By the end of 2019, UK investor funds under management (FUM) in UK and overseas domiciled funds had reached a record £1.31 trillion. Funds under management had recovered to £1.28 trillion by June 2020 despite a 14% fall in March.

COVID-19 AND THE CHANGING PATTERN OF RETAIL FUND SALES

UK investors reacted strongly to extreme levels of market turbulence through 2020. The March 2020 outflow of £9.7 billion from UK retail funds was the highest ever, largely dominated (76%) by outflows from fixed income funds. The £1.12 billion outflow from equities was significantly lower given that the steep decline in equity valuations may have made it unattractive for investors to sell out of them in March.

Sales rallied strongly in Q2 2020 at £11.2 billion taking net retail sales for the first half of 2020 to £8.6 billion. By way of comparison, first half net retail sales in 2019 were £3.5 billion in a year of fairly weak total sales (£9.8 billion), which followed an even weaker 2018 (£7.7 billion).

The last five years have seen unusually volatile flow amidst rising domestic political and economic uncertainty.

EROSION OF HOME BIAS IN EQUITIES

Allocations to UK equity funds have declined substantially as a proportion of total UK investor FUM in the last 15 years falling from 39% of FUM in 2005 to 14% by June 2020.

Since the Brexit referendum was announced in January 2016, up until June 2020, UK equity funds have seen heavy outflows of £12.7 billion.

Three factors have contributed to the decline:
- A more uncertain economic outlook for the UK as a result of the Brexit referendum
- Weaker total returns from the FTSE relative to global capital markets and a dependence on dividends to boost total returns
- Relatively low capital growth over a sustained period and a low weighting of the FTSE All-Share to higher growth industry sectors

INVESTOR INTEREST IN INDEXING FUNDS IS INCREASING

Indexing funds under management reached £230 billion at the end of 2019, up 26% year on year from 2018. In June 2020, FUM remained at £230 billion.

Growth has accelerated post-2012 when indexing funds accounted for just 8% of FUM. Total funds in indexing funds accounted for 18% of FUM in June 2020.

Sales to indexing funds have remained resilient during periods when capital markets were experiencing sharp falls. In March 2020, indexing funds saw positive net sales of £467 million against an outflow of £10.1 billion from active funds.
> The FUM in responsible investment funds rose by 89% from January 2019 to June 2020. FUM reached a high of £33 billion in June 2020 as asset prices recovered and inflows continued.

> Sales to RI funds have weathered the market shock of 2020: net retail sales between January 2019 and June 2020 were £7.0 billion with net inflows each month over this period. This includes March 2020 where net retail sales remained positive, albeit depressed, at £124 million.

> In the first six months of 2020, net sales to responsible investment funds were four times higher than in H1 2019.

> The first half of 2020 has seen a shift in the patterns in distribution. Flows through the ‘Other UK Intermediaries including IFAs’ channel have been strong with particularly strong sales in the first quarter during a period when other channels saw flat sales or outflows.

> UK Fund Platforms saw higher outflows from general investment accounts in 2020, whereas funds wrapped by ISAs or pensions were more resilient on platform. Outflows from unwrapped accounts for the first half of 2020 were at £903 million due to heavy outflows in the first quarter.

> UK fund platforms remain the dominant retail distribution channel in 2019 with a 49% share of total gross sales. Sales through platforms rose by 17% year on year to reach £127 billion.

> Platforms were also the largest channel for net sales in 2019 despite a £2 billion decrease to £10.9 billion. The ‘Other UK Intermediaries including IFAs’ channel saw net sales of £3 billion, up from £0.2 billion in 2018.
Our analysis of the UK investment fund market is based on proprietary IA sales data looking at UK investor behaviour, particularly retail. This data provides insight for the first half of 2020, offering more up-to-date analysis than the total assets under management data at investment management industry level. Chapter 5 looks in detail at both recent developments in UK retail fund investor behaviour and longer-term trends in the UK funds industry.

UK INVESTOR FUNDS UNDER MANAGEMENT

By the end of 2019, UK investor funds under management (FUM) in UK and overseas domiciled funds had reached a record £1.31 trillion, up from £1.15 trillion at year-end 2018 and a 14% increase year on year (see Chart 37). Although FUM fell at the end of 2018 as a result of a sharp reversal in global capital markets, market returns rebounded over the course of 2019, with asset appreciation driving the 14% increase in FUM.

Through Q1 2020, the UK retail fund market faced significant headwinds as investors grappled with the implications of Covid-19 for investment returns. Whilst the coronavirus pandemic is not a financial crisis in origin, the measures implemented to contain the virus, including the locking down of populations globally, had a swift and dramatic impact on capital market returns in March: the FTSE All-Share lost 28% of its value between 4-23 March, a pattern that was replicated across the global equity markets.

Between December 2019 and March 2020, the gains in FUM made during 2019 were therefore wiped out: FUM declined by 14% to £1.13 trillion as a result of March’s steep market falls. However, as markets recovered, so funds under management have since risen to £1.28 trillion as at June 2020, a decline of 2% from December 2019.

Looking over the past 15 years, despite strong growth in overall sales (total £294.3 billion), asset appreciation and depreciation have been the most significant driver of total FUM. Chart 38 particularly illustrates the impact of market movements on funds under management in 2008, as markets were affected by the GFC and again by major turbulence in 2018. Even at moments of acute stress when the industry sees significant outflows, it is market movement that overwhelmingly accounts for the change in overall FUM.

IA data show 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 68.
UK INVESTOR FUM BY ASSET CLASS

As we explore in later sections of this chapter, a major historic trend within the overall asset mix is the decline in UK equities as a proportion of total FUM since 2004 – falling from 39% to 14% in June 2020 (see Chart 39). In contrast, overseas equities accounted for 36% of FUM in June 2020, an increase of 4 percentage points from 2005. This rise aligns with the wider increase in overseas equities as a proportion of total assets under management (See Chapter 3) as home bias continues to erode. That erosion is much more pronounced in parts of the institutional market, notably DB pension schemes, than in UK retail.

The overall proportion of funds allocated to equities has also fallen, again a trend seen in the institutional market. This sees funds invested in fixed income now representing 20% of FUM in June 2020, compared with 15% in 2005. Mixed asset as a proportion of FUM is now 16% against 12% in 2005.

CHART 39: FUM BY ASSET CLASS (2004–2020 JUNE)

The highest increase as a proportion of FUM over the last 15 years is seen outside the main fund categories (equities, fixed income and mixed assets). This takes the ‘Other’ category to 14% of FUM in June 2020: a substantial increase from 2% in 2005. This shift has particularly been driven by the rise in preference for outcome-oriented funds, notably targeted absolute return and volatility-managed funds, which now account for a combined total of 7% of total FUM (see Chart 40).

COVID-19 AND CHANGING PATTERNS OF RETAIL FUND SALES

After a comparatively uneventful beginning to the year, total outflows in March 2020 reached £9.7 billion overall, the highest ever seen in a month, the next highest being £2.5 billion in June 2016 following the Brexit referendum. This has been offset to a significant extent by a return to inflows in April totalling £11.2 billion through to June. Overall net retail sales for the first half of 2020 were £8.6 billion. By way of comparison, first half net retail sales in 2019 were £3.5 billion in a year of fairly weak total sales (£9.8 billion), which followed an even weaker 2018 (£7.7 billion). As we show later in this section, the last five years have seen unusually volatile flow amidst rising domestic political and economic uncertainty.
As Chart 42 shows, different patterns can be observed across different regions.

- **Global.** Despite the overall restraint in equity sales, global equities saw large outflows of £1.33 billion in March. Sales to global funds have also enjoyed the strongest sales rebound in Q2 2020, as assets totalling £2.4 billion flooded back over the period.

- **North America.** Outflows from North American equities were £256 million in March. Net retail sales picked up again in May, taking inflows in the second quarter to £1.0 billion. The S&P 500, the major US index, gained 36% between 23 March and 29 June 2020: this compares with a 23% gain for the FTSE 100 over the same period.

- **Europe.** European equities have seen eight consecutive quarterly outflows up to Q2 2020: the highest outflows over this period coming in Q1 2019 of £1.3 billion. In March, £239 million flowed out and May saw higher outflows of £500 million despite rebounding returns in the European capital markets. The ECB has been less decisive than other Central Banks in using the monetary policy levers at its disposal.

- **Asia.** Asian countries faced earlier restrictions in their efforts to contain the virus and whilst sales to Asian equities have been relatively volatile month on month through 2020, outflows were more concentrated in Q1: March’s outflow of £179 million pushed Asian equities to net retail sales of £1.12 billion in March at the bottom of the market.

- **UK.** Outflows from all the other major geographic locations in March were offset by a £747 million inflow across UK equities. As equity markets around the world, including the FTSE, lost 20-30% of their value reaching a low on 23 March, the net retail inflow to the UK All Companies sector of £965 million was the second highest on record. One explanation for this may be that some investors were prepared to allocate more capital to UK equities at relatively cheap valuations in March. These investors were banking on a steep recovery in performance. From
March through to May inflows totalled £2.2 billion. There are signs in June that investors have started to bank these gains as £1.1 billion flowed out of UK equities. An element of greater familiarity with companies listed in or deriving significant revenues from the UK may have guided some retail investors to risk allocating more capital to UK equities in March: we did not see UK investors taking this approach for global and US equities.

- Some 80% of fixed income funds recorded net outflows in March, and this is by far the highest proportion of funds seeing outflows in the main asset classes in current IA data (which goes back to 2002).

The largest fixed income net outflows in March were across funds in the £ Corporate, £ Strategic and the Global Bond sectors, the three largest fixed income sectors by FUM. There were also large-scale outflows from the High Yield sector which invests in sterling non-investment grade debt with the promise of higher yields and is therefore more vulnerable to credit defaults. However, there were outflows across all the fixed income sectors to varying degrees.

Assets have flowed back to fixed income funds in Q2, recouping 65% of March 2020’s £7.4 billion outflow by June 2020. Whilst sales to bond funds have rebounded, the spectre of investment grade bond downgrades remains. Funds investing in this type of debt would have to adjust allocations to avoid too great an exposure to non-investment grade debt if the pace of downgrades accelerate. Globally, the strength of the dollar has also affected emerging market debt issuers as debt is often dollar denominated making it tougher to pay down when the dollar is strong.

### FIXED INCOME FLOWS

Through 2019, net sales to fixed income had recovered substantially after outflows in Q4 2018 and the total over the year reached £6.7 billion. As we approached the height of the Covid-19 market crisis in Spring 2020, one might have expected that investors would avoid selling out of assets in fixed income funds, an asset class that is classically less risky for investors than equities. This was not the case:

- Outflows of £7.4 billion from fixed income funds in March accounted for 76% of the total retail outflow.
- All nine fixed income sectors recorded their highest ever outflow as a proportion of sector FUM in March.
We see three key drivers of the heavy fixed income outflows:

- **Re-balancing portfolios as equity valuations fell:** Equity valuations dropped 20% -30% over a short period of time, reaching a low on 23 March. Portfolios with a 60 /40 weighting to bonds and equities would have moved significantly out of alignment, leaving them with a much higher weighting to bonds. The prospect of selling down equities when valuations are low is unappealing. In particular, discretionary managers looked to balance portfolios in the short-term. Investors selling out of fixed income for re-balancing purposes appear to have sold down more liquid fixed income funds first, and this is part of the explanation for high outflows from £ corporate bond funds and £ strategic bond funds. As equity markets rebounded, further adjustments back into fixed income have been made.

- **Calls on cash:** Some of the activity in March must represent a move to cash, either as a ‘flight to safety’ and/or reflecting the need to draw on assets invested to convert them into cash for immediate expenses. If a household income dropped significantly as a result of being furloughed or self-employed in an industry that was effectively shut-down, drawing on investments may not have been desirable but could have been a necessity in order to pay mortgages or other household expenses. To meet these needs, investors may have sold down fixed income or mixed asset funds to avoid crystallising the losses sustained on equities.

- **Short-term risk management plays:** Volatility was a feature across asset classes, with conditions in both the bond and equity markets becoming exceptionally challenging in mid-March. It is possible that some investors may have opted to reduce their exposure to bonds in immediate reaction to this. The massive scale of bond buying programmes from the Federal Reserve, the BoE and the ECB helped to drive greater liquidity and improve price stability but this pulled through into bond markets at the end of March.

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**PROPERTY CHALLENGES**

Sales to funds investing in property have been consistently lower in the years following the Brexit referendum and the suspension of redemptions from funds investing in UK physical commercial property in July 2016, and have been in net outflow (see Chart 45). Funds under management had also dropped back at the end of 2019 to £28.2 billion, levels last seen in 2016. 53% of the £28.2 billion was invested in funds investing directly in property, 21% of FUM was in property securities funds and 5% of property FUM was invested in hybrid funds.

**CHART 45: NET RETAIL SALES BY TYPE OF PROPERTY FUND (2010-2020)**

In 2018, the IA split the Property sector into UK Property Direct and Property Other, which contains funds investing in property securities, a hybrid of direct and securities and global physical property funds. Chart 45 shows that sales to funds investing in property securities, which are more liquid, have outstripped sales to funds investing in direct property since 2017. Cumulative sales to property security funds over 2019 were £530 million, compared with an outflow of £1.8 billion from funds investing directly in property.
The net retail sales data in 2020 in Chart 45 is affected by the widespread suspension of redemptions and subscriptions for daily and quarterly-traded open-ended property funds investing directly in physical UK property. This is due to valuers qualifying their valuations with a material uncertainty clause meaning that fund managers cannot price units with any certainty. According to data from the Association of Real Estate Funds, 35 property funds suspended in March (21 UK domiciled funds). Whilst most funds remain suspended, at the time of writing some firms have begun to lift their suspensions.21

The material uncertainty clauses were invoked by valuers once the UK Government took steps to introduce the national lockdown required to halt the spread of Covid-19. The material uncertainty was a result of the following drivers:

- Over lockdown, people shopped less, travelled less, could not eat out or commute in to offices, instead working from home.
- The revenue of retailers, hotels and restaurants was significantly reduced, and in some cases, revenues were non-existent during lockdown, which meant that they were less able to pay rent.
- The investment value of a property is derived from its income stream, the rent. If this is at risk, so is the value.

OUTCOME AND ALLOCATION

The last 15 years have seen what increasingly appears to be a structural shift in investor preference for what the IA terms outcome and allocation funds. These include the mixed asset sectors as well as some specialist funds, money market funds, targeted absolute return and volatility managed. The proportion of total net sales to outcome and allocation funds has risen from 23% in the decade before the Global Financial Crisis to 43% since 2009. This shift in the balance of net retail sales is largely at the expense of flows to equity growth funds, which have declined as a proportion of sales to 16% from 33% in the preceding period (see Chart 46).

This story remains intact into 2020 as Chart 47 shows. However, there are some important sub-trends, particularly affecting Targeted Absolute Return funds. Whilst we continue to see steady inflows to mixed investment funds over the last fifteen years, the targeted absolute return sector, which was launched in 2008 and initially proved very popular with investors, has moved into outflow each quarter from Q3 2018. Total retail outflows through 2019 were £5.0 billion.

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21 This number is based on publicly available data on suspensions and information provided to AREF by its members. It is possible that there are fund suspensions that AREF is not aware of. Of these funds, the majority are Property Authorised Investment Funds (PAIFs) – either Non UCITs Retail Schemes (NURS) or Qualified Investor Schemes (QIS). They are all open ended.
In 2020, as the investment industry navigated the impact of the coronavirus on performance and on net sales, some suggested that the targeted absolute return sector might return to inflow. This type of outcome fund should be attractive for investors looking to achieve returns irrespective of market conditions. Whilst some funds in the sector have achieved positive net retail sales, Chart 48 shows that 2020 hasn’t heralded the reversal in fortune that might have been anticipated and net outflows for the first two quarters of 2020 have reached £3.2 billion.

The volatility managed sector was one of only six sectors to see an inflow in March 2020, net retail sales for the month were £250 million and proved able to weather March’s significant outflows more effectively than the mixed asset sectors.

Where flows to targeted absolute return funds have faltered, the Volatility Managed sector has consistently attracted inflows since its launch in 2017. This type of fund often maps to the advisers’ risk profiling process to help build investor portfolios that are suitable for different risk appetites. A medium risk tolerance is likely to be the most common result. Chart 49 divides the funds in the volatility managed sector into funds managing returns within low, medium and high volatility parameters.

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As there is no standardised industry approach to what constitutes a low, medium or high volatility parameter, this chart is based on fund names and investment objectives.

The other sectors being UK All Companies, Property Other, Global Emerging Markets, Standard Money Markets and Short-term Money Markets.
COMPARING THE PATTERN OF RETAIL SALES WITH PREVIOUS CRISES

The conditions that led to the GFC were completely different from 2020 but 2008 does bear comparison with 2020 because it gives us some sense of how investors have responded to significant market shocks in the past and how 2020 differs.24

**CHART 50: TOTAL SALES AS A PERCENTAGE OF FUM THROUGH CRISES**

Chart 50 shows that in 2007, when the run on Northern Rock made it apparent that the crisis was spreading internationally, we start to see outflows. The striking difference between 2008 and 2020 is the speed of events and the scale of outflows:

- In 2007/8 the full impact on sales plays out over a much longer time period than in 2020: the highest outflow of 0.5% of total FUM occurs ten months after Northern Rock in 2008, and sales are volatile over a 13 month period before moving into a sustained recovery.

- Outflows in 2020 begin in February but reach 0.91% of FUM in March, the highest outflow ever in percentage terms as well as absolute terms. Inflows in April of 0.69% of FUM demonstrate the strength of the rebound in sales, and is far swifter than in 2008.

LONGER-TERM PATTERNS

The historic data clearly suggest that investors do react to significant events - and outflows are likely to occur if there are further shocks - but that sales recover quickly.

Looking back at net retail sales over the last 15 years allow us to compare the long-term effects of the global financial crisis and the Brexit referendum with events of 2020 and the impact of the coronavirus pandemic:

- In 2008, in the depths of the Global Financial Crisis, net retail sales declined significantly year on year to £4.8 billion but they rebounded dramatically in 2009 to a then record level of £29.8 billion.

- A similar effect can be seen in response to the Brexit referendum. In 2016, net retail sales of £7.0 billion for the year were followed by a record £48.6 billion in 2017.

**CHART 51: NET RETAIL SALES (2005- H1 2020)**

24 The scale of the UK funds market in 2008 was smaller, and IA data did not capture FUM in overseas domiciled funds at that time. This means that the most effective way of comparing the events of 2020 and 2008 is to look at outflows as a proportion of total FUM. We have combined institutional and retail sales as funds under management includes both institutional and retail assets.
Pension providers reported receiving just over 57,000 transfers from DB schemes into DC plans in 2018/19 to the FCA. The number of transfers in the second 6 months of 2019 (24,800 received by 76 firms) was down 24% on those in the first 6 months (32,500 received by 83 firms). This was also noticeably lower than seen in the first 6 months that firms reported data to the FCA: from October 2017 to March 2018 (34,750), when the FCA states that there was a smaller population of reporting firms. The FCA attributes the decline to a range of factors, including a greater awareness of the risks of transfers as a result of increased media attention and FCA supervisory activity.

However, a rebound in retail sales over 2021 similar to that seen in 2017 and 2009 may be optimistic:

- One very significant driver of the increase in average inflows post-2008 was the sharp reduction in interest rates. In 2007, the Bank of England base rate stood at 5.5%. It was lowered to 0.5% in 2008, where it remained for over seven years before being dropped to 0.25% in 2016. This made bank and building society deposits a relatively unattractive means of saving in the UK and investment funds benefited from this.

- Despite the record-breaking inflow in 2017, we see a sharp reversal in 2018 and then a decline in the moving five-year sales average into 2020. This draws attention to a number of factors pre-dating the pandemic that have weighed on sales. A more negative outlook for global trade has affected markets since the ratcheting up of trade tensions between the US and China. Investors are also now used to a persistently low interest environment and there is therefore no clear new impetus for savers to transfer cash savings to funds. The assets flowing into funds from DB transfers through 2016 and 2017 have also slowed substantially through 2018/2019 according to FCA data.25

UK EQUITIES – THE EROSION OF HOME BIAS

UK equities have declined substantially as a proportion of total UK investor FUM in the last 15 years. In 2005, UK equities represented 39% of FUM but this had fallen to 14% by June 2020 (See Chart 39). Since 2016’s Brexit referendum, UK equity funds have also seen sustained outflows. In this section, we explore three factors behind the erosion of UK investors’ home bias:

- A more uncertain economic outlook for the UK as a result of the Brexit referendum.
- Weaker total returns from the FTSE compared with other global capital markets and a dependence on dividends to boost total returns.
- Flat capital growth over a sustained period and a low weighting of the FTSE All-Share to higher growth industry sectors.

IMPACT OF THE BREXIT REFERENDUM ON NET RETAIL SALES

Chart 52 shows net retail sales over the last five years to the IA’s three UK equity sectors:

- UK All Companies, the largest sector by FUM at £150 billion in June 2020
- UK Equity Income (£41.8 billion as at June 2020)
- UK Smaller Companies (£13.7 billion as at June 2020).

In the years preceding the Brexit referendum, sales to UK equities had been volatile but between January 2016 when the referendum was announced, until June 2020 UK equities have seen heavy outflows of £12.7 billion. The last quarter of 2019 saw a shift in this pattern in the run up to the UK general election as the prospect of a sizeable Conservative majority became a reality. Boris Johnson’s government set out a clear and

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25 Pension providers reported receiving just over 57,000 transfers from DB schemes into DC plans in 2018/19 to the FCA. The number of transfers in the second 6 months of 2019 (24,800 received by 76 firms) was down 24% on those in the first 6 months (32,500 received by 83 firms). This was also noticeably lower than seen in the first 6 months that firms reported data to the FCA: from October 2017 to March 2018 (34,750), when the FCA states that there was a smaller population of reporting firms. The FCA attributes the decline to a range of factors, including a greater awareness of the risks of transfers as a result of increased media attention and FCA supervisory activity.
stricter timetable for Brexit transition. Greater certainty around Brexit looks to have been a factor in attracting investors back to UK equities.

CHART 52: NET RETAIL SALES, UK EQUITY SECTORS (2015 - JUNE 2020)

COMPARATIVELY WEAK FTSE ALL-SHARE TOTAL RETURNS

The uncertainty surrounding the outlook for the UK economy as a result of the Brexit transition has been a factor in driving retail sales but the FTSE attracts companies from around the world to list on it and UK companies trade globally too, so the fortunes of the UK economy are not the only influence on investor sentiment.

The rise and fall in UK equity funds under management is principally governed by market movements rather than sales, and as Chart 53 illustrates, the total return delivered to investors by the FTSE All-Share has been the lowest of the major global markets in the last five years.

CHART 53: MAJOR GLOBAL EQUITY MARKETS TOTAL RETURN (2015 - JUNE 2020)

The FTSE is very reliant on dividend payments from the companies that list on it to boost total returns. Chart 54 shows the total return and capital return performance of the FTSE since 1985, illustrating the significant contribution that dividends have long made to total return. Capital returns over the same period have been flat.

CHART 54: FTSE ALL-SHARE TOTAL RETURN AND CAPITAL RETURN (1985 - JUNE 2020)

Source: Morningstar

Source: Refinitiv
If we strip out capital returns and look at how the FTSE All-Share compares with its global peers on the basis of dividend distributions then, the FTSE All-Share has offered the highest distributions since 2015. Higher dividend distributions do not make up for the lag on capital returns, however. The outlook for dividend distributions has weakened significantly in 2020: UK company dividend payments fell by 57% in Q2 2020 compared with Q2 2019.

**THE PROFILE OF COMPANIES LISTED ON THE FTSE**

Chart 56 shows the significant differences in the profile of company listed on the FTSE All-Share, with those of its US counterpart, the Russell 3000. Technology, communication services and healthcare are industry sectors that have remained resilient through 2020 and these are grouped on the left-hand side of the chart. These industries account for 49% of the Russell 3000 but just 22% of the FTSE All-Share.

Technology companies have delivered strong growth in capital returns in recent years. The FAANG stocks: Facebook, Apple, Amazon, Netflix and Google (Alphabet) are all listed on the Nasdaq. These technology giants make up a substantial proportion of the market capitalisation of the S&P 500 and the Russell 3000. Technology companies overall make up 24% of the Russell 3000 but only 2% of the FTSE All-Share.
Just over a third of the FTSE All-Share, according to Morningstar’s categorisation of the underlying stocks, is comprised of financials (17%), energy (9%) and basic materials (10%). These companies account for 18% of the Russell 3000.

Energy and financial companies have historically been consistent and generous dividend payers. However, on the 31st of March 2020, the Bank of England asked deposit takers, which include the major banks listed on the FTSE, to suspend dividend payments and share buybacks until at least January 2021 (at the current time of writing). The BoE made this request in order to provide ‘extra headroom’ on capital reserves in an uncertain economic outlook where rising loan defaults are in prospect.

In the energy sector, Royal Dutch Shell, the third largest company on the FTSE 100 by market capitalisation, announced a reduction in its dividend payment in Q1 2020 to 0.16 per share shrinking the dividend payment by 66%. This comes on the back of a steep fall in oil prices.

The low weighting to industry sectors that have the highest capital growth potential and the reduction in dividend payments from core industry sectors means that investors in this broad spectrum of UK listed equities face stronger headwinds than those investing in the FTSE’s US and global peers.

**INCREASING INTEREST IN INDEXING FUNDS**

The growth of assets in indexing funds as a proportion of FUM mirrors the pattern that we see in AUM. Growth has been gradual but the pace is accelerating post 2012 when indexing funds accounted for 8% of FUM to 18% in June 2020.

Any increase in FUM is always supported by strong asset appreciation, and as markets rose, particularly in Q4 2019, this contributed to indexing funds under management reaching £230 billion at the end of the year, up 26% year on year from 2018. This compares with a 1% increase between 2017 and 2018 as challenging markets in the last quarter of 2018 eroded gains in FUM.


FUM IN INDEXING FUNDS IS UP 26% BETWEEN YEAR-END 2018 AND 2019
Chart 58 shows that net sales have also made a significant contribution to the growth of FUM. In addition, it shows the relative resilience of net sales when assets depreciated sharply in March 2020.

CHART 58: DRIVERS OF INDEX FUND GROWTH (2013 - JUNE 2020)

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The pattern of net retail sales to indexing funds in 2019 and 2020

Net retail sales to indexing funds have been persistent over the last ten years, with no quarterly net outflows. Sales to active funds have shown much greater volatility. From 2018, a step change in the level of sales flowing to indexing funds occurs. Net retail sales to indexing funds in 2018 are up at £9.0 billion, whereas active fund sales ended the year on an outflow of £1.3 billion. Whilst this is slightly lower than the £10.8 billion in sales to index trackers in 2017, 2017 was a record year for sales and index trackers accounted for 22% of total inflows. In 2018, this balance shifted significantly.

This pattern is repeated in 2019, cumulative net retail sales to indexing funds stood at £18.1 billion, whereas outflows from active funds reached £8.3 billion.

CHART 59: NET RETAIL SALES BY INDEX FUNDS AND ACTIVE FUNDS PRE- AND POST-2014

Since 2014, nearly half of total net retail sales are to index trackers.
Sales to indexing funds are resilient when markets fall

When capital market returns have fallen sharply, as in the last quarter of 2018 and again in March 2020 in one of the steepest declines ever seen over a month, sales to indexing funds have remained resilient. In Q4 2018, £6.1 billion in inflows to index funds compared with outflows of £7.7 billion from active funds.

In March 2020, the month of the highest ever outflow from retail funds, index funds still managed to generate positive sales of £467 million against an outflow of £10.1 billion from active funds. Despite the fact that indexing funds by their nature follow the markets down, the data show that market shocks have not deterred investors from using index trackers.

Sales to indexing funds by asset class

Traditionally, indexing funds are seen as dominated by funds tracking developed market equity indices such as the S&P 500 or the MSCI World, the argument for using lower cost indexing funds being that in these markets it is harder for more expensive actively managed funds to beat the index benchmark because of the wide availability of research. Sales to equity index trackers accounted for 50% of net retail sales to indexing funds in 2019 but as Chart 61 shows, net sales to fixed income and multi-asset indexing funds have been rising as a proportion of sales since 2016.
RESPONSIBLE AND SUSTAINABLE INVESTMENT

2019 and the first half of 2020 have seen a rise in the prominence of sustainability issues, both in the investment management industry and in wider society. In 2019, the particular focus was on climate change and the need to decarbonise the global economy while in 2020, the Covid-19 pandemic has focused attention on the social impacts of business activity.

The FUM in responsible investment funds grew by 89% between January 2019 and June 2020. This increase meant that the RI share of industry FUM rose by over 70% over the 18 months leading to June 2020 (see Chart 62), illustrating the impact of the growing prominence of sustainability and social responsibility on the funds market. While absolute values for RI FUM suffered in line with market movements in March 2020, funds investing responsibly have continued to grow as a proportion of FUM month on month, with FUM reaching a high of £33 billion in June 2020 as asset prices recovered and inflows continued.

Net retail sales to RI funds have proved remarkably consistent across the past 18 months, with net inflows for every month. Net retail sales between January 2019 and June 2020 were £7.0 billion. In the first six months of 2020, net retail sales to RI funds were four times higher than the same period in 2019. Sales to RI funds are not confined to equities: sales to fixed income funds (19%) and mixed asset funds (34%) accounted for over half of total sales between January 2019 and June 2020.

Even as the wider industry saw record outflows of £9.7 billion in March 2020, the net retail flows to RI funds remained positive, if somewhat reduced, at £124 million.

Total sales from January 2019 to June 2020 were £7.2 billion, a significant driver of the £15.5 billion increase in the FUM shown in Chart 63. Alongside institutional inflows of £1.8 billion, and asset appreciation, the addition of new funds has also been a driver, with a 30% increase in the number of RI funds as managers have created new products to meet investor demand.
Responsible Investment can be considered an area where active management offers particular value to investors. These funds have the potential to increase returns through identifying opportunities and risks brought about by societal change, whilst also allowing investors to align their investments with non-financial objectives.

Investing in companies that promote societal good, or at the very least avoiding companies that are deemed unethical, do not necessitate that investors sacrifice returns: and active investment managers are seeking to correct this legacy perception.

Chart 64 compares net retail sales to actively managed funds with those to actively managed RI funds, which so far represent the overwhelming majority of RI funds. Active funds as a whole show considerable volatility in sales patterns and have seen outflows of £8.6 billion through 2019/20. Active RI funds have attracted consistent inflows, taking in £7 billion in investor money. This suggests that RI funds are less affected by short term market events and sentiment, attracting investors with a different set of priorities.

**CHART 64: RESPONSIBLE INVESTMENT ACTIVE SALES AND INDUSTRY ACTIVE SALES (2019 - JUNE 2020)**

<table>
<thead>
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<th>£bn</th>
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<th>1,000</th>
<th>800</th>
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<tr>
<td>Q4 19</td>
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</tr>
<tr>
<td>Q1 20</td>
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<td>Q2 20</td>
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</table>

**UK INVESTORS AND OVERSEAS DOMICILLED FUNDS**

While many thousands of overseas funds are recognised for UK distribution, UK retail investors in particular have had a historic preference for UK-domiciled funds. Nevertheless, as Chart 65 shows, overseas domiciled funds are now 16% as a proportion of UK investor FUM, an increase of 5% from Q1 2017.

**CHART 65: UK INVESTOR FUM IN OVERSEAS DOMICILED FUNDS (2017- Q2 2020)**
Chart 66 shows the breakdown of total UK investor FUM by fund structure, both UK and overseas. There are three overseas fund structures principally invested in by UK investors:

- Société d’investissement à Capital Variable (SICAV), mainly domiciled in Luxembourg.
- Irish Collective Asset-management Vehicle (ICAV).
- Overseas Open-Ended Investment Company (OEIC) / Investment Company with Variable Capital (ICVC), the majority of these funds in IA data are domiciled in Ireland.

The growth in FUM in overseas domiciled funds has chiefly been in overseas OEICs/ICVCs, whilst FUM in SICAVs has remained flat since 2012. ICAVs represent a tiny proportion of total FUM.

Net retail sales can be used as a barometer of investor sentiment towards overseas domiciled funds. Chart 67 does not suggest that investors and their investment advisers have been unduly influenced by the domicile of the fund when making investment decisions in the context of the UK leaving the European Union. Sales in 2019 to overseas domiciled funds were £4.2 billion, an increase on 2018’s £1.3 billion in inflows.

In March 2020, we did see substantial outflows from overseas OEICs/ICVCs and SICAVs accounting for nearly half of total outflows that month. Rather than this being a sign that investors were turned off funds domiciled overseas, it is due to the scale of outflows from the fixed income asset class: 57% of funds investing in fixed income are domiciled overseas.
OVERSEAS INVESTORS IN UK DOMICILED FUNDS

As at June 2020, FUM in UK domiciled funds including funds managed on behalf of overseas investors is £1.32 trillion – the overseas investor portion of this total is £40.7 billion.

As Chart 68 shows, UK domiciled funds under management held by overseas investors has remained at 4% of FUM since Q4 2018. The decline from 7% in Q1 2018 to 4% in Q4 2018 was driven by operational decisions at a number of firms to move overseas investors out of non-sterling denominated share classes in UK domiciled funds, it is not a reaction by overseas investors to the impending Brexit.

SALES BY DISTRIBUTION CHANNEL

UK fund platforms remain the dominant retail distribution channel in 2019 with a 49% share of total gross sales. Sales through platforms rose by 17% year on year to reach £127 billion, while gross sales as a whole rose by 6% to reach a total of £257 billion, reversing the slight decline seen from 2017 to 2018 and taking gross sales to a new high.

Other UK Intermediaries including IFAs and Non-UK Intermediaries both saw gross sales increase year on year, by 14% and 9% respectively. All other channels saw gross sales decline, most notably the Discretionary Manager channel with an 18% decline from £28 billion in 2018 to £23 billion in 2019. The rise of discretionary model portfolios run by discretionary managers on platform is likely to mean that some of the gross sales recorded as discretionary are now showing up in gross sales through platforms.

The growth of the UK fund platform channel represents the increasing use of fund platforms by both direct and advised investors, and additionally reflects the recategorization of a number of businesses as fund platforms as business models have shifted over time.
Platforms were also the largest channel for net sales in 2019, however net retail sales for 2019 decreased by £2 billion to £10.9 billion. The ‘Other UK Intermediaries including IFAs’ channel appears to have staged something of a comeback with net sales of £3 billion, up from £0.2 billion in 2018. This is still a long way short of the sales seen in 2017.

Discretionary Managers show a rise in outflows to £1.1 billion, though this is at least in part driven by managers moving portfolios from funds to segregated mandates rather than a genuine outflow from the industry. The Direct channel continues to see outflows as the industry moves away from the traditional model of investors buying directly from asset managers.

The first half of 2020 has seen a shift in the patterns in distribution. Flows through the Other UK Intermediaries including IFAs channel have been strong and just under half are in the first quarter, a period when other channels saw flat sales or outflows.

Sales through UK Fund Platforms remain healthy but have not been as dominant in 2020 as in previous years being only slightly higher than Other UK Intermediaries including IFAs. Sales through UK Fund Platforms have been concentrated in Q2 after being flat in Q1. The Discretionary Managers channel saw heavy outflows in Q1. This has reversed somewhat in Q2, with money returning particularly to fixed income funds. However, sales through Discretionary Managers remain in a deficit for the year so far.

SALES TO TAX WRAPPERS

Net sales to pension wrappers of £4.6 billion in 2019 remain the highest of any wrapper on platforms reporting data to the IA. This is a reduction of 32% from the levels seen in 2018 and of nearly 50% from 2017 at the height of the influx of DB pension transfers into pension wrappers on platform. The rise in net sales to pension wrappers follows the introduction of the pension freedoms in 2015. Whilst sales to pensions remain the highest as a proportion of total sales to wrappers, they have declined year on year following 2017’s high. At the half way point in 2020 sales were a promising £2.0 billion but it is too early to say if they will top 2019.

2019 saw high outflows of £4.2 billion from unwrapped general investment accounts, the most significant over the last ten years. Outflows continued into the first half of 2020 at £903 million but were concentrated in the first quarter.

Unwrapped assets are the least sticky. Without the commitment of a tax wrapper, investors appear to have chosen to withdraw unwrapped assets first in 2020 rather than sacrifice the tax incentives provided by ISAs (ISA sales are £1.1 billion for H1 2020). The significant penalties for early withdrawal from pensions probably precluded many investors from calling on cash from them during the Covid–19 crisis.
Sales to ISAs fall in 2019

In 2019, assets in stocks and shares ISAs were £314 billion according to data from HMRC, a decrease of 11% from 2018. Assets in funds stood at £227 million or 71% of total assets, a decline of 4% from 2018.

In 2019, sales of stocks and shares ISAs were just £14 million, a decrease of 99% year on year. IA data covers five of the largest platforms by assets under administration but HMRC data for the 2018/19 tax year, which is more comprehensive, also show a decline in subscriptions to stocks and shares ISAs.

In 2018/19 there was a 19% decrease in the amount subscribed to stocks and shares ISAs to £26 billion. Average subscription amounts only fell slightly by 4% to £9,331 and remain higher than the average cash ISA subscription of £5,187 in 2018/19. There was a sharper decrease in the number of people using stocks and shares ISAs in 2018/19 compared with cash ISAs however. A 16% fall in the numbers of people subscribing to stocks and share ISAs in 2018/2019 corresponds to a 20% increase in the number of subscriptions to cash ISAs. This is the first year since 2013/14 that we have seen an increase year on year in the number of cash ISA subscriptions.

IA data show that in 2019 there was a huge fall in sales to ISA wrappers on platform (see Chart 71): sales of just £14 million are a decrease of 99% year on year. IA data covers five of the largest platforms by assets under administration but HMRC data for the 2018/19 tax year, which is more comprehensive, also show a decline in subscriptions to stocks and shares ISAs.

2018/19 may be a blip or it may be the beginning of a sustained trend. IA sales data to ISAs for H1 2020 is more promising, with sales of £1.6 billion in Q2 more than recovering the first quarter outflow of £522 million. Very low interest rates of 0.25% make cash ISAs unattractive but if volatility in investment returns increases through H2 2020 into 2021, nervy investors could be drawn to the perceived safety of cash.
INVESTOR AVERAGE HOLDING PERIODS

A reduction in investor holding periods has been observed since the widespread adoption of investment platforms in the UK, making it substantially easier to switch assets between funds on platform. The rise of the centralised investment proposition, now used by 82% of advisers and often taking the form of a model portfolio of funds, means that fund allocations are now rebalanced on a quarterly basis. This also helps to explain the reduction in average holding periods.

Average investor holding periods stood at around 3.4 years in 2019 following a low of 3.2 in 2018. For investment managers seeking to encourage longer-term investment horizons, it is encouraging to see holding periods stabilise rather than fall further. It is likely that three years is a floor for investor holding periods; it is typically the minimum track record that advisers want to see before investing in a fund.

EUROPEAN DOMICILED FUNDS

The pattern of sales to European domiciled funds shows that after the outflows experienced in Q4 2018, sales rebounded on the back of rising capital market returns through 2019. The pace of the recovery was slow in the first half of the year: 77% of inflows came in the second half of 2019. Total sales to UCITS funds for 2019 were €395.9 billion, compared with net sales of €118.4 billion in 2018.

Outflows across Europe in the first quarter of 2020 were €176 billion in a similar pattern to UK retail fund outflows. March’s sharp downturn in capital market returns coincided with a challenging environment in the bond markets. There were short-term bond and multi-asset fund suspensions in Finland, Norway and Sweden and in Denmark some equity funds, alongside bond and multi-asset funds, were temporarily suspended from taking subscriptions and redemptions. These suspensions were brief as a result of the swift intervention of Central Banks in the bond markets through quantitative easing.


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29 We calculate the average holding period as the average FUM in retail funds over two years (less net sales in the second year), divided by the repurchases from these funds.

30 According to EFAMA data, in Denmark there were 406 fund suspensions (213 equity, 122 bond, 73 multi-asset); in Finland 20 bond fund suspensions; in Sweden 24 bond and 8 multi-asset fund suspensions and in Norway one High Yield bond fund suspension in March.
Total sales to UCITS ETFs increased dramatically in 2019 to €104.4 billion, an increase of 477% on 2018 where total sales to UCITS ETFs were €18.1 billion, indicating that 2019 marked a step change in the uptake of ETFs by European investors. ETFs were also affected by challenging market conditions in March and saw outflows in Q1 2020 of €10.6 billion. Fears that ETF structures might pose risks in challenging market conditions were quelled, however and fixed income ETFs emerged as efficient price discovery tools in the bond markets at the height of the crisis.

**FUM by domicile**

Funds under management in UCITS and AIFs domiciled in Luxembourg, Ireland and the UK all rose year on year from 2018 but the rise in FUM is more substantial in Ireland than in the UK and Luxembourg.

- FUM in funds domiciled in Luxembourg rose to €4.7 trillion, an increase of 16% from 2018.
- Ireland’s FUM total reached €3.0 trillion up from €2.4 trillion in 2018, a rise of 26%.
- In the UK, FUM in 2019 was €1.7 trillion increasing by 17%, a similar proportion year on year to Luxembourg.

**CHART 76: ASSETS IN UCITS AND AIFS BY DOMICILE**

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</tr>
<tr>
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<td>1,500</td>
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**SALES OF UCITS ETFS WERE €104.4 BN IN 2019**