5 UK RETAIL FUNDS MARKET

KEY FINDINGS

EVOLUTION OF UK FUNDS UNDER MANAGEMENT

- The UK retail funds market has grown significantly over the last 10 years and is more focussed on meeting investor demand for investment solutions and outcome-oriented funds.
- In 2018, total UK investor FUM reached £1.15 trillion, a slight decrease of 6.6% year on year and the first since 2011.
- Investor demand for outcome-oriented and mixed asset funds is a long-term trend, suggesting a permanent shift in investor expectations and an increasing emphasis on the role of retail fund managers as asset allocators.

RETAIL SALES TRENDS

- Following extremely strong growth in 2017, net retail sales were relatively weak during 2018, particularly in the second half of the year. Although this volatility is making the outlook for sales unclear, average five year inflows since 2008 remain significantly higher than in the period preceding the global financial crisis.
- Recent outflows from funds in the outcome-oriented Targeted Absolute Return sector, one of the best-selling sectors over 10 years, suggest that investor preference is shifting in the near-term to volatility managed strategies.
- In contrast, mixed asset funds have not seen the levels of sales volatility experienced by funds in other asset classes. Mixed asset sectors have not had a year of negative sales since 2002.
- Outflows from UK equity funds have been notable since the Brexit referendum in 2016. Retail outflows over this period of £11billion represent 4.6% of the average UK investor funds under management.

ACTIVE VS. TRACKER SALES TRENDS

- The proportion of UK investor funds under management in passive index-tracking funds has grown gradually to 16% in 2018. Although slow, the pace of growth has accelerated since 2013 when the retail distribution review was implemented.
- Net flows to tracker funds were one-third of total net sales between 2013 and 2018, a significant increase on the previous five years.
- Sales to index tracking funds outstripped sales to active funds in 2018 and notably garnered positive inflows in UK equity sectors whereas active funds suffered outflows.

RESPONSIBLE FUNDS

- FUM in funds pursuing dedicated 'responsible investment approaches' was £69 billion, equivalent to 6% of UK investor FUM. Net sales to these funds reached £1.08 billion in 2018.

TRENDS IN RETAIL FUND DISTRIBUTION

- In 2018, UK fund platforms remain the largest distribution channel for UK retail investors by gross and net sales. 45% of gross retail sales are flowing through UK fund platforms.
- UK fund platforms received the highest proportion of net retail sales (£12.6 billion) but sales were 47% lower than in 2017.

This chapter looks specifically at funds under management (FUM) for UK investors, with a particular focus on trends in the UK retail fund market. The data and analysis draw heavily on IA sectors to explain long-term trends in patterns of demand and total FUM.

There are 37 IA sectors, as outlined in Figure 12 overleaf. The IA sectors help investors to:

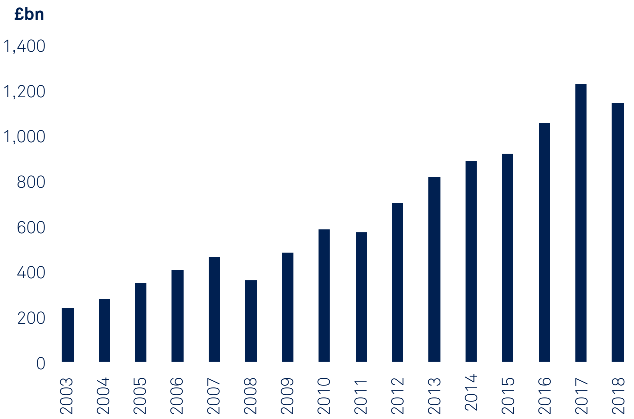
- Find certain types of fund based on their investment goals e.g. growth, income.
- Narrow down the fund universe and navigate investments by type of asset e.g. fixed income, equity.
- Perhaps compare performance or charges within the sector peer group.

Each sector has a clear definition setting out the criteria that funds in that sector must fulfil. The funds can broadly be split into funds targeting 'capital growth' and 'income' as shown by the classification schematic. Where we refer in the chapter to Mixed Assets, we are referencing a range of funds, with different risk characteristics as grouped into the Mixed Investment sectors.

EVOLUTION OF UK INVESTOR FUNDS UNDER MANAGEMENT

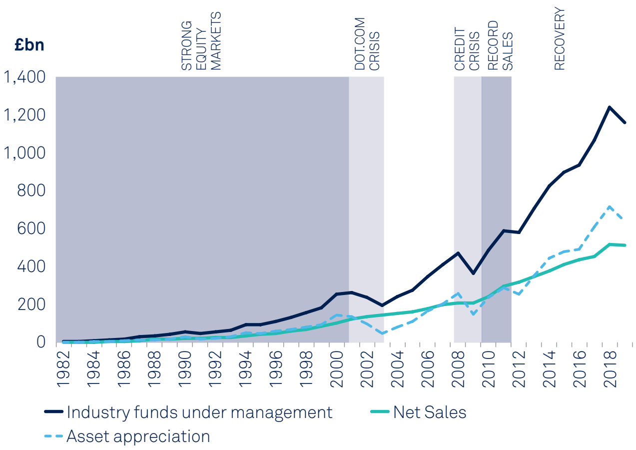
In 2018, total UK investor funds under management (FUM) were £1.15 trillion, a decrease of £81.3 billion or 6.6% year on year. This was the first annual drop since 2011, but as Chart 46 shows, UK investor FUM has grown significantly over the last 15 years from £242 billion in 2003 and has remained greater than £1 trillion for the last three years.[27]

CHART 46: TOTAL INDUSTRY FUNDS UNDER MANAGEMENT (2003-2018)



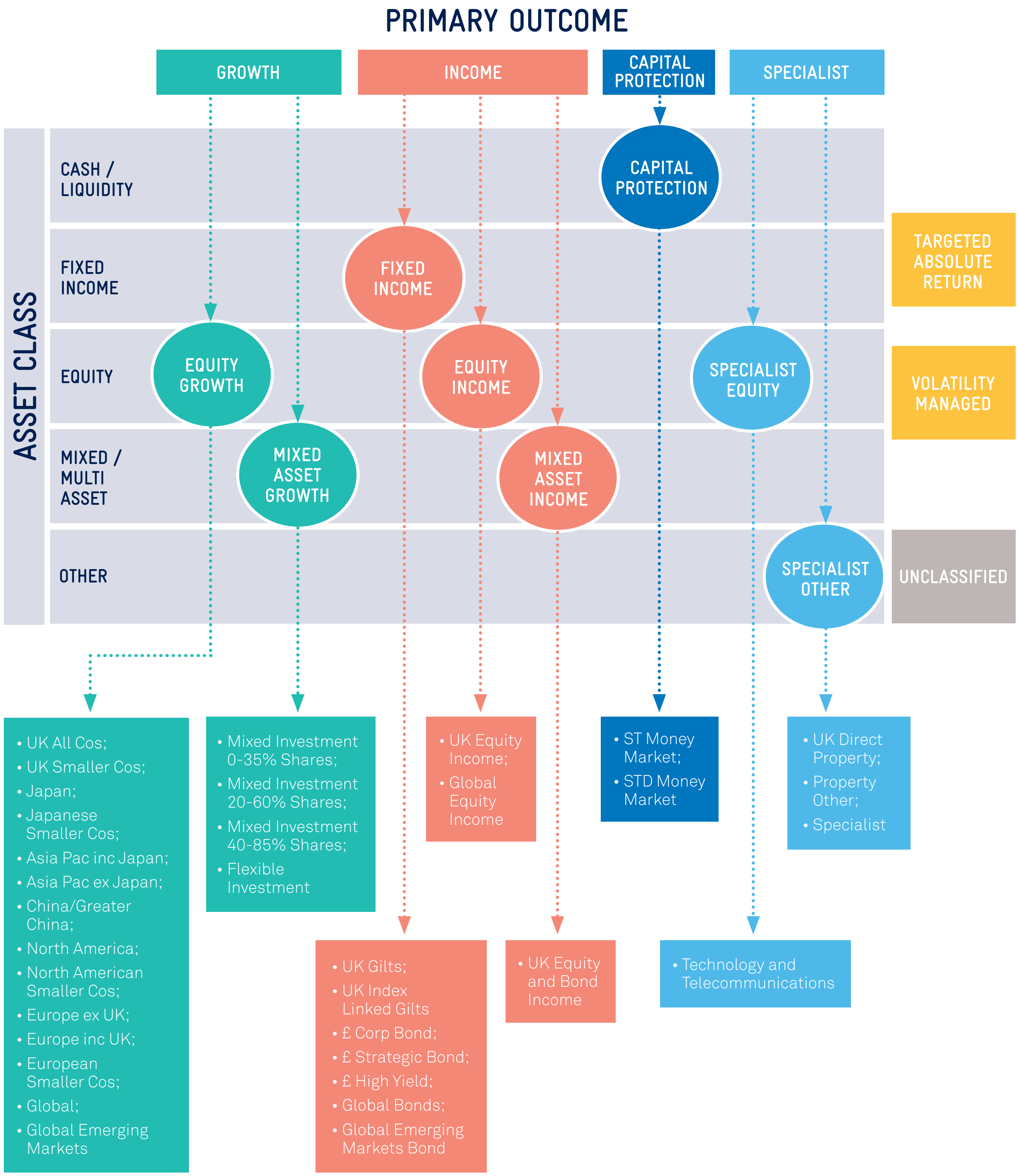
As Chart 47 illustrates, 2018's dip in FUM is largely attributable to asset values shrinking amidst challenging market conditions in the second half of the year, rather than as a result of net outflows. Turbulent markets reflected a range of events including the Sino-US trade dispute, US Federal Reserve rate hikes and various geo-political tensions.

CHART 47: DRIVERS OF INDUSTRY GROWTH (1980-2018)



[27] Chart 46 shows retail and institutional funds under management for UK investors in UK domiciled and overseas domiciled funds but from 2012 does not include overseas investors in UK domiciled funds. Prior to 2012 the data represents all investors in UK domiciled funds. Data on overseas investors in UK domiciled funds is shown in Chart 49.

FIGURE 12: IA SECTOR CLASSIFICATION SCHEMATIC



THE SHIFTING PROFILE OF UK INVESTOR FUM

UK investors' home bias to investing in UK equities has eroded significantly over the last 15 years. Chart 48 shows that in 2003, UK equities represented the highest proportion of total FUM. By 2018, FUM in overseas equities is double that of UK equities.

- The decline in **UK equities** as a proportion of FUM is notable. In 2003, UK equity FUM stood at 40%, this dropped to 17% in 2018. The Brexit referendum has undoubtedly accelerated this decline: between year-end 2015 and end 2016 FUM decreased by 4 percentage points from 24% to 20%.
- FUM in **overseas equities** has risen slightly from 33% in 2003 to 35% in 2018. It has the highest share of UK investor FUM in 2018.
- Growth in **mixed asset** FUM has been more gradual than the steady stream of net sales to this asset class would suggest. FUM in mixed asset funds has moved from 11% in 2003 to 16% in 2018.

CHART 48: FUM BY ASSET CLASS (2003-2018)

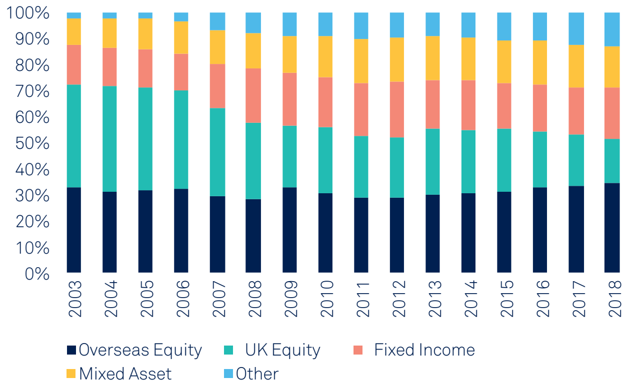
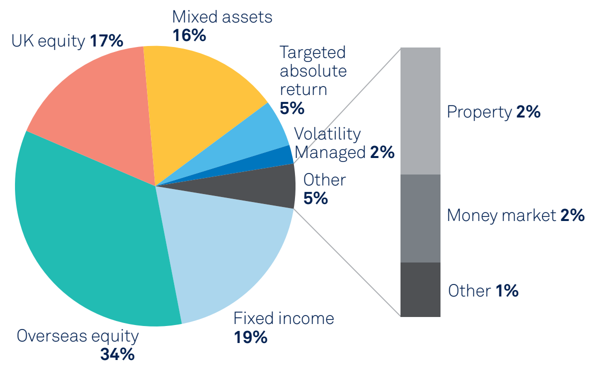


Chart 49 offers more detail on the profile of funds that fall into the 'Other' asset class in Chart 48. FUM in 'Other' has been steadily increasing, so it is helpful to provide greater detail on its contents.

Chart 49 splits out the percentage of total FUM in Targeted Absolute Return (TAR) funds (5%) and in volatility managed funds (2%). Funds in these sectors offer investors a specific outcome: TAR funds' objective is to deliver a positive return irrespective of market conditions. Volatility managed funds seek to ensure that the volatility of returns are kept within set parameters. Money market funds, where the objective is to protect investors' capital, are also included as outcome-oriented funds.

FUM in outcome-oriented funds and mixed asset sectors, where there is typically a diverse allocation across different types of asset, is one quarter of total FUM in 2018.[28]

CHART 49: UK INVESTOR FUM BY ASSET/FUND SECTOR



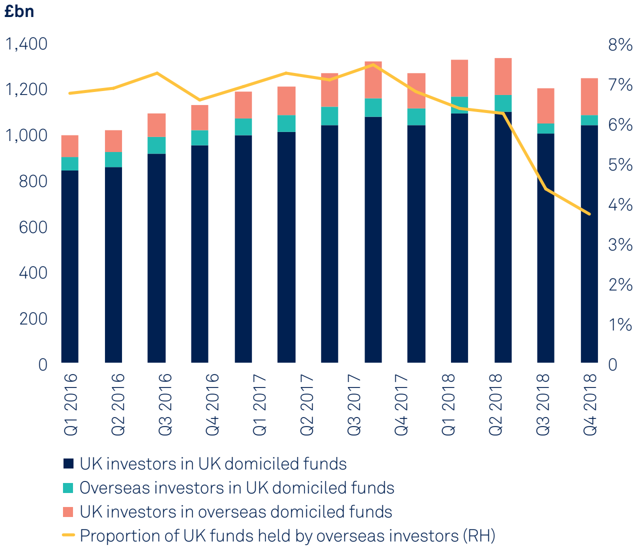
OVERSEAS INVESTORS IN UK DOMICILED FUNDS

Overseas investors in UK domiciled funds are an important facet of the UK funds landscape but Brexit is driving down the proportion of UK domiciled funds held by these investors. So far, the most significant factor in this decline appears to have been operational decisions made by firms to ensure business continuity post-Brexit. Chart 50 shows funds under management in UK domiciled funds and the profile of investors in those funds since Q1 2016, just before the Brexit referendum. £1.04 trillion was managed in UK domiciled funds in 2018, of which £46 billion or 4% was managed on behalf of overseas investors.[29] This compares with 7% just before the referendum.

[28] The IA classes funds in the following sectors as pursuing an outcome or allocation strategy: Mixed Investment 0-35% Shares; Mixed Investment 20-60% Shares; Mixed Investment 40-85% Shares; Money Market; Targeted Absolute Return; Volatility Managed.

[29] This chart differs from the £1.15tn cited at the beginning of the chapter because it incorporates overseas investors in UK domiciled funds but removes overseas domiciled funds invested in by UK investors.

CHART 50: UK DOMICILED FUNDS BY INVESTOR PROFILE (2016-2018)



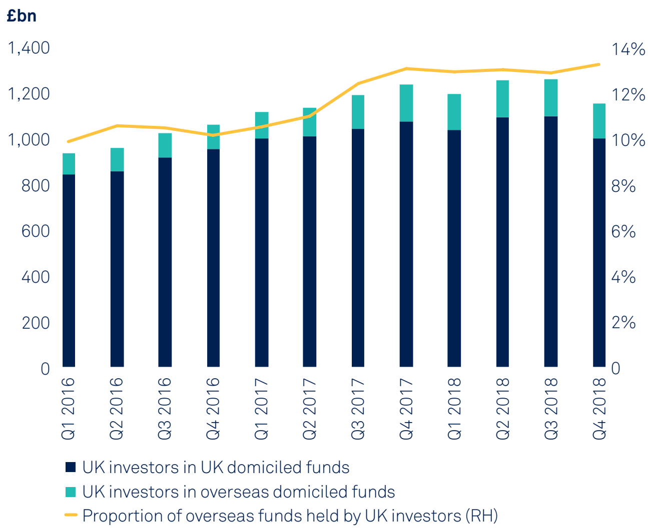
The steep drop observed between Q3 and Q4 2018 in Chart 50 was largely precipitated by operational decisions made by firms to transfer assets in non-sterling share classes to funds domiciled in the European Union. It is more difficult to quantify the impact of negative overseas investor sentiment or to predict future trends.

UK INVESTORS IN OVERSEAS DOMICILED FUNDS

UK investors have not been deterred from investing in overseas domiciled funds since the Brexit referendum, IA data suggest. UK investor FUM in overseas domiciled funds has gradually increased from 10% at the beginning of 2016 to 13% at the end of 2018. In 2018, UK investors appear to have adopted a 'wait and see' attitude to concerns expressed in some quarters that Brexit could affect passporting rights and impede access to funds domiciled overseas.

- UK investor FUM (retail and institutional) in overseas funds represents £150 billion invested in 1,754 funds.[30] As a point of comparison, UK investor FUM in UK domiciled funds is £1.0 trillion invested in 2,797 funds. It appears that UK investors are using overseas domiciled funds for a smaller proportion of their portfolios.
- Gross retail sales are more indicative of investor demand because they do not account for redemptions. Chart 49 suggests that retail investors' appetite for investing in overseas domiciled funds has not shifted dramatically post-referendum. The percentage of gross retail sales from UK investors into overseas domiciled funds has risen from 16% at the end of 2016 to 22% in 2018.
- Net retail sales from UK investors to overseas domiciled funds in 2018 were £1.07 billion, 14% of total net retail sales. Since 2013, net retail sales to overseas domiciled funds have consistently been circa £1 billion. 2017 is the exception: net retail sales to overseas domiciled funds rose to £17.8 billion or 37% of total net retail sales. If and when material changes to passporting rights occur, we would expect to see this pattern of flows alter.

CHART 51: UK INVESTOR FUM IN OVERSEAS DOMICILED FUNDS (2016-2018)



[30] IA FUM data does not account for ETFs or international money market funds, which are mainly domiciled overseas. UK investor FUM in overseas domiciled funds is therefore higher than £0.15tn. IMMFA data show that €296.7bn was invested in international money market funds by UK investors as at December 2017. It is difficult to assess UK investor FUM in ETFs. London Stock Exchange (LSE) data indicates that 40% of European trading turnover for ETFs goes through the exchange and 1100 ETFs are traded on the LSE, but the LSE is an international trading venue and not a reliable indicator of UK investor flows or FUM.

SALES TRENDS

Over the last 10 years, net retail sales have been volatile, particularly in the equity asset class. This makes it difficult to determine a long-term trend and it is unclear whether this volatility will continue when a new market cycle begins.

As Chart 52 shows, the shockwaves of global events are felt by the UK retail funds market and can negatively affect net retail sales. Most recently, the global financial crisis caused net retail sales to halve between 2007 and 2008 and UK retail flows were not immune to the effects of the dot.com bubble bursting in the early 2000s (see Chart 47).

In 2016 the Brexit referendum significantly depressed net retail sales, which decreased by circa £10 billion from net sales of £16.9 billion in 2015 to £7.0 billion in 2016.

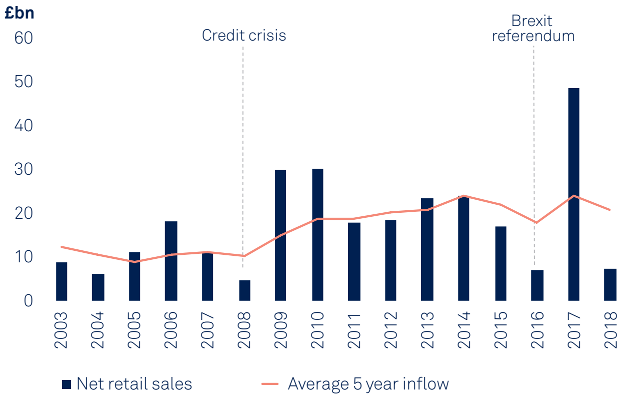
But five year average net sales remain significantly higher than pre-2008 levels and the negative impact of major events on net retail sales over the last 10 years has been short-lived.

In 2017, UK net retail sales rebounded from the Brexit-dominated negative sentiment in 2016 to record levels of £48 billion. In 2009, the data tells a similar story with then-record flows of £29.8 billion following net flows of £4.8 billion in 2008.

The impetus behind the scale of the 2017 surge remains hard to explain. 2017 was also an exceptional year for net sales to European[31] investment funds at €984 billion compared with €258 billion in 2018, which suggests that across Europe, investors were attracted by a benign economic climate in 2017 and that supra-national forces were a determinant of flows. The global economy in 2017 has been described as a goldilocks economy: 'not too hot, not too cold, but just right.' Economic growth was stable, staving off recessionary forces and inflation remained in check. This meant that shares performed well and it was an attractive environment for investors to place more assets into funds.

Domestic circumstances also played a role: sales were further augmented by defined benefit pension transfers into funds in personal pensions, defined contribution pensions or self-invested personal pensions. The DB transfer market was unlocked by the introduction of the pension freedoms in April 2015 and reached a peak in 2017[32] when transfer values were high, inflated by low gilt yields and a Bank of England base rate of 0.25%[33]. Between 1 April 2017 and 31 March 2018 the total value of DB transfers was approximately £14.3 billion.[34]

CHART 52: NET RETAIL SALES (2003-2018)



[31] EFAMA Fact Book 2019.
[32] ONS data show £37 billion in pension transfers in 2017 compared with £13 billion in 2016; a significant proportion of this total is likely to represent transfers out of defined benefit schemes and into funds in SIPPs, personal pensions and defined contribution pensions.
[33] The Bank of England raised the base rate to 0.5% at the end of October 2017 and while the rate rise may have had little immediate impact on transfer values, the expectation of further rate rises, which did take place in 2018, will have affected the cash equivalent transfer value.
[35] This data comes from The Pensions Regulator's reponse to a Freedom of Information request and represents 72,700 transfers out of DB schemes. TPR estimates the actual figure to be in the region of 100,000.

THE PATTERN OF NET RETAIL SALES IN 2018

In 2018, net retail sales dropped to £7.2 billion, a sharp fall of 85% compared with 2017. Sales to funds that track an index were a significant factor in driving a positive net flows total in 2018 as active funds saw outflows.

Chart 53 shows the increase in equity market volatility in Q4 and a sharp deterioration in capital returns in December 2018 across most major equity indices. Concerns over slowing economic growth and global trade tensions introduced a climate of uncertainty. Bond yields also declined and the ECB signalled the end of quantitative easing in the Eurozone. These factors played a part in creating a tougher environment for fixed income managers.

Unfavourable macro-economic conditions are likely to have had some impact on the shape of flows at the end of 2018 but while the retail fund market flow data does respond to changes in the political and economic environment, the scale of change is often limited.

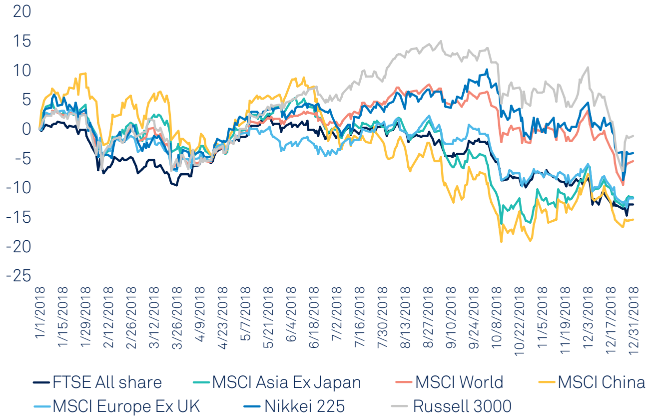
A tougher regulatory stance on DB transfer advice following a series of mis-selling scandals and a rise in professional indemnity premiums for advisers offering this type of advice, helped to dampen the flow of pension transfer assets in 2018.

NET RETAIL SALES WERE

£7.2BN

IN 2018, A FALL OF 85% FROM 2017

CHART 53: PERFORMANCE OF MAJOR EQUITY INDICES (CAPITAL RETURN BASIS)



Source: Lipper data as of Dec. 31. 2018

The pattern of sales in 2018 supports the long-term trend to sales volatility. Net retail sales started well in Q1 at £6.8 billion. Outflows were largely concentrated in the last quarter of the year but affected most asset classes. The notable exception is the mixed asset class: inflows to mixed asset funds were consistent quarter-on-quarter.

Chart 54 shows net retail sales by asset class over 2018[35].

- Equity funds net inflows reached £1.0 billion but net retail sales fluctuated across the year. Only four months in 2018 saw positive net sales but from May onwards, apart from the brief respite in September[36], net sales were negative.
- Fixed income fund flows were negative for the year at -£2.0 billion. Net sales ebbed and flowed before the large outflows in Q4 turned annual net sales negative.
- Net sales to mixed asset funds were £7.9 billion and bucked the trend to outflows in Q4 achieving positive sales each month.

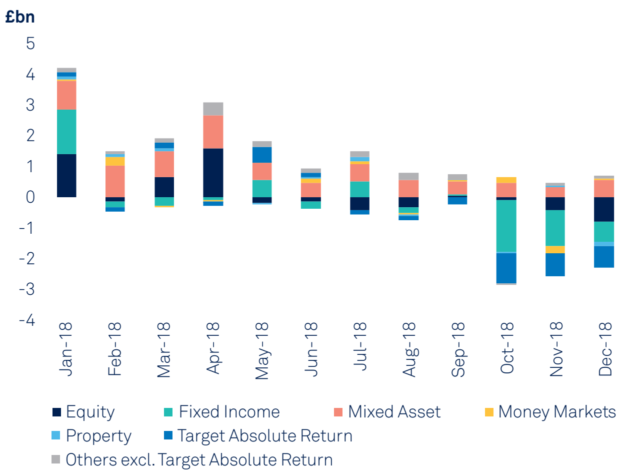
[35] As one of the largest components of Other, targeted absolute return has been broken out in Chart 54. Alongside targeted absolute return, the Other asset class includes the following IA sectors: Specialist; Unallocated; Unclassified and Volatility Managed.

[36] Net sales to Fixed income and Property were also positive in September, as were sales to Other if targeted absolute return fund sales are excluded from the data.

5

- Sales to funds in the 'Other' asset class were mixed: the Targeted Absolute Return sector, which sits in 'Other', saw net outflows of -£2.2 billion. Sales to funds in the Volatility Managed sector were far more consistent, achieving positive sales each month in 2018 to reach sales of £1.7 billion for the year.

CHART 54: NET RETAIL SALES BY ASSET CLASS 2018



It is important to emphasise not just the direction of fund flow in Q4, but the scale. The fixed income outflows of Q4 2018 amounted to only 0.3% of total FUM. Analysis of regional equities show that UK equity funds remain extremely out of favour following the referendum. However, cumulative outflows of £593m in Q4 represent only 0.05% of total FUM.

ARE SHORTENING INVESTOR HOLDING PERIODS PROMOTING SALES VOLATILITY?

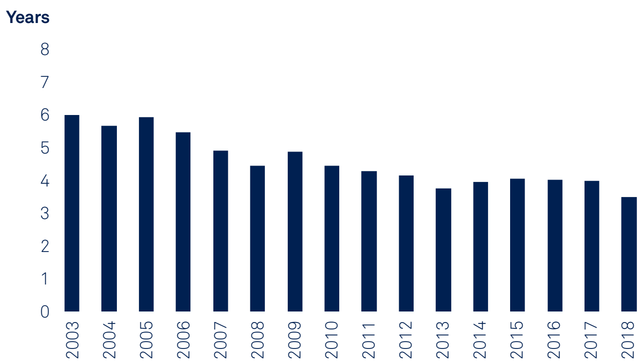
The shortening of average retail investor holding periods could be a factor in promoting more volatile net sales over the past 10 years.

From an average holding period of six years in 2003, IA calculations based on patterns of flow show that funds are now being held by retail investors for just over three years (see Chart 55). Two drivers of this may be the increasing dominance of investment platforms and the widespread adoption of centralised investment propositions by financial advisers.

- The ascent of direct and adviser investment platforms in the retail market, where assets can be switched between funds at the click of a button, means that it is now far easier to change fund selection. Although it remains challenging to move money between platforms, work is underway to address this.[37]

- Centralised investment propositions (CIPs) are now widely used by advisers following the Retail Distribution Review[38]. CIPs are designed to meet the needs of different client segments and improve the consistency of investment advice offered to clients. They are typically offered as a range of risk-rated model portfolios and are re-balanced quarterly. Advisers and their investment committees use track records as an important indicator of performance when selecting funds, many requiring at least a three year track record to effectively assess fund performance. It may be no coincidence that average holding periods align with this minimum 3 year term.

CHART 55: RETAIL INVESTOR AVERAGE HOLDING PERIODS (2003-2018)



[37] The FCA outlines its concerns that 'consumers and advisers who want to switch platforms find it difficult to do so because of time, complexity and the cost of switching platforms' but welcomes the progress being made by STAR, a not-for-profit joint industry venture to improve transfer times in the Investment Platforms Market Study, Final Report, MS17/1.3 March 2019.

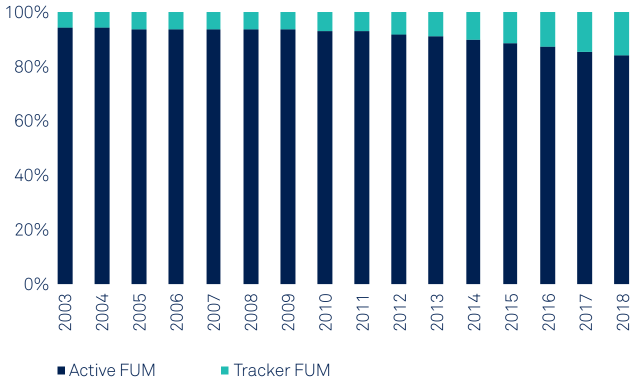
[38] The FCA set out its expectations for advice firms on CIPs in its 2012 report: Assessing suitability: replacement business and centralised investment propositions.

LONG-TERM TRENDS: ACTIVE V. PASSIVE[39]

The increasing use of index-tracking funds by UK retail investors has been much commented upon. The data presented in Chart 56 show that FUM in index trackers has been increasing as a percentage of total UK investor FUM but that this increase has been extremely gradual over the last 15 years.

Tracker fund FUM growth starts to accelerate following the introduction of the RDR in 2013. Chart 56 suggests that the removal of commission and the commission-bias has been an important factor in the growth of trackers as a proportion of FUM.

CHART 56: ACTIVE FUNDS AND TRACKER FUNDS AS A PROPORTION OF TOTAL FUNDS UNDER MANAGEMENT (2003-2018)



In 2018, as Chart 57 illustrates, net retail sales to trackers were £9.0 billion whereas net retail sales to active funds were -£1.7 billion (outflows were concentrated in Q3 and Q4 as explained in the section on page 72).

Between 2013 and 2018, cumulative net sales to tracker funds were £43.7 billion. In the period between 2008 and 2013, they were just £9.2 billion (sales to active funds over this period were £92 billion). The implementation of the RDR has removed the barrier of commission, resulting in higher net retail sales to trackers.

CHART 57: NET RETAIL SALES TO ACTIVE AND INDEX TRACKING FUNDS (2008-2018)

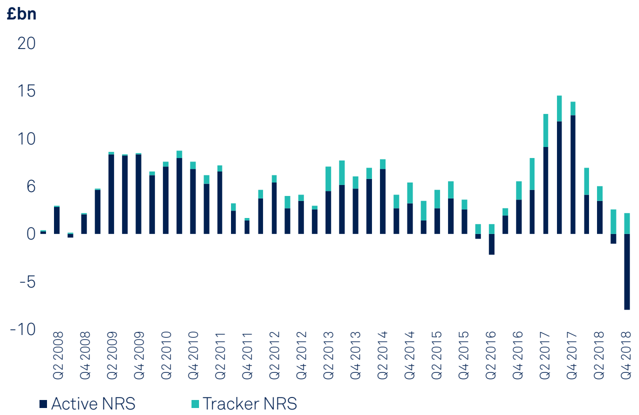
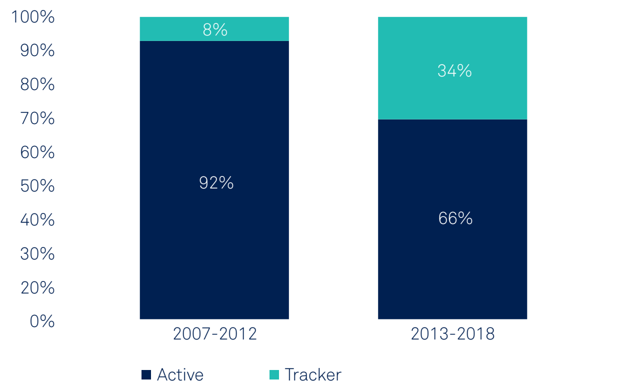


Chart 58 shows that the proportion of net flows to tracker funds was one-third of total net sales between 2013 and 2018, whereas sales to tracker funds only accounted for 8% of total net retail sales in the five years preceding the RDR.

CHART 58: NET RETAIL SALES BY TRACKER FUND AND ACTIVE FUND PRE- AND POST-2013



[39] The passive universe of funds encompasses Exchange Traded Funds (ETFs) (although ETFs can be active) but IA data does not include the FUM or sales of ETFs.

Looking at the share of net sales to tracker funds by asset class, trackers have been a more popular way of gaining exposure to UK equities than actively managed funds since the referendum.

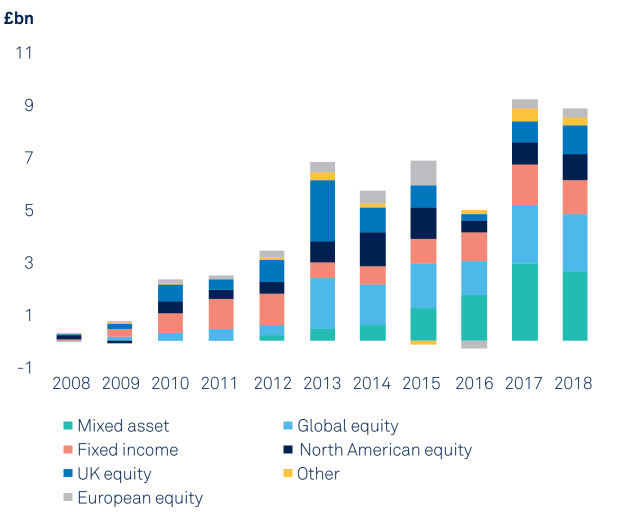
Chart 59 shows that trackers have bucked the trend to UK equity outflows, attracting positive flows into UK equities since 2016. Sales to trackers of UK equity indices were £7.3 billion over the period 2016 to 2018.

Comparing sales to active funds and tracker funds in the UK All Companies sectors between 2016 and 2018 gives further colour to the difference in fortune between UK equity trackers and active funds.

- Cumulative sales to active funds in the UK All Companies sector between 2016 and 2018, were -£12.8 billion. Every quarter between Q1 2016 and Q4 2018 has seen negative net retail sales.
- Sales to tracker funds in the UK All Companies sector were not immune to the negative impact of the referendum: three of the 12 quarters between 2016 and 2018 saw negative net sales. But trackers did substantially better over the period with net retail sales of £1.9 billion.

Trackers have been a more popular way of gaining exposure to UK equities than actively managed funds since the referendum.

CHART 59: NET RETAIL SALES OF TRACKER FUNDS BY INDEX INVESTMENT TYPE (2008-2018)



The advent, in 2018, of ex-post and ex-ante costs and charges disclosure to investors under the MiFID II regulation may prove another fillip for low-cost passives and tracker funds. Investors have been used to seeing charges expressed as a percentage of their invested assets. This is arguably a less tangible way of expressing fees than outlining them in pounds and pence. Now that retail investors are seeing advice, platform and fund fees in monetary terms, it could increase fee sensitivity. Tracker funds are an obvious means of reducing the total cost of ownership for investors and this could drive further increases in sales.

INVESTMENT FUNDS AND THE RISE OF RESPONSIBLE INVESTING

As we note in Chapter Two of this report, the rise of responsible investment as well as a focus on dedicated responsible investment approaches at the fund level has intensified over the course of 2018 and is a powerful catalyst for evolution in the investment environment. Responsible investment is very broad in scope and specific funds' characteristics range from social impact investing to negative screening for shares that could be deemed "unethical", for example tobacco or arms manufacturers. There is also a wide array of terms used to describe fund objectives including "ESG" and "ethical".

The IA has collected data using the Global Sustainable Investment Alliance (GSIA) definitions outlined in Table 5 overleaf. Investment management firms that have applied ESG integration to investment processes and are pursuing corporate engagement and shareholder action strategies can be described as taking a responsible approach to investing but many go further at the fund-level and adopt a variety of very specific sustainability-related investment approaches in their objectives.

The broad range of terms for responsible investment approaches means that there are classification and data collection challenges as well as issues around the consistency of interpretation. It can also be hard to determine if responsible investment characteristics apply at a fund level or at the firm level. The IA is working to ameliorate these issues by creating an industry-agreed responsible investment framework with an accompanying glossary of definitions, and will report further on this later in 2019.

Total funds under management and retail sales

Using GSIA definitions, we present our investment fund data in two ways:

1. There is a universe of funds that can be said to pursue dedicated responsible investment approaches at fund level: negative screening; positive screening; norms-based screening; sustainability themed investing and impact/community investing. Many of these funds are overtly marketed as "sustainable" or "ESG" funds with names that reflect these attributes and objectives. The FUM of funds that are pursuing sustainable investment approaches was £69 billion or 6% of total FUM in 2018. Net retail sales in 2018 were £1.08 billion.[40]

2. The wider universe of funds is referred to as "responsible investment". This includes not only dedicated responsible investment approaches at a fund-level but also incorporates funds sold by investment managers that have adopted ESG integration and/or corporate engagement at a firm-level applying them across their fund ranges. Using this wider definition, the latest data show that total FUM in funds managed with reference to responsible and sustainable criteria reached £103 billion at the end of 2018. This represents 9% of total UK investor FUM. On this basis, net retail sales are slightly negative (£-0.53 billion).

FUM OF FUNDS USING SUSTAINABLE INVESTMENT APPROACHES WAS

£69BN

IN 2018

TABLE 5: GLOBAL SUSTAINABLE INVESTMENT ALLIANCE (GSIA) DEFINITIONS

Category	Definitions
Integration of ESG factors	The systematic and explicit inclusion by investment managers of environmental social, and governance factors into traditional financial analysis.
Corporate engagement and shareholder action	The use of shareholder power to influence corporate behaviour, including through direct corporate engagement (i.e. communicating with senior management and/or boards of companies), filing or co-filing shareholder proposals, and proxy voting that is guided by comprehensive ESG guidelines.
Negative/ exclusionary screening	The exclusion from a fund or portfolio of certain sectors, companies or practices based on specific ESG criteria.
Positive/ best-in-class screening	Investments in sectors, companies, or projects selected for positive ESG performance relative to industry peers.
Norms-based screening	Screening of investments against minimum standards of business practice based on international norms.
Sustainability-themed investing	Investment in themes or assets specifically related to sustainability (for example clean energy, green technology, or sustainable agriculture).
Impact/ community investing	Targeted investments, typically made in private markets, aimed at solving social or environmental problems, and including community investing, where capital is specifically directed to traditionally underserved individuals or communities, as well as financing that is provided to businesses with a clear social or environmental purpose.

[40] Compared to previous years, the IA has changed its approach to the collection and reporting of both fund-level and wider assets under management data on responsible investments to improve its accuracy. This means that year-on-year comparison between the funds under management data and retail sales data is not possible.

SALES BY INVESTOR OBJECTIVE

To understand how retail investor motivation has shifted over time, Chart 60 analyses sales data by grouping funds by the investor's objective. Investors typically look to grow their capital, protect their capital or to deliver an income from their investments. They may also be seeking a particular outcome, for example to achieve positive returns irrespective of market conditions or to smooth the volatility of returns. The chart illustrates the rise and fall of sales to these types of funds.

Chart 60 shows net retail sales by investors' principal objectives between 2003 and 2018.

- Investor preference for funds that offer a specific outcome or diversified allocation has increased post-2008. As Table 6 shows, cumulative sales to these funds since 2008 are £81 billion outstripping sales to fixed income, equity growth and equity income. Over five years, the pattern of sales remains the same: sales to outcome and allocations funds were just over twice as high as sales to fixed income funds.

- Sales to fixed income, equity income and equity growth funds have been less consistent. Whilst net outflows are relatively rare, in periods of economic or political instability in 2008 and 2016, equity growth funds saw net outflows.

- Outflows were seen in fixed income in 2015, amid a climate of volatile bond yields for developed market bonds, and in 2018, as bond yields declined. This may be more a reflection that investors dislike uncertainty than that they are highly responsive to the vagaries of the price or yield of corporate and government debt.

CHART 60: NET RETAIL SALES BY INVESTOR OBJECTIVE (2003-2018)

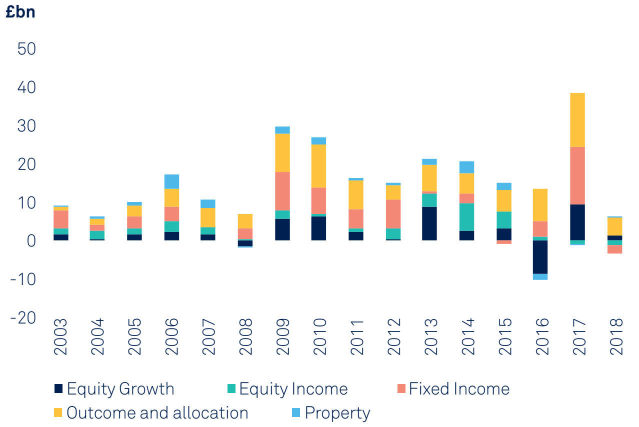


TABLE 6: CUMULATIVE SALES TO FUNDS BY INVESTOR OBJECTIVE

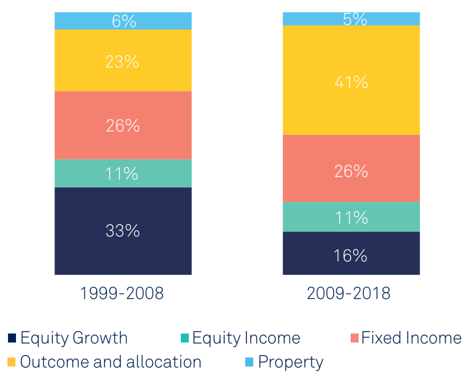
	Cumulative sales Last five years (£bn)	Cumulative sales Last ten years (£bn)
Outcome & allocation	44.6	81.0
Fixed income	19.2	51.2
Equity growth	16.0	29.0
Equity income	14.3	21.2
Property	4.9	9.0

There is compelling evidence that investor demand for outcome and allocation funds is a structural change: over the last 10 years investors have increasingly opted for funds that act as investment solutions where the allocation of assets is done within the fund rather than at the portfolio level.

The shift away from equity growth funds to outcome and allocation funds after 2008 is outlined in Chart 61:

- **Equity growth funds** made up the highest percentage (33%) of cumulative net sales between 1999 and 2008 but in the following ten years, this percentage roughly halved to 16%.
- Sales to **outcome and allocation** funds between 2009 and 2018 were £77.3 billion or 41% of the total net retail sales, the highest share of net sales over the period. Between 1999 and 2008 this percentage was 23%, less significant than sales to equity growth and fixed income funds (26%).
- In **fixed income, equity income** and **property** there has been little change in the proportion of sales between 1999 to 2008 and 2009 to 2018.

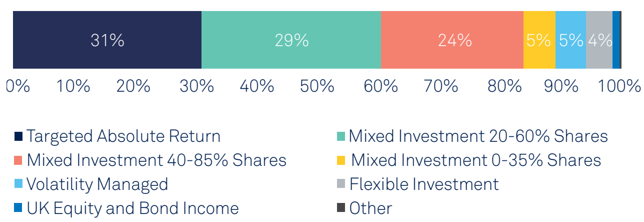
CHART 61: NET RETAIL SALES BY INVESTOR OBJECTIVE PRE-2008 AND POST-2008



The balance of sales within outcome and allocation funds is illustrated in Chart 62.

- 68% of net sales went to the combined mixed asset sectors, this represents £46.3 billion. Mixed asset funds have not had a negative quarter of net sales since 2002.
- Targeted Absolute Return and Mixed Investment 20-60% shares attracted roughly one third of flows each over the ten year period.

CHART 62: NET RETAIL SALES TO OUTCOME AND ALLOCATION FUNDS BY SECTOR (2009-2018)



This chart does not convey the recent downwards trajectory of sales to Targeted Absolute Return funds. This sector experienced -£2.2 billion outflows in 2018 (See Chart 63). Outflows were concentrated in the second half of 2018: Targeted Absolute Return funds had positive annual net sales for the rest of this ten year period.

However, looking in more detail at Chart 63, the pattern of net sales by fund profile looks more mixed than one of outflows across the board.

- Outflows in 2018 were very concentrated among TAR funds with a **mixed asset** profile. Outflows from these funds were £3.1 billion in 2018 compared with inflows of £1.2 billion in 2017.
- Sales to TAR **fixed income** funds were positive, and the second highest in the last 10 years, at £0.8 billion against a backdrop of challenging market conditions for fixed income managers in the second half of the year.
- TAR **equity** funds had three consecutive years of outflows between 2010 and 2012 but have achieved net inflows from 2013 onwards. Net retail sales in 2018 were £0.08 billion but were considerably weaker than sales of £1.7 billion in 2016 and of £0.9 billion in 2017.

The outflows from mixed asset TAR funds run contrary to the more general trend of positive sales to mixed asset funds.

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CHART 63: NET RETAIL SALES TO TARGETED ABSOLUTE RETURN FUNDS BY ASSET CATEGORY (2008-2018)

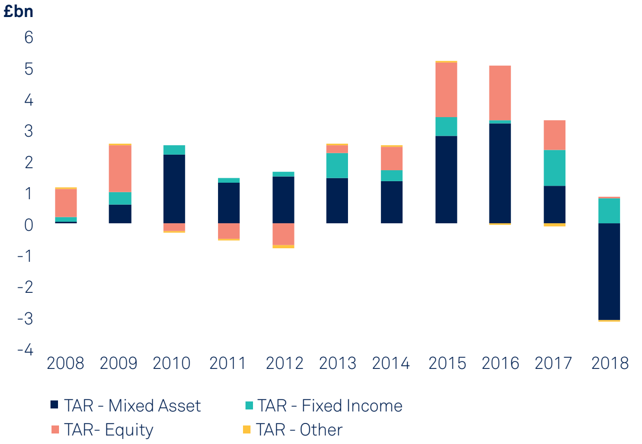
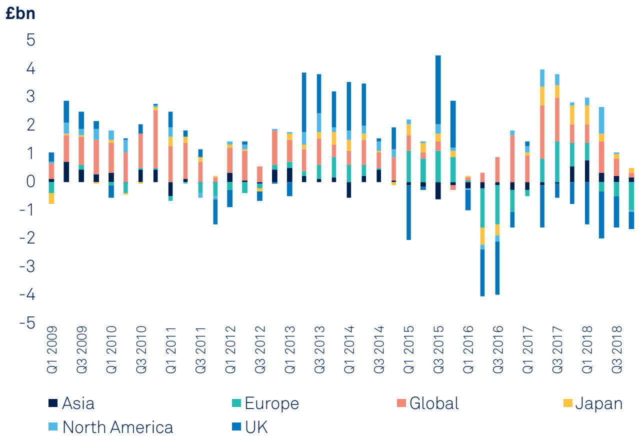


CHART 64: EQUITY FUNDS, NET RETAIL SALES BY REGION (2009-2018)



REGIONAL EQUITY FUND SALES OVER 10 YEARS

The picture for sales to equity funds remains mixed. Global equity funds have consistently attracted strong retail inflows. There has only been one quarter of negative sales to global equity funds between 2008 and 2018 in Q4 2015. Global equity funds have high levels of geographic diversification: investors have found this diversified exposure consistently attractive. Funds invested in narrower geographic regions have seen more volatility of sales, affected by the health of these regional or national economies and the stability of their political systems.

In the case of UK equities, we can see the immediate impact of the referendum. Net sales to UK equities have been weak and net outflows have been rising since 2016 when the UK voted to exit the EU. Net retail outflows from UK equities between 2016 and 2018 total £12.4 billion: the five year cumulative sales picture in Table 7 masks the extent of outflows since the referendum.

TABLE 7: CUMULATIVE SALES TO EQUITY FUNDS BY REGION OVER FIVE AND 10 YEARS

	Cumulative sales Last five years (£bn)	Cumulative sales Last ten years (£bn)
Global	17.2	35.8
North America	5.3	8.0
Japan	5.0	5.6
Europe	4.5	-0.4
Asia	0.3	3.2
UK	-1.9	-2.3

FIXED INCOME – A 10 YEAR REVIEW

In the last 10 years, investors have been attracted to fixed income funds with a diverse allocation of fixed interest securities and with global exposure. Sales to sterling strategic bonds and global bonds have been consistent over five and 10 year periods and strategic bonds is the highest selling fixed income sector over five and 10 years (see Chart 65 and Table 8)[41].

Net sales to sterling corporate bonds have been highly volatile over the last five years. Assets have washed in and out of funds in the corporate bond sector: three of the past five years have seen net outflows and the pattern of flows each quarter has been lumpy.

Performance appears to be less of a driver of flows in fixed income than investor confidence. The strategic bond sector and corporate bonds have had similar performance on a total return basis over five years[42], but strategic bonds draw from across the universe of fixed interest securities and managers are relatively unconstrained in what they can invest in. This means that strategic bond funds are typically more diversified than corporate bonds where fund managers have tighter parameters. The data throughout this chapter shows that investors are attracted by diversification and that they are less content to make allocation decisions themselves.

CHART 65: FIXED INCOME, NET RETAIL SALES BY SECTOR (2008-2018)

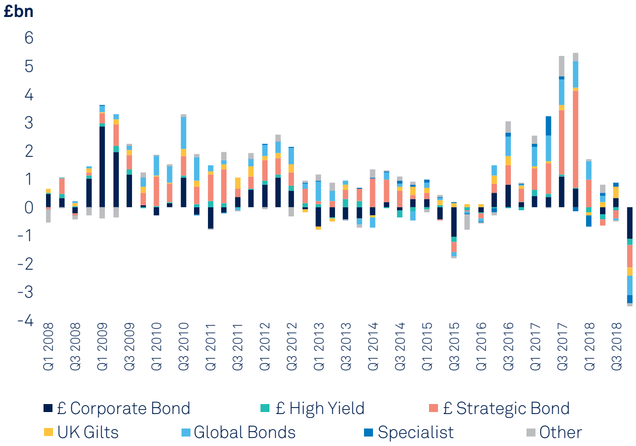


Table 4 shows the breakdown of net retail sales into fund of funds by distribution channel.

TABLE 8: CUMULATIVE SALES TO FIXED INCOME FUNDS BY SECTOR (2008-2018)

	Cumulative net retail sales Last five years (£bn)	Cumulative net retail sales Last ten years (£bn)
£ Strategic Bonds	11.9	22.6
Global bonds (inc. GEMB)	5.1	11.4
UK Gilts (inc. index-linked)	2.4	5.4
£ Corporate Bond	-0.5	9.9
£ High Yield	-0.6	1.3
Specialist	0.9	0.9
Other	1.9	1.2

[41] Gilts and index linked gilts have been grouped in Table 8 and Chart 65. Global bonds and Global emerging market bonds have also been grouped together as GEMB became a sector in Q1 2014: cumulative sales to GEMB between Q1 2014 and Q4 2018 are £0.34 billion.
[42] Morningstar data show that on an annualised total return basis over 5 years to year-end 2018, the IA £ Corporate bond sector returned 4.79% and the IA £ Strategic bond sector returned 3.62%.

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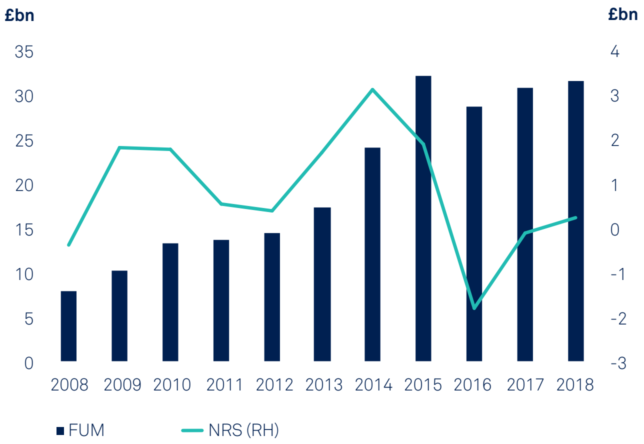
PROPERTY

FUM in property funds reached £31.4 billion in 2018, growing by 2% year on year since 2017 (see Chart 66). Net retail sales in 2018 were £0.25 billion, a stronger result than the outflows of -£0.13 billion in 2017 and -£1.8 billion in 2016, when a number of direct property funds were suspended in order to meet investor redemption requests.

Cumulative net retail sales since 2013 total £4.9 billion and net retail sales since 2008 are £9.1 billion. Property fund sales grew steadily between 2013 and 2015 before the 2016 outflows.

CHART 66: PROPERTY, FUM AND NET RETAIL SALES (2008-2018)



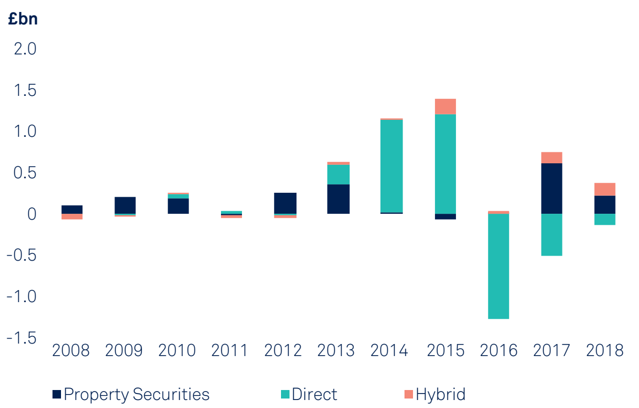
Property funds can be broken into three categories:

- Direct funds that invest directly in commercial buildings
- Indirect funds that invest in property related securities
- Hybrid funds that invest in a mixture of property related securities and physical buildings.

Funds that invest directly in property are more illiquid than their indirect and hybrid counterparts.

Property fund sales rebounded somewhat in 2018 but the underlying data, shown in Chart 67, suggest that investors prefer more liquid funds. Funds that invest directly in UK commercial property continued to see outflows, albeit smaller outflows than in 2016 and 2017. Sales to indirect (£0.22 billion) and hybrid funds (£0.16 billion) were positive while direct property funds suffered outflows of –£0.14 billion.[43]

CHART 67: NET RETAIL SALES BY TYPE OF PROPERTY FUND (2008-2018)



[43] In 2018, the IA asked all property fund managers to categorise their funds as: property securities; indirect, direct and hybrid. The data in Chart 67 does not include funds in unclassified or unallocated sectors so does not equate to total 2018 net retail sales to property funds.

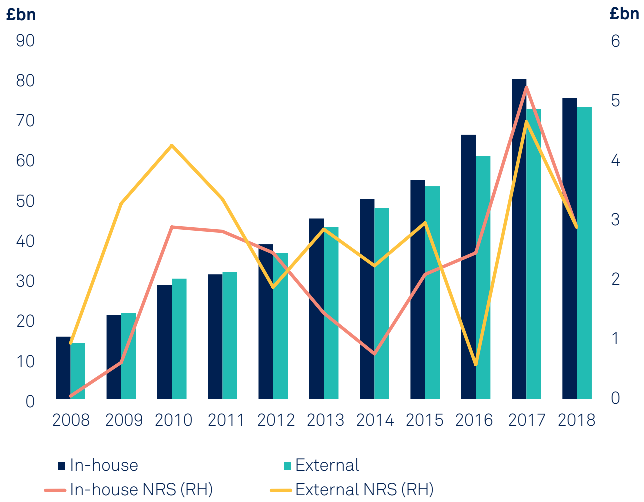
FUND OF FUNDS SALES & FUM

Net sales to fund of funds that are managed in-house[44] were £2.9 billion in 2018 and sales to external[45] fund of funds were also £2.9 billion. Funds under management in 2018, as shown by Chart 68, remain evenly split:

- FUM in in-house fund of funds was £75.0 billion, a decrease of 7% year on year.
- FUM in external fund of funds was £73.0 billion, FUM is unchanged between 2017 and 2018.
- Cumulative net sales to external fund of funds were £29.8 billion between 2008 and 2018, compared with £23.6 billion to in-house, indicating that investors prefer a whole of market approach.
- The picture for in-house fund of funds sales between 2013 to 2018 was £14.8 billion. Sales to externally managed fund of funds reached £16.0 billion.

Overall, the data suggest a slight investor preference for funds of funds that invest in external managers.

CHART 68: FUND OF FUNDS, FUM AND NET RETAIL SALES (2008-2018)

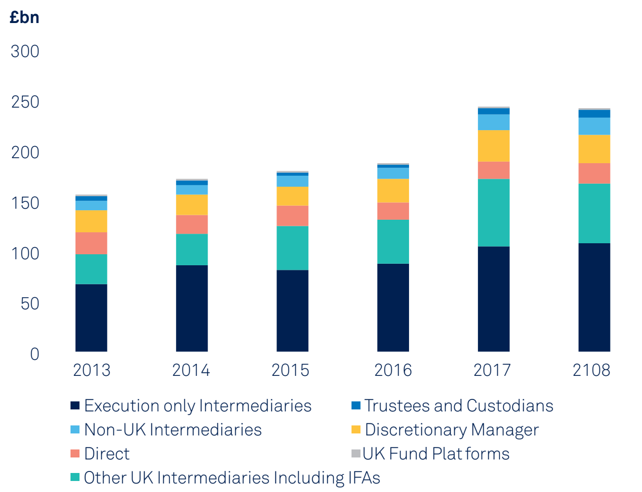


UK FUND DISTRIBUTION

In 2018, UK fund platforms[46] remain the largest distribution channel for UK retail investors by gross sales. 45% of gross retail sales are flowing through UK fund platforms (see Chart 69).

- Gross retail sales through UK fund platforms reached £108 billion in 2018, a 2% increase year on year.
- The 'other intermediary including IFA's channel saw a 9% decrease in gross sales between 2017 and 2018. It is likely that some of these sales are being re-directed through platforms. IFAs are placing more business on platform on behalf of their clients: platforms make it easy for advisers to deduct fees through the platform and to manage and report on client portfolios.
- Gross sales through execution-only intermediaries rose by 25% year on year, the highest increase of any channel. This suggests that non-advised investors still had some appetite to invest new money in 2018, although gross sales through execution only-intermediaries represent only 1% of total gross sales.

CHART 69: GROSS RETAIL SALES BY DISTRIBUTION CHANNEL (2013-2018)



[44] Fund of funds can be constrained to invest only in in-house managers from the same firm, this type of fund of fund has been termed in-house in the commentary

[45] Many fund of fund managers are free to select funds from the whole market. These funds are called external or externally managed in the commentary.

[46] UK fund platforms covers fund companies' transactions (reported by fund companies) with the following: Ascentric; AEGON (Cofunds); Avalon (Embark); Aviva Wrap; Fidelity FundsNetwork; FNZ (platforms powered by); Hargreaves Lansdown; James Hay Wrap; Novia; Nucleus; Old Mutual Wealth (including Selestia, Skandia Multifunds and Skandia Life); Parmenion; Standard Life Savings; Transact; Wealthtime.

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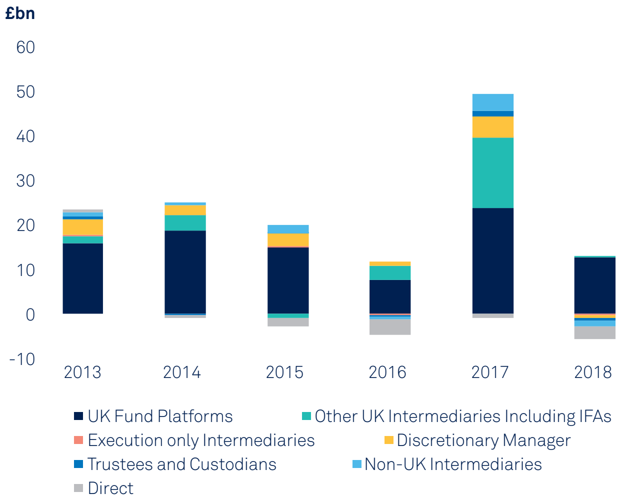
The net retail sales data in Chart 70 shows how redemptions have affected sales through UK distribution channels.

- UK fund platforms received the highest proportion of net retail sales (£12.6 billion) but sales were 47% lower than in 2017.
- 'Other UK intermediaries including IFAs' also attracted positive net sales in 2018 but sales dropped by 99% between 2017 and 2018.
- All other channels experienced net outflows. Outflows from the non-UK intermediary channel were the second highest, totalling £1.2 billion. This indicates the negative influence of Brexit on this channel, which also saw net outflows in 2016, the only other year of outflows since 2012.

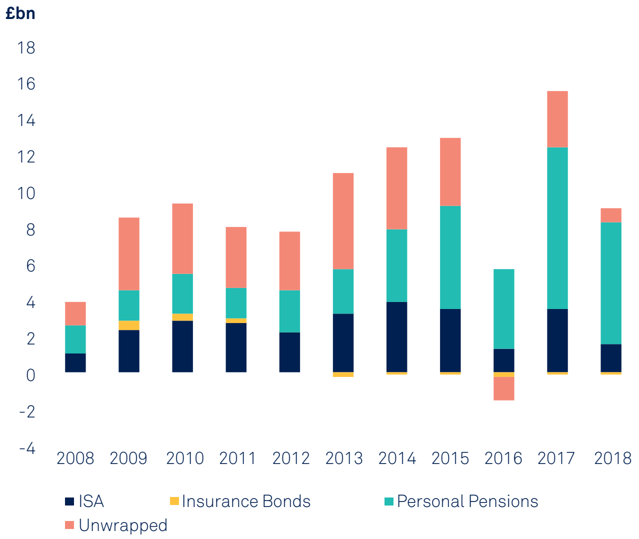
CHART 70: NET RETAIL SALES BY DISTRIBUTION CHANNEL (2013-2018)



WRAPPERS USED BY RETAIL INVESTORS IN THE UK

Since the pension freedoms were introduced in April 2015, net sales to pension wrappers have been steadily increasingly and in 2018 net sales to pension tax wrappers were again the highest (see Chart 71). There has been a steady shift away from sales to unwrapped funds, which account for funds in the general investment account on platforms. The increase in the annual tax free allowance for ISAs to £20,000 in 2017-2018 means that sales may be shifting from unwrapped (9% of sales in 2018) to ISAs (17% of sales in 2018).

CHART 71: NET RETAIL SALES TO TAX WRAPPERS THROUGH UK FUND PLATFORMS (2008-2018)



THE UK MARKET IN THE CONTEXT OF EUROPE

The UK is the fifth largest European domicile with €1.5 trillion in equivalent UK domiciled funds and a market share of 10%.

TABLE 9: ASSETS DOMICILED IN EUROPEAN UCITS AND ALTERNATIVE INVESTMENT FUNDS (AIFS) IN 2018

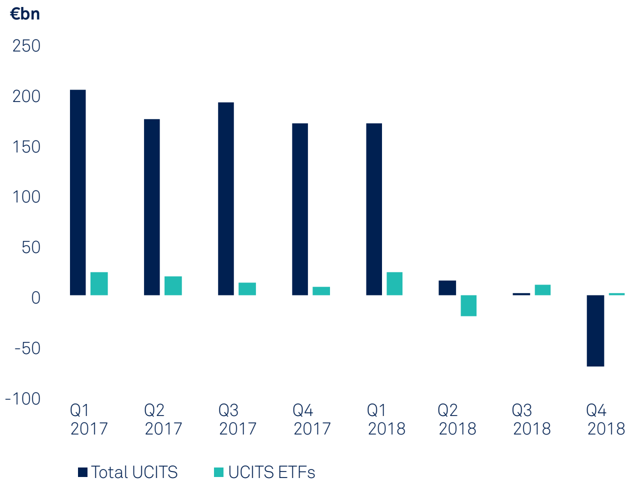
	Net assets (€bn)	Market share (%)
1. Luxembourg	4,065	27%
2. Ireland	2,421	16%
3. Germany	2,037	13%
4. France	1,813	12%
5. United Kingdom	1,493	10%
6. Netherlands	828	5%
7. Switzerland	532	4%
8. Sweden	333	2%
9. Italy	302	2%
10. Spain	286	2%
Rest of Europe	1040	7%
TOTAL	15,150	100%

Source: EFAMA

The pattern of net sales to UCITS funds in Europe mirrors that of the UK (see Chart 72) with large outflows of €70.5 billion over Q4 2018. Sales to UCITS ETFs were just positive for that quarter at €2.8 billion but still weak.

- Total net sales to UCITS funds in 2018 were €118.4 billion compared with €739.7 billion in 2017.
- UCITS ETFs attracted net sales of €18.1 billion in 2018: in 2017 net sales had reached €64.5 billion.

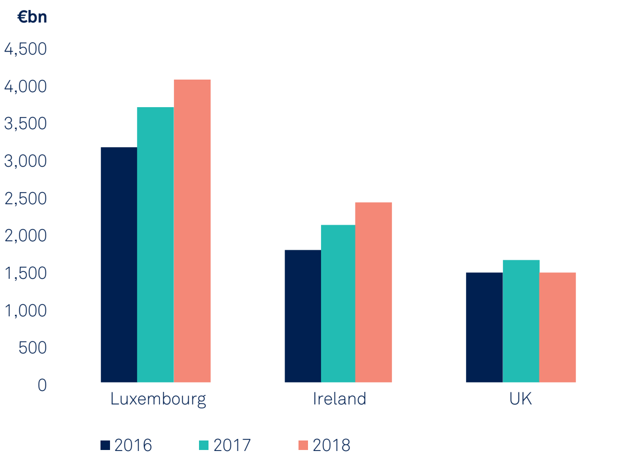
CHART 72: EUROPEAN NET SALES OF UCITS FUNDS (2017-2018)



Source: EFAMA

Chart 73 shows that assets in UK domiciled UCITS and AIFs have dropped back slightly in 2018 to 2016 levels. This contrasts with the growth in assets in the two largest European fund domiciles, Luxembourg and Ireland. As noted earlier, some investment firms have made the operational decision to move non-sterling share classes away from UK domiciled funds into European domiciles, which will have had some impact on the 2018 figures.

CHART 73: ASSETS IN UCITS AND AIFS BY DOMICILE



Source: EFAMA