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The Implications of Passive Investing for Securities Markets

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Abstract

The popularity of passive investing through index mutual funds and exchange-traded funds (ETFs) has grown substantially over recent years, displacing higher-cost active investment styles. A shift towards passive investing could affect securities markets in two key ways. First, it could result in higher correlation of returns and less security-specific price information. Second, it could affect aggregate investment fund flows and market price dynamics. In this context, active mutual funds exhibited persistent outflows in recent stress periods, whereas passive mutual fund flows were fairly stable. ETF flows were relatively volatile, although their link with underlying prices is less straightforward than for other fund types.

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