuel innovation.

Times are changing for balanced funds in Canada. If investors continue to seek out cheaper and robust portfolios, the change will be for the better.

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Methodology

Size and Flows

We defined size and flows in this report to mean retail assets and retail flows. We used the estimated monthly flows on a share-class level while removing institutional share classes, virtual share classes (funds denoted in U.S. dollars), and funds with one holding. This was to focus exclusively on share classes accessible by retail investors and to avoid double-counting funds.

Fees

Morningstar's Representative Cost ex-Transaction Fees data point was used for all references to fees. This data point is an indication of the known recurring costs for the share class, excluding transaction fees. This data point includes the fund's stated management expense ratio. Mutual funds with Representative Cost ex-Transaction Fees below 30 basis points were excluded from the study. This minimum does not apply to ETFs.

Performance

The study on performance based on fees was conducted by taking the 10-year net return on a fund's cheapest retail share class. Share classes were first screened out if the share class did not register a 10-year return ended March 31, 2023. The methodology on fees were followed as well. Finally, the cheapest share class on March 31, 2013, by fund, was chosen and ranked by category.

Peer Group Categories

Morningstar Canada leverages the category definitions used by the Canadian Investment Fund Standards Committee, of with Morningstar is a voting member. Balanced category limitations are applied on geographic exposure (domestic versus nondomestic) and asset allocation (percentage of equity). Guidelines are as follows:

Exhibit 21 CIFSC Balanced Category Geographic and Asset Allocation Guidelines

Morningstar Fund Category	Geographic Exposure (domestic)	Asset Allocation (equities)
Canadian Equity Balanced	70% or more	60 to 90%
Canadian Neutral Balanced	70% or more	40 to 60%
Canadian Fixed Income Balanced	70% or more	5 to 40%
Global Equity Balanced	70% or less	60 to 90%
Global Neutral Balanced	70% or less	40 to 60%
Global Fixed Income Balanced	70% or less	5 to 40%

Source: www.cifsc.org

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