A Brief History of the Mutual Fund

By James McWhinney

Mutual funds really captured the public's attention in the 1980s and '90s when mutual fund investment hit record highs and investors saw incredible returns. However, the idea of pooling assets for investment purposes has been around for a long time.

Here we look at the evolution of this investment vehicle, from its beginnings in the Netherlands in the 19th century to its present status as a growing, international industry with fund holdings accounting for trillions of dollars in the United States alone.

In the Beginning

Historians are uncertain of the origins of investment funds. Some cite the closed-end investment companies launched in the Netherlands in 1822 by King William I as the first mutual funds, while others point to a Dutch merchant named Adriaan van Ketwich whose earlier investment trust created in 1774 may have given the king the idea. Van Ketwich probably theorized that diversification would increase the appeal of investments to smaller investors with minimal capital. The name of van Ketwich's fund, Eendragt Maakt Magt, translates to "unity creates strength." The next wave of near-mutual funds included an investment trust launched in Switzerland in 1849, followed by similar vehicles created in Scotland in the 1880s.

The idea of pooling resources and spreading risk using closed-end investments soon took root in Great Britain and France, making its way to the United States in the 1890s. The Boston Personal Property Trust, formed in 1893, was the first closed-end fund in the U.S. The creation of the Alexander Fund in Philadelphia in 1907 was an important step in the evolution toward what we know as the modern mutual fund. The Alexander Fund featured semiannual issues and allowed investors to make withdrawals on demand.

The Arrival of the Modern Fund

The creation of the Massachusetts Investors' Trust in Boston, heralded the arrival of the modern mutual fund in 1924. The fund was opened to investors in 1928, eventually spawning the mutual fund firm known today as MFS Investment Management. State Street Investors' Trust was the custodian of the Massachusetts Investors' Trust. Later, State Street started its own fund in 1924 with Richard Paine, Richard Saltonstall and Paul Cabot at the helm. Saltonstall was also affiliated with Scudder, Stevens and Clark, an outfit that would launch the first no-load fund in 1928. A momentous year in the history of the mutual fund, 1928 also saw the launch of the Wellington Fund, which was the first mutual fund to include stocks *and* bonds, as opposed to direct merchant-bank style of investments in business and trade.

Regulation and Expansion

By 1929, there were 19 open-ended mutual funds competing with nearly 700 closed-end funds. With the stock market crash of 1929, the dynamic began to change as highly leveraged closed-end funds were wiped out and small open-end funds managed to survive.

Government regulators also began to take notice of the fledgling mutual fund industry. The creation of the Securities and Exchange Commission (SEC), the passage of the Securities Act of 1933 and the enactment of the Securities Exchange Act of 1934 put in place safeguards to protect investors: Mutual funds were required to register with the SEC and to provide disclosure in the form of a prospectus. The Investment Company Act of 1940 put in place additional regulations that required more disclosures and sought to minimize conflicts of interest.

The mutual fund industry continued to expand. At the beginning of the 1950s, the number of open-end funds topped 100. In 1954, the financial markets overcame their pre-1929 crash peak, and the mutual fund industry began to grow in earnest, adding some 50 new funds over the course of the decade. The 1960s saw the rise of aggressive growth funds, with more than 100 new funds established and billions of dollars in new asset inflows.

Hundreds of new funds were launched throughout the 1960s until the bear market of 1969 cooled the public appetite for mutual funds. Money flowed out of mutual funds as quickly as investors could redeem their shares, but the industry's growth later resumed.

Recent Developments

In 1971, William Fouse and John McQuown of Wells Fargo established the first index fund, a concept that John Bogle would use as a foundation on which to build The Vanguard Group, a mutual fund powerhouse renowned for low-cost index funds. The 1970s also saw the rise of the no-load fund. This new way of doing business had an enormous impact on the way mutual funds were sold and would make a major contribution to the industry's success.

With the 1980s and '90s came bull market mania and previously obscure fund managers became superstars. Max Heine, Michael Price and Peter Lynch, the mutual fund industry's top gunslingers, became household names and money poured into the retail investment industry at a stunning pace. The burst of the tech bubble in 1997 and a spate of scandals involving big names in the industry took much of the shine off of the industry's reputation. Then the Great Recession of 2007 scared a lot of people out of mutual funds once again. For part of this period, the entire world was in a financial crisis. Shady dealings at major fund companies demonstrated that mutual funds aren't always benign investments managed by folks who have their shareholders' best interests in mind.

The Bottom Line

Despite the 2003 mutual fund scandals and the global financial crisis of 2008-09, the story of the mutual fund is far from over. In fact, the industry is still growing. In the U.S. alone there are more than 10,000 mutual funds, and if one accounts for all share classes of similar funds, fund holdings are measured in the trillions of dollars. Despite the launch of separate accounts, exchange-traded funds, and other competing products, the mutual fund industry remains healthy and fund ownership continues to grow. (See also: *Advantages of Mutual Funds*)