1 UK INVESTMENT MANAGEMENT INDUSTRY: A GLOBAL CENTRE

KEY FINDINGS

SIZE OF THE UK INDUSTRY

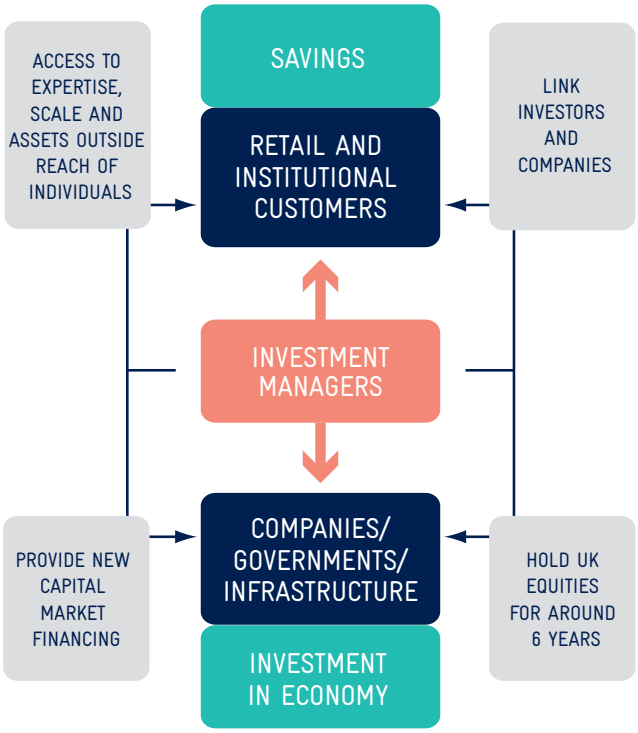
- Global market performance in 2019 saw total UK managed assets under management rise to £8.5 trillion, a 10% increase year on year. Despite the high market volatility in 2020, we estimate that as of the end of June strong market recoveries have seen assets return to the same levels recorded at the end of 2019.
- Based on the pool of firms with UK headquarters, one fifth of assets are managed by firms headquartered in Scotland. If we look more broadly at total UK managed assets, 7% of total assets (£590 billion) are managed in Scotland. This is unchanged in relative terms from 2018 but represents a £60 billion increase in nominal terms.
- The wider investment management industry (including hedge funds, private equity, commercial property and discretionary wealth managers) is estimated to manage £9.9 trillion from the UK, up from a revised £9.0 trillion in 2018.

UK INVESTMENT MANAGEMENT IN THE GLOBAL CONTEXT

- The UK is the second largest investment management centre in the world after the US, which has a significantly larger domestic market. With a European market share of 37%, it is larger than the next three European centres combined.
- The investment management industry in the UK continues to serve a very global client base. There have been strong year on year increases in assets managed on behalf of clients from non-EEA European clients, North America and Asia. Total overseas client assets have increased three percentage points year on year to 43% in 2019.
- £1.9 trillion is managed in the UK for overseas funds (up from £1.8 trillion at the end of 2018). This represents 59% of UK managed funds, a figure which has remained fairly stable over the last three years. Three quarters of assets in overseas domiciled funds are managed for funds domiciled in Ireland and Luxembourg.

This Chapter looks at the growth of the UK as a pre-eminent global investment management centre and considers the importance of the industry, both to the UK economy and to investors around the globe.

FIGURE 2: THE ROLE OF INVESTMENT MANAGERS IN CHANNELLING SAVINGS TO INVESTMENTS



ROLE OF INVESTMENT MANAGEMENT

The investment management industry has a central role in the economy channelling savings into investments and it is these two sides that define the industry's purpose – see Figure 2.

The primary purpose of investment managers is to deliver good outcomes to their clients, whether these are individual savers or institutions such as pension schemes. This includes providing wider expertise in areas such as risk management, achieving economies of scale, and giving access to a wide range of assets that would normally be out of reach for individual investors. The ultimate goal is to provide customers with a basket of shares, bonds and other assets such as property, which can deliver returns over many years without exposing them to undue risk.

The second side of the industry's role reflects the actual investment, ensuring that capital markets work effectively for this investment to take place. In doing so, investment manager activity contributes to efficient markets which price information correctly and allow buyers and sellers to transact. This facilitates both primary issuance when companies or governments are trying to raise money, and secondary trading of different instruments. Without efficient markets, market economies cannot grow effectively or may even destabilise. Investment managers thus contribute to sustainable growth in the economy, benefiting both clients and wider society.

Investment managers are not unique in this as other financial institutions and individuals contribute to capital market efficiency but the industry has historically been at the heart of long-term capital allocation, whether through shares, bonds or other assets. As long term holders of investments, UK investment managers hold UK equities for approximately six years.[1] The industry therefore also has an important responsibility to undertake stewardship activity over the companies they invest in to protect the value for their clients. As we discuss in Chapter Two, this increasingly extends to broader issues such as environmental sustainability and executive remuneration.

[1] The contribution of asset management to the UK economy, July 2016, Oxera

SIZE OF UK INDUSTRY

At the end of 2019, IA members managed £8.5 trillion of client money in the UK, an increase of 10% on the previous year (see Chart 1). Despite the relative volatility in assets under management (AUM) over the last five years, total assets as of 2019 were broadly in line with the long term growth rate over the last ten years.

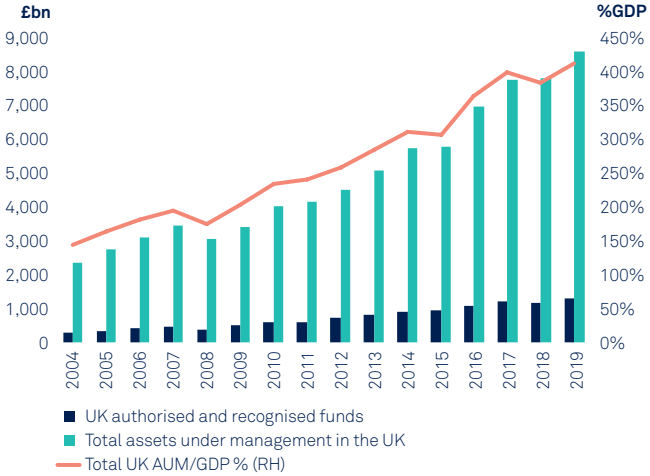
Asset valuations remain a key driver of growth in industry AUM and are heavily affected by market movements. Between 2017 and 2018, total assets remained unchanged at £7.7 trillion due to the high level of volatility in global markets in the last quarter of 2018. Since then, equity markets in particular have rebounded strongly (*See Review of global markets 2019 overleaf*).

The growth in industry assets is positive news against the backdrop of political instability and the UK's departure from the European Union on 31 January 2020. In the aftermath of the 2016 Brexit referendum, industry assets saw a significant 20% increase. This was largely a result of the depreciation in sterling versus all major currencies at the time and the high allocation to overseas assets. Currency depreciation was not a major driver in the 2019 growth in assets.

Total assets in the UK funds market by UK investors[2] have increased 12% year on year to £1.3 trillion following a 5% fall at the end of 2018. Compound annual growth rates in the UK funds market have kept pace with total UK managed funds with both increasing 10% year on year over the last decade. We cover the UK fund market in more detail in Chapter Five.

The impact of the coronavirus pandemic on global markets was extreme with global markets recording the sharpest falls since the Global Financial Crisis in 2008. However, the impact was short lived and markets have rebounded so strongly that at mid-year IA estimates put total AUM back to the level recorded at the end of 2019 despite the market volatility. By the end of Q2 2020, total assets in the UK funds market were close to, though slightly lower than, pre-coronavirus levels. However, the industry is facing a highly uncertain economic outlook as we continue to navigate through the fallout from the crisis. At time of writing data from the ONS show that in April and June 2020, the UK economy entered the deepest recession since records began.

CHART 1: TOTAL ASSETS UNDER MANAGEMENT IN THE UK AND IN UK FUNDS (2004-2019)



Source: IA, ONS

By the end of 2019, the size of the industry relative to GDP had increased to over four times the size of the UK's economy. This is characterised by the right hand side of Chart 1. By comparison, the latest data available for Europe excluding the UK indicated that outside of the UK the average size of an investment management industry in Europe is just over the size of local GDP. This means that investment management is considerably more important to the UK economy than it is to the economies of other European countries.[3]

ONS data for Q2 2020 shows that UK GDP contracted 20% over the second quarter of the year, the largest contraction on record by a substantial margin. If the IA estimate of broadly unchanged AUM as of June 2020 is correct, then the industry has demonstrated remarkable resilience during a period of significant economic turmoil.

[2] Total UK investor funds under management (FUM) comprises retail and institutional FUM for UK investors in UK domiciled and overseas domiciled funds. Prior to 2012, the data reported by the IA represented all investors in UK domiciled funds.
[3] IA analysis of EFAMA data.

REVIEW OF GLOBAL MARKETS IN 2019

After a difficult fourth quarter in 2018, a number of risks loomed over markets at the start of 2019 including a global economic slowdown and a potential trade war between the US and China.

Table 1 shows the annual total return of select indices. In spite of the economic and political uncertainty, overall global stock markets bounced back after the steep decline in Q4 2018: the annual total return of global stocks was 22% [1] in Sterling terms in 2019. Whilst annual performance across equity markets in 2019 was far superior to 2018, the rally in the main equity markets was partly due to a recovery in Q1 from the slump experienced at the end of 2018 rather than a significant shift in the outlook for global economic growth. Markets were boosted globally in Q4 2019 by the apparent easing of Sino-US trade tensions as President Trump looked set to sign a Phase One trade deal with China in early 2020.

US equities led the way in 2019 and the S&P 500, the main US index, delivered returns of 26% despite ongoing trade tensions with China. The Federal Reserve cut interest rates three times to counteract the impact of slowing global growth and Trump's impending trade war. This shift in approach from 2018's interest rate rises helped to bolster US market performance.

The UK stock market underperformed its US and European counterparts in 2019 but still ended the year up by 19%, compared with a return of –9.5% in 2018. Returns rallied in the last quarter of the year as the Conservative party won a significant parliamentary majority in the December general election. This victory helped to ease political uncertainty and quell concerns over a protracted Brexit timetable, benefitting smaller companies and the more domestically focused industry sectors in the FTSE.

The US Federal Reserve was not the only central bank to lower rates during 2019 and central bank intervention, as in 2020, played an important role in propping up positive market performance. The European Central Bank cut rates further into negative territory to a low of –0.5% in September in order to stimulate economic growth in the Eurozone, which had been relatively weak. This monetary policy move helped European equity market returns to reach 20% over2019.

In Japan inflation remained muted and corporate earnings declined in 2019, in a similar situation to Europe. Japanese equities returned 17% over the year, market performance in Japan was also influenced by the twists and turns of the US-China dispute.

Non-gilts (primarily made up of corporate bonds) outperformed government bonds in the UK during 2019.UK gilts returned 7% over the year but non-gilts fared slightly better, returning 9%. Generally corporate bonds offer higher yields than gilts (the yield is the coupon paid by the bond divided by the price of the bond, effectively the return that the investor makes) but government backed gilts are perceived as safer assets making them attractive to risk averse investors.

Global bonds performed strongly in the first eight months of 2019 but bond returns started declining sharply after September to finish the year up just 2.7%. An environment of interest rate cuts from the Fed and the ECB translated to rising bond prices, which ultimately pushed bond yields lower. There is an inverse relationship between bond prices and bond yields: bond coupons or interest payments are fixed so if the bond price rises, the investor has to pay more for the same return.

TABLE 1: SELECTED BOND AND EQUITY MARKET RETURNS IN 2019 (£ TERMS)

Global equity	22%
UK equity	19%
Europe ex UK equity	20%
Emerging Market equity	16%
Japan equity	17%
US equity	26%
Global bonds	3%
UK Gilts	7%
UK Non-Gilts	9%

Source: Morningstar

SCOTLAND AS A MAJOR CENTRE

Although the City of London remains the leading centre of investment management activity in the UK, Scotland, and particularly Edinburgh, plays a key role nationally.

At the end of 2019 total assets managed in Scotland by IA members stood at 7%, equivalent to £590 billion. This proportion is unchanged year on year but represents a £60 billion increase in nominal terms compared with 2018.

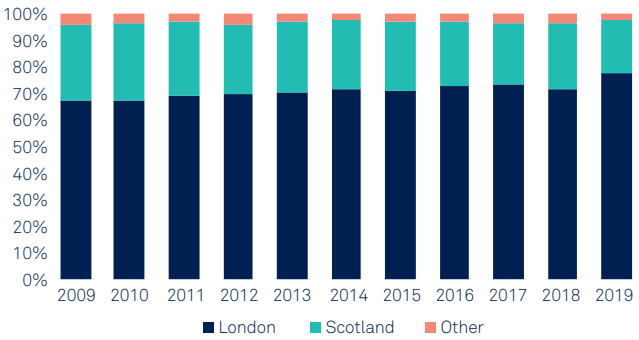
Among UK-headquartered investment managers, one fifth (20%) of assets are managed by firms with headquarters in Scotland. Chart 2 shows how the regional split has evolved over the last 10 years. UK managed assets have become increasingly dominated by firms headquartered in London, a trend that has accelerated in 2019 due to M&A activity in Scotland.

Many IA members headquartered in Scotland undertake investment management activity in other regions, primarily London, which is why there is an imbalance between Scottish managed assets and location of firm headquarters.

This is consistent with the data collected on staffing levels, which clearly shows that London is more likely to be a location for portfolio manager jobs than other areas of the UK (see p 99 – staffing table).

In our interviews with members this year some senior figures have suggested that we might see an increase in regional offices outside of the city clusters as a consequence of the operational changes caused by the pandemic. The shift to working from home through the crisis has called into question the need for and use of office spaces. It remains to be seen whether there will be long term consequences of the decentralisation of work spaces in 2020.

CHART 2: UK-MANAGED ASSETS BY UK REGIONAL HEADQUARTERS (JUNE 2009-2019)



SCALE OF WIDER INDUSTRY

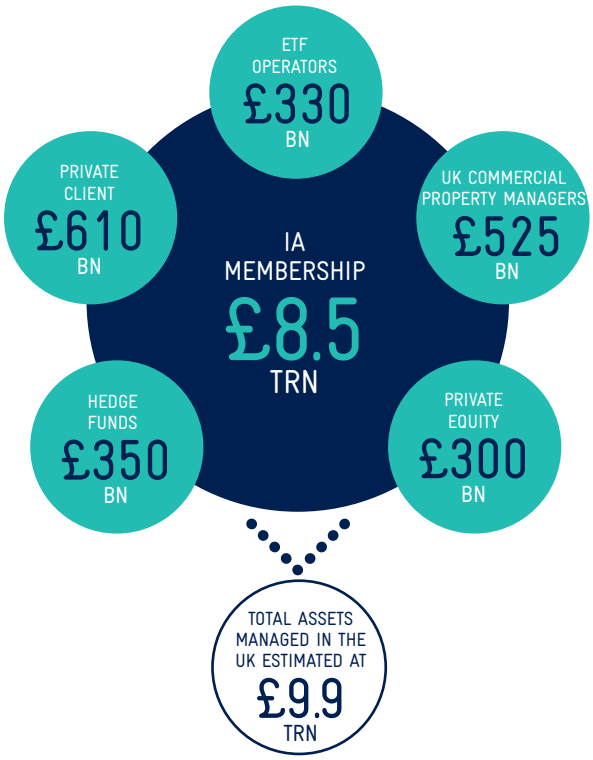
IA members represent the majority of the UK investment management industry in asset terms (85%). Firms not covered in detail in this report can be broadly split into the following categories:

- Hedge funds
- Private equity funds
- Commercial property management
- Discretionary private client management
- A small number of dedicated ETF operators
- Firms who are not members of the IA for reasons not noted above[4]

Figure 3 provides estimates to show how these wider parts of the industry contribute to total assets under management in the UK. Many IA members are also active players in some of the more niche areas of investment management outlined in the list above. There is therefore some overlap in the figures presented in Figure 3 below. As of 2019 we estimate the size of the wider industry at £9.9 trillion up from a revised £9.0 trillion in 2018.

[4] This last group is more difficult to size as there is no consistent third party data available.

FIGURE 3: WIDER INVESTMENT MANAGEMENT INDUSTRY



Source: ComPeer, Morningstar, Preqin, Investment Property forum, IA estimates

UK INVESTMENT MANAGEMENT IN EUROPEAN AND GLOBAL CONTEXT

The UK is the largest investment management centre in Europe with a market share of 37% in 2018. This proportion has remained fairly stable since 2011.

Looking at the market shares of the other major investment management centres across Europe, the UK remains larger than then next three jurisdictions combined.

FIGURE 4: ASSETS UNDER MANAGEMENT IN EUROPEAN COUNTRIES (DECEMBER 2018)

Country	Net assets (€bn)	Market share
1. UK	8,609	37%
2. France	4,072	18%
3. Germany	2,190	10%
4. Switzerland	1,912	8%
5. Italy	1,315	6%
6. Netherlands	1,207	5%
7. Denmark	387	2%
8. Spain	369	2%
9. Belgium	287	1%
10. Austria	131	1%
Other	2,617	11%
TOTAL	**23,096**	

Source: EFAMA[5]

[5] Provisional data from Asset Management in Europe, 12th Annual Review, EFAMA, 2020

When we look more globally the UK is the second largest investment management centre behind the United States, which accounts for just under half of global assets under management and has higher total assets than all European nations combined (Table 2). The U.S. asset management industry serves a more domestic market. Outside of Europe and the U.S., Japan is a notable investment management centre with total assets of about £4.4 trillion.

TABLE 2: GLOBAL ASSETS UNDER MANAGEMENT

	Assets under management (local currency)	Assets under management (£ equivalent)
US	$38 trillion[6]	£31.9 trillion
Europe	€23 trillion[5]	£27.3 trillion
Japan	¥642 trillion[7]	£4.4 trillion

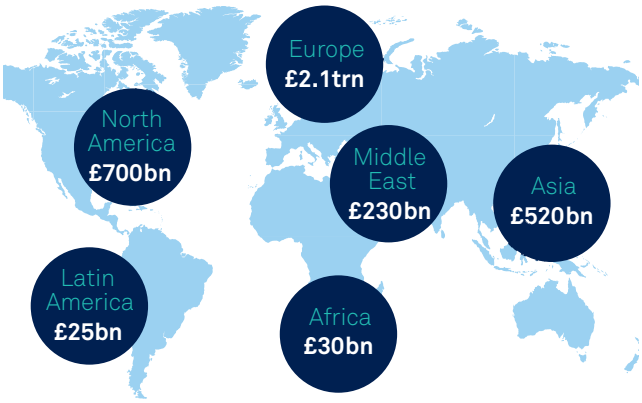
OVERSEAS CLIENT MARKET

From the perspective of total assets under management for overseas investors, the UK's departure from the European Union on 31 January 2020 has not impacted its position as a preeminent centre of excellence for investment management. At the end of 2019 assets managed in the UK on behalf of overseas clients increased by £550 billion to £3.6 trillion, equivalent to 43% of total assets. This proportion has fluctuated around 40% for a number of years, though the three percentage point increase year on year does represent a new high. It remains to be seen what the impact will be once we reach the end of the transition period at the end of 2020.

Figure 5 shows that the largest overseas client base in 2019 was still the EEA, for which the UK industry manages approximately £1.9 trillion. A further £190 billion is managed for clients in other parts of Europe, predominantly Switzerland which accounts for over three quarters of this figure. Although starting from a substantially lower base, this represents a 44% increase on the 2018 figure. This takes the total European share of overseas assets to 58%, down one percentage point from 2018 given the higher relative increase of assets from clients in other regions.

Outside of Europe, North American client assets are the next largest reaching over £700 billion, almost a quarter higher than in 2018. The other region which has seen notable growth in 2019 has been Asian client assets which increased £120 billion to £520 billion. Assets managed on behalf of clients in Latin America and Africa remained unchanged in 2019.

FIGURE 5: ASSETS MANAGED FOR OVERSEAS CLIENTS



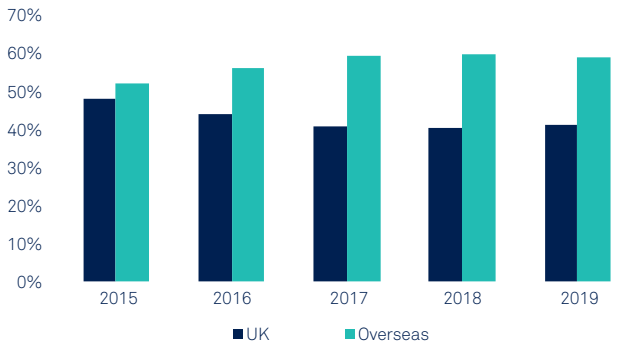
[6] Estimate based on North America Data. Global Asset Management 2020: Protect, Adapt and Innovate, BCG, 2020
[7] Financial Services in Japan 2019/2020, NRI

SERVICES TO OVERSEAS FUNDS

As we saw from the European data in Figure 4, the UK is a dominant player in portfolio management but it is not as dominant as a fund domicile. IA members manage assets for funds domiciled across all continents from their UK offices. These overseas domiciled funds allow UK investment management expertise to be accessed from around the world.

At the end of 2019, £1.9 trillion was managed in the UK for overseas funds representing 59% of total UK managed funds (see Chart 3). Three quarters of these assets were in funds domiciled in Ireland and Luxembourg. Although the proportion of assets in overseas domiciled funds has increased from 52% in 2015 it has remained broadly unchanged for the last three years. This is likely to reflect the fact that in their preparations for Brexit some firms transferred European client assets to overseas domiciled funds to ensure that these clients continue to be serviced regardless of the outcomes of negotiations. This shift was largely completed by the end of 2017, since then the split has remained relatively stable.

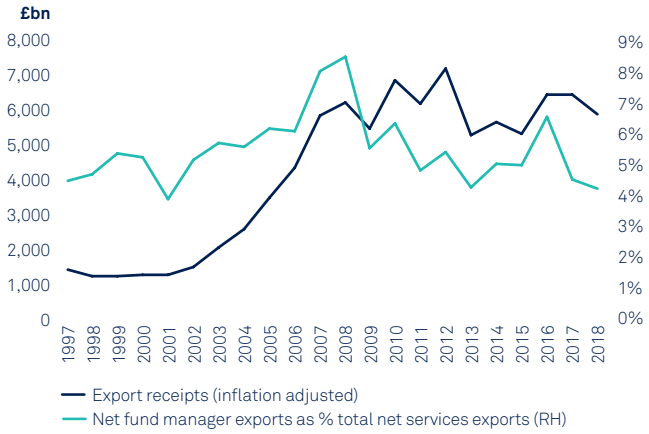
CHART 3: PROPORTION OF ASSETS MANAGED FOR UK AND OVERSEAS FUNDS (2015-2019)



IMPORTANCE TO UK SERVICE EXPORTS

Overseas client assets account for 43% of total UK-managed investments, a 12% increase over the last decade. Given the size of its overseas client base, the investment management industry makes a significant contribution to the UK's service exports through overseas earnings. The last 20 years have seen this contribution increase from £820 million in 1998 to £5.8 billion in 2018 (Chart 4). The right hand side of Chart 4 indicates that export earnings represented an average of 5% of total net exports over the past ten years though this figure has been quite volatile and has declined in the aftermath of the global financial crisis in 2008 from a high of 8.4% to a low of 4.2% in 2018.[8]

CHART 4: EXPORT EARNINGS OF FUND MANAGERS AND CONTRIBUTION TO SERVICES EXPORTS (1997-2018)



Source: ONS

[8] The data in Chart 4 captures earnings by independent asset managers but is likely to understate earnings from asset managers that are part of a wider financial services group such as an investment bank or insurer. As such, this estimate is conservative and the actual contribution of investment management overall to service exports is likely to be higher.