



## Can Your Mutual Fund Withstand Mass Redemptions?

Posted By [WSJ Staff](#) On February 24, 2009 @ 10:59 am In [investing](#) | [No Comments](#)

*Journal reporter **Eleanor Laise** writes:*

Sick of the market's ugly performance, many investors are dumping their mutual funds. But those redemptions can have all sorts of negative repercussions for other shareholders. So money managers are getting serious about addressing the issue.

When investors yank money out of a mutual fund, the fund and its remaining shareholders often take a beating. Managers facing big redemptions may be forced to sell holdings at inopportune times, which can drag down fund performance, create bigger tax bills for shareholders, and boost trading costs.

Academic research suggests that trades made in response to "flows," or investors moving money in and out of the fund, are more costly than trades that are part of the manager's long-term strategy. "If you're forced to sell because you're trying to meet redemptions, you may be selling things you'd rather be buying," says **Karen Dolan**, director of fund analysis at investment research firm Morningstar Inc. Big shareholder redemptions can also force funds to liquidate.

Many types of funds experienced hefty redemptions last year. Investors pulled \$11.1 billion out of ultra-short bond funds, for example, and \$22.7 billion out of world stock funds, according to Morningstar.

Now, more managers are taking steps to minimize redemptions' impact on remaining fund shareholders. ReFlow, a company that provides cash to funds with big outflows, offers one solution. The company essentially acts as a "shareholder of last resort," says president **Paul Schaeffer**. It buys shares and holds them for up to 28 days, allowing managers to meet redemptions and get some breathing room to sell off fund holdings or perhaps attract new investor money. The company collects a fee for the service. The fee, which is determined in a daily auction, is a minimum of 0.15% of the capital provided.

Though ReFlow has been offering the service since 2003, it has struggled to gain traction among mutual funds — until now. The company provided over \$1 billion in capital to funds last year and is on pace to double that number this year, Mr. Schaeffer says.

It's not easy for investors to spot funds that may run into redemption trouble in the future. One red flag: A very small cash stake.

"Funds with more cash definitely have more flexibility" in dealing with redemptions, Ms. Dolan says. She adds that a cash position under 2% of fund assets is pretty tight. With less than 2% in cash, "you're pretty close to being forced to sell" if shareholders head for the exits, she says.

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Article printed from The Wallet: <http://blogs.wsj.com/wallet>

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