5 RETAIL FUND MARKET

KEY FINDINGS

2020 FUND SALES REBOUNDED FOLLOWING A RECORD MARCH OUTFLOW

- Q1 2020 was a tumultuous start to the year for the retail funds market as Covid-19 took hold. Capital markets suffered a significant correction in March, leading to a record monthly outflow of £9.7 billion from retail funds, equalling 0.76% of FUM.
- However, fund sales rebounded strongly. The year ended with annual inflows of £30.8 billion, making 2020 the second highest year on record for net retail sales after 2017. High savings rates over lockdown and record low interest rates supported a sustained sales recovery. The rally included a record monthly inflow in November (£8.3 billion) as markets rose on the news of successful vaccine trials.
- Quick and decisive Bank of England intervention in March proved critical to a swift market recovery. Comparing the Global Financial Crisis and Covid-19 shows that Central Bank intervention in 08/09 had an even greater effect on stimulating fund sales. Annual net retail sales of £29.8 billion in 2009 were 8% of FUM, compared with sales in 2020 of £30.8 billion - equivalent to 3% of FUM.
- Despite the steep falls in capital markets in March, which led to an 11% drop in FUM, UK investor funds under management recovered as markets rebounded, reaching a record £1.44 trillion by the end of the year, up by 9% from £1.32 trillion in 2019.

RESPONSIBLE INVESTMENT FUND SALES ACCELERATED THROUGH THE PANDEMIC

- The growth in FUM and net retail sales to responsible investment (RI) funds is one of the standout developments of 2020 as the pandemic brought social concerns to the fore and strong fund performance attracted investors.
  - Net retail sales to RI funds reached £11.7 billion in 2020, making up 38% of total net retail sales.
  - FUM increased by £20 billion over the year, reaching £55 billion by the end of December 2020. This represents a 60% increase in FUM to RI funds, compared to a rise of 9% for industry FUM overall.
- The percentage of UK investor FUM in RI funds remains small at 3.9%, but this is up from 2.6% at the beginning of the year.
- RI has also been an active area for new fund launches, swelling the number of funds in IA data through 2020 by 17%, from 193 to 226.

SALES TO ACTIVE FUNDS RECOVERED IN 2020

- The inflow to active funds in 2020 marks a shift in the near-term pattern of sales. In 2019, outflows from active funds reached £8.1 billion as sales to index tracking funds dominated with inflows of £18.1 billion. However, in a strong year for net retail sales overall, sales to active funds recovered in 2020 to £12.4 billion.
- Investor appetite for low cost index tracking funds has not been dented through the pandemic, in spite of the rise in active fund sales, and both sales and FUM have grown steadily since 2012.
- Inflows to index trackers in 2020 remained consistent with the previous year at £18.4 billion, and in March index funds recorded an inflow of £469 million in an exceptionally challenging month for fund flows.

5

UK INVESTORS MAINTAIN A PREFERENCE FOR GLOBAL DIVERSIFICATION

- Investor preferences over the last 15 years have shifted in favour of an allocation or outcome investment objective, where investors opt for an investment solution. This pattern held fast in 2020 - 42% of net retail sales were to outcome and allocation funds. The return to active inflows also boosted sales to equity growth funds, which were the highest selling category by investor objective (£9.9 billion).
- At the asset class level, investors continue to show a preference for globally diversified funds. Net retail sales to Global equity funds of £37.3 billion are the highest of any equity sector over the last ten years.
- In 2020, globally diversified funds recorded inflows of £6.1 billion through the sales rebound over the last three quarters. This is nearly three times higher than North America, the next highest selling equity region.
- Strong sales to Global Bond funds suggest a similar preference for global diversification in fixed income. Since 2010, inflows to the Global Bonds sector account for nearly a third (31%) of total fixed income sales and were the highest of any fixed income sector in 2020 at £4.5 billion.
- The erosion of the UK equity home bias continues. The proportion of total FUM in UK equities has dropped from 39% in 2005 to 14% in 2020. UK equities have seen £16.5 billion in outflows since the Brexit referendum in 2016 and sustained £2.8 billion in outflows in 2020 as the FTSE continued to underperform its global peers.

PLATFORMS REMAIN THE DOMINANT DISTRIBUTION CHANNEL

- UK Platforms have been the lead distribution channel every year for the past decade and remain the dominant channel for UK investors in 2020 with a net £16.3 billion inflow.
- The Direct channel is in outflow in 2020 for the seventh consecutive year, showing the long-term shift away from direct investor distribution by fund managers. Discretionary Managers also show a third year of net outflows, suggesting that more money is being managed by discretionary managers on platforms.
- Net retail sales to the 'Other UK Intermediaries including IFAs' channel jumped in 2020, reaching £15.2 billion, up from £3.0 billion in 2019. Half the yearly inflow came in the last quarter as capital markets surged. Annual inflows from the off-platform IFA channel are typically modest compared with platforms but spike in exceptionally strong years for net retail sales, including 2017 and 2009.

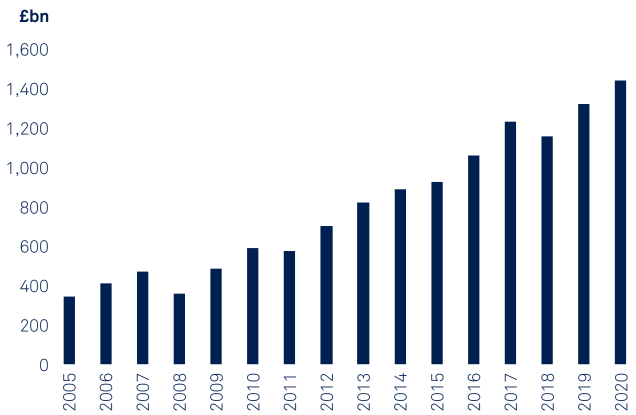
This chapter focuses on UK retail investor behaviour looking at flow data for both UK and overseas-domiciled funds that are sold in the UK. It also examines the evolution of the UK fund market, based on total funds under management (FUM) for UK-domiciled funds, which constitute the large majority of UK retail investors' holdings.

We continue to look closely at the impact of the pandemic on the retail fund market as well as a range of long-term trends, including the growth of responsible and sustainable investment funds. We also set some of our analysis in the context of patterns since the Global Financial Crisis, when monetary policy intervention was also decisive in shaping the recovery.

UK INVESTOR FUNDS UNDER MANAGEMENT

At the end of 2020, UK investor funds under management reached a record £1.44 trillion, growing by 9% from £1.32 trillion in 2019 (see Chart 37).

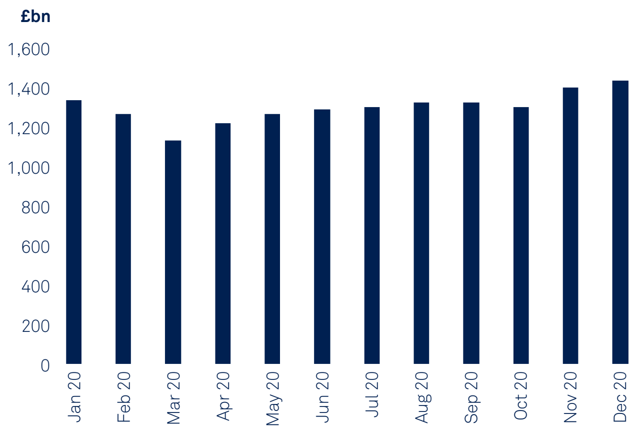
CHART 37: TOTAL INDUSTRY FUNDS UNDER MANAGEMENT (2005-2020)



Although UK investor FUM ended 2020 at a record level, FUM fluctuated throughout the year. The steepest decline was seen in March 2020 as FUM dropped by 11% over the month to £1.14 trillion, as Chart 38 shows. Although FUM started to fall at the beginning of 2020, declining by 5% between January and February, the impact on markets of the effective economic shutdown imposed by lockdown was severe. Between the 4th and the 23rd of March 2020, the FTSE All-Share reached its lowest valuation,[25] losing 28% of its value (Chart 39).

As markets recovered in 2020, FUM rose to exceed pre-Covid levels, increasing by 8% between October and November 2020. FUM growth at the end of 2020 was boosted by strong equity market performance following the announcement of a successful vaccine trial by Pfizer BioNtech. The FTSE All-Share returned 12.4% on a capital return basis over November as the major global equity markets rose sharply in value over the month.

CHART 38: UK INVESTOR FUM THROUGH 2020

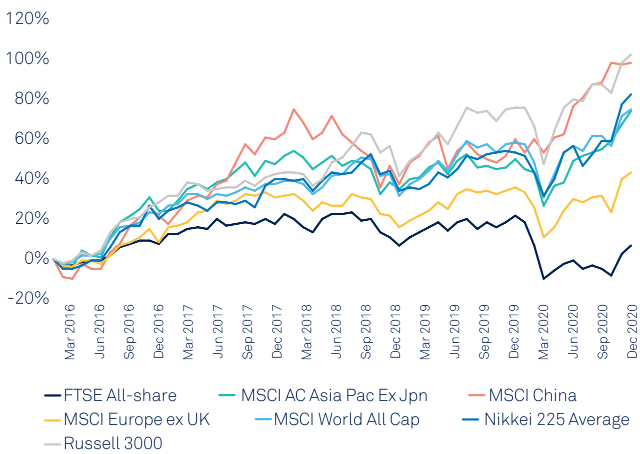


[25] London Stock Exchange data records that the FTSE All-Share valuation on the 23rd of March 2020 was 2727.86, down from 3795.38 at the beginning of March 2020.

5

The swift and decisive action of Central Banks in implementing large-scale quantitative easing programmes was critical in supporting the recovery of markets. The global stock market rally extended from the March floor through 2020 as sectors such as technology and healthcare benefited from the conditions created by the pandemic.

CHART 39: PERFORMANCE OF THE MAJOR EQUITY INDICES ON A CAPITAL RETURN BASIS (2016-2020)



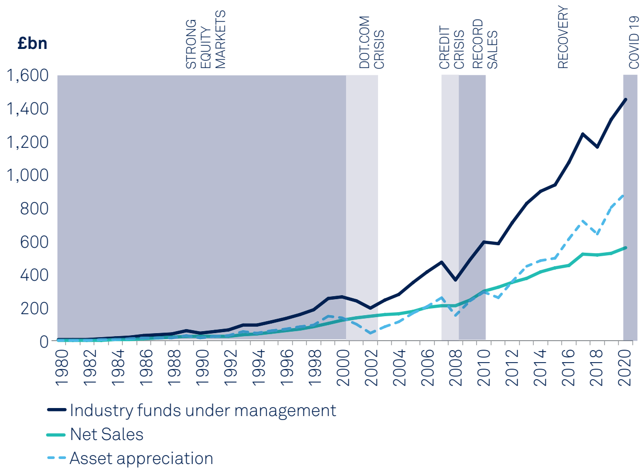
Source: Morningstar

THE IMPACT OF ASSET APPRECIATION AND DEPRECIATION ON UK INVESTOR FUM

A capital market correction of the magnitude of March 2020 was last seen during the Global Financial Crisis. The FTSE All-Share lost 29% of its value between the 6th of September and the 18th of October 2008, when the All-Share reached a credit crisis low. This led to a fall in FUM of 11% over two consecutive months in September and October 2008, a similar level to March 2020.

Indeed, asset appreciation and depreciation have been a more significant factor than net sales in the level of total funds under management over the last 15 years (see Chart 40). In the last quarter of 2018, the most recent significant market correction pre-Covid, FUM declined by 8% over the quarter as a result of asset depreciation. The net outflow from funds[26] over the quarter were equivalent to 0.7% of total FUM. In 2020, net outflows from funds accounted for just 1% of the 14% decrease in FUM between the last quarter of 2019 and the first quarter of 2020.

CHART 40: DRIVERS OF INDUSTRY GROWTH (1980-2020)



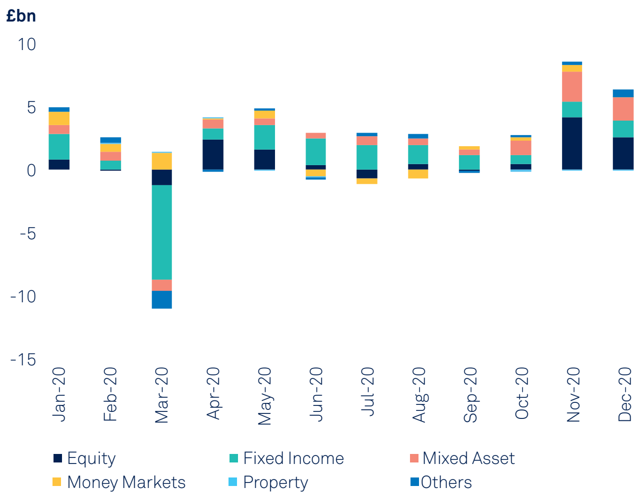
[26] Chart 40 shows combined net sales to retail and institutional funds. In all other charts in Chapter 5, sales data denotes net retail sales.

THE PATTERN OF NET RETAIL SALES THROUGH THE PANDEMIC

In March 2020, as capital markets plummeted, the record outflow from retail funds reached £9.7 billion, just £200 million less than total net retail sales in 2019 (Chart 41). By November 2020 net retail sales had shifted to a record monthly inflow of £8.3 billion, as markets responded to the announcement of successful vaccine trials.

Following March, the return to inflows from April through to December has been significant and sustained: total net retail sales over this period were £33.1 billion. Annual inflows of £30.8 billion for the year make 2020 the second highest year for net retail sales recorded. Here we explore the drivers behind the trends in net retail sales in 2020.

CHART 41: MONTHLY NET RETAIL SALES BY ASSET CLASS IN 2020



March's record outflow

March's net retail outflow of £9.7 billion is the highest ever seen in a month, the next highest being £2.5 billion in June 2016 following the Brexit referendum.

- Outflows of £7.4 billion from fixed income funds accounted for 76% of the total outflow and every IA fixed income sector recorded the highest monthly outflow as a percentage of FUM.[27]
- Despite net retail sales of -£1.1 billion in equities, investors showed a contrarian impulse towards UK equities and UK All Companies saw inflows of £965 million.
- Outflows of £1 billion from mixed asset funds ran counter to the long-term trend to consistent inflows.
- In contrast, responsible investment funds (£85 million) and index trackers (£468 million) maintained inflows despite challenging market conditions.
- Widespread property fund suspensions prevented outflows in March (£3 million) and money market fund inflows were £1.3 billion, a sign that investors were managing their risk through cash-like investments.

November's record inflow

In November 2020, net retail sales to funds reached £8.3 billion. The equity markets climbed as successful vaccine trials were announced. A Biden victory in the US, that would bring a $1.9 trillion fiscal stimulus package, also looked increasingly certain. Markets anticipated that these developments would support a faster economic recovery from Covid-19.

- Inflows to actively managed funds of £5.4 billion are the highest ever recorded. Net retail sales to tracker funds were £3 billion, which is also a record.
- £4.1 billion in net retail sales to equity funds is another record monthly inflow.
- Mixed asset fund sales were £2.5 billion, the highest inflow ever and unmatched through the record sales year of 2017.
- Net retail sales to fixed income funds were £1.2 billion, lower than the peak of the bond bounce back in June 2020 of £2.1 billion.

[27] The Global Emerging Market Bonds – Local Currency sector has since seen a higher outflow in June 2020.

COMPARING THE GFC AND COVID CRISES: THE IMPACT ON THE RETAIL FUNDS MARKET

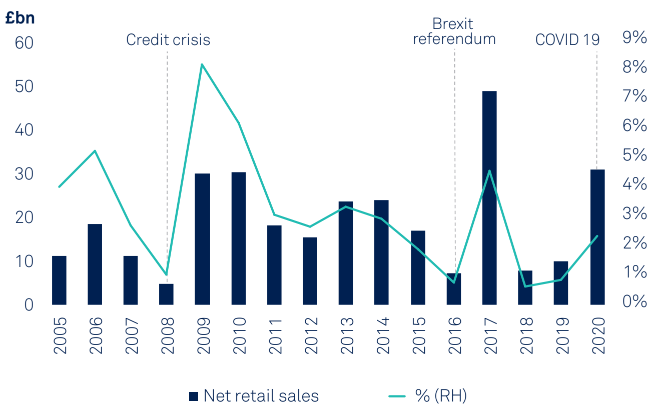
NET RETAIL SALES THROUGH COVID-19 COMPARED WITH THE GLOBAL FINANCIAL CRISIS

Over the past twenty years, the last market correction of the scale seen in March 2020 occurred during the Global Financial Crisis (GFC) in 2008. In both 2020 and 2008, Central Bank intervention through base rate cuts and quantitative easing has proved critical in stimulating the economy and in supporting markets. Since 2008, we are operating in a new era where monetary policy has been one of the defining influences on market performance and asset prices. This in turn has affected the pattern of fund sales and investor sentiment and so we have compared the trends in net retail sales over the two crises.

During the GFC, sharp falls in markets weakened net retail sales to funds and introduced sales volatility through 2008. Chart 42 shows that in 2008, net retail sales fell to £4.8 billion, a decline of 57% on inflows in 2007. The data also show that in 2009, net retail sales rebounded strongly to a then record level of £29.8 billion. The inflow to funds in 2009 was equivalent to 8% of total FUM.

Whilst the new record annual sales of £48.6 billion in 2017 are greater in absolute terms than in 2009, FUM in the UK funds market in 2017 was also three times higher. The 2017 inflow was equivalent to 5% of FUM, as shown in Chart 42, which illustrates the strength of the return to inflows in 2009.

CHART 42: TOTAL NET RETAIL SALES AND NET RETAIL SALES AS A PERCENTAGE OF FUM (2005-2020)

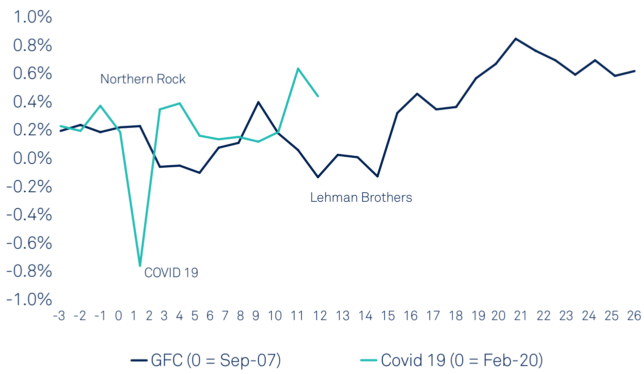


The pattern of net retail sales during the pandemic has some parallels with the trend seen in 2008/2009. A key difference in 2020, however, is the speed of events. The record outflow and the rebound to inflows occur over a much shorter period, as shown in Chart 43.

In Chart 43, to allow a more direct comparison given the difference in the size of the funds market in 2020 and in 2008, monthly net retail sales as a percentage of FUM are compared during the pandemic and the GFC. In 2008/2009, volatile sales are a feature for nearly eighteen months but net retail outflows never exceed 0.13% of FUM. In 2020, at 0.76% of FUM, the March outflow from retail funds is nearly six times higher than the 0.13% outflows seen in 2008 but the shift to inflows from April is immediate and sustained.

However, the net sales recovery from March 2020 never quite matches the highest month of sales in 2009, where sales reached 0.85% of FUM. November 2020's net retail sales of £8.3 billion is a record in absolute terms but is 0.64% of FUM.

CHART 43: NET RETAIL SALES AS A PERCENTAGE OF FUM THROUGH COVID-19 AND THE GFC



5

Monetary policy compared
Although in both crises, Central Banks deployed quantitative easing (QE), in 2020 they benefited from the lessons of the GFC. Decision-making was far quicker in March 2020 and the scale of QE in 2020 was significant – the Bank of England conducted three rounds of bond buying in March, June and November 2020 totalling £895 billion. The speed of the implementation of QE from the major Central Banks supported a swift recovery in the performance of capital markets, which in turn helped the quick and sustained return to net inflows shown in Chart 43. In the Global Financial Crisis, the Bank of England started to deploy QE in November 2009, over a year on from the sharpest falls in capital market valuations through September and October 2008. Levels of QE reached £200 billion.

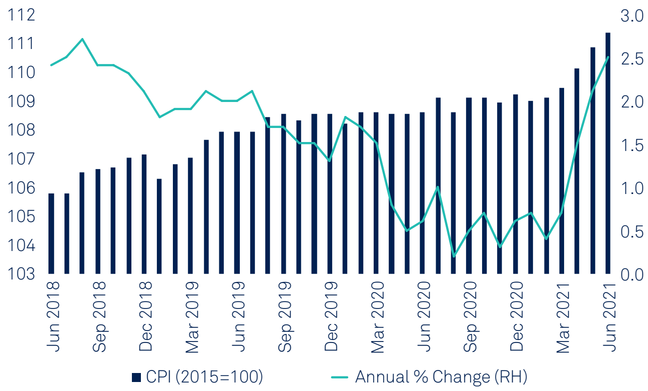
The experience with key policy rates is also different. In 2007, at the beginning of the GFC, the Bank of England base rate stood at 5.5%. It was lowered incrementally on five successive occasions, finally reaching 0.5% in 2008. Cuts to the base rate helped stimulate the economic recovery and to make it relatively inexpensive to repay loans. This had a significant impact on fund flows in 2009 because in a short period of time it severely reduced the return that households could get on cash savings. Confidence in banks to safeguard cash savings was also very low, which benefited retail fund flows.

In 2020, the data suggest that the base rate cut has had less impact on fund flows than in 2008/2009. In March 2020, the Bank of England cut the base rate from 0.75% to 0.25% and then made a further cut to 0.1%. The cuts come after over a decade of low interest rates on cash savings. Net retail sales in 2020 are equivalent to 3% of FUM compared with 8% of FUM in 2009, showing the likely significance of the base rate cut during the GFC.

INFLATION, THE MONETARY POLICY RESPONSE AND THE OUTLOOK FOR ASSET ALLOCATION

Consistent inflows to retail funds through 2020 show the resilience of the fund market through Covid-19, which benefited from decisive Central Bank action. However, rising inflation in 2021 and longer term could pose a challenge for investors and will require the attention of Central Banks. In June 2021, the Consumer Price Index, which is an important measure of price inflation, rose by 2.5% on an annual basis. This is above the 2% target set by the Bank of England (BoE) and is an annualised increase of more than 2% for the second consecutive month.

CHART 44: CONSUMER PRICE INDEX VALUES AND ANNUAL PERCENTAGE GROWTH IN CPI (JUNE 2018 – JUNE 2021)



Source: ONS

If the BoE sees rising inflation as transitory, a symptom of the release of pent-up demand for goods and services as the UK economy opens up, then it may take no action to tighten monetary policy. But if rising inflation is persistent, the monetary policy decisions taken by Central Banks could be decisive in the performance of capital markets. The uncertainty around the outlook for economic growth and inflation over the longer term makes the timing and the degree of the re-calibration of monetary policy a delicate decision.

Rising inflation erodes the value of cash in the near term and this makes cash saving unattractive, which could benefit funds. However, if rising inflation persists, there is a higher probability that the Bank of England will raise the base rate to combat inflation. Although adjustment to the base rate is likely to be incremental, banks and building societies could also raise interest rates on cash savings accounts meaning better returns on cash saving, which could have a negative impact on fund flows.

The Bank of England could also curtail the economic stimulus provided by its £895 billion quantitative easing programme, which would help to stop the economy overheating. The timing of any reduction or curtailment of QE is delicate as markets are sensitive to changes in monetary policy. Sudden announcements have the capacity to move markets. 2013's 'Taper Tantrum' occurred when the US Federal Reserve announced that it was reducing its QE programme, a move that markets were not expecting, causing US Treasury yields to surge. Reducing QE is also likely to affect stock markets as the value of stocks have been supported by QE in the post-March 2020 recovery. This could have an impact on the equity markets.

The implications for asset allocation

Historically, rising inflation has the most negative impact on bond funds but there are wider implications for allocations to equities and alternative asset classes, which can be used as a hedge against inflation:

- If rising inflation is persistent, it could affect investors' allocation to bonds. Bond investors demand a higher yield to offset the negative impact of inflation on future cash flows, and as bond prices move inversely to bond yields, this causes prices to fall. Bonds with longer maturities are most affected as they have a longer period of fixed interest payments before maturing. Investors may seek out inflation-linked bond funds or opt for bonds with shorter duration.

- Investors are also likely to seek out other asset classes that can protect against rising inflation through funds investing in alternative assets such as gold or commodities. Property funds could also benefit because as inflation rises, so do property values and the amount that landlords can charge in rent.

- Certain types of equities should perform better when inflation rises including stocks that have strong current cash flows rather than stocks that are dependent on future earnings growth, which becomes more uncertain. This could benefit UK equities, where industry sectors such as financials and industrials make up a high percentage of the companies listed on the FTSE, compared with higher growth sectors such as technology.

INVESTOR BEHAVIOUR: COVID-19'S IMPACT ON WEALTH, SAVINGS AND INVESTMENTS

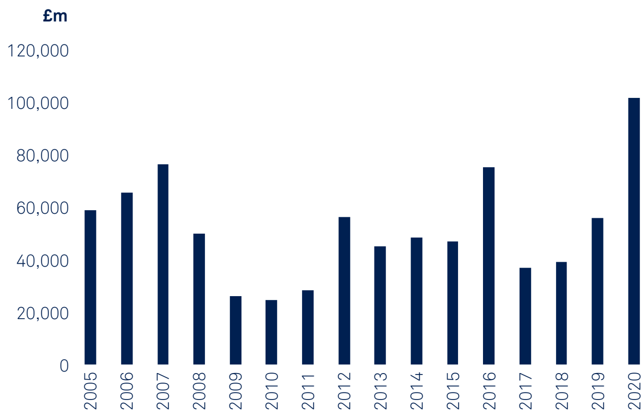
The nation faced a series of lockdowns over 2020 and economic activity was severely restricted. This led to a record decline in UK GDP in the second quarter of 2020, which contracted by 20.4% (in the US, the contraction was even more pronounced at 32.9% at an annualised rate). Sectors less able to move to remote working were hard hit. To combat a severe rise in unemployment, the UK Government introduced the 'Coronavirus Job Retention' scheme in March 2020. By June 2020, 30% of workers in all British industries were on furlough and in the arts, entertainment and recreation industry this figure ran at 71%.[28]

The measures implemented to contain the spread of the virus accelerated the advance of digital commerce and online working – through 2020 some 40% of respondents to the ONS Opinions and Lifestyle Survey consistently worked from home because of Covid-19. Many industries, including the investment management industry, successfully made the transition to operating remotely and weathered the restrictions of lockdown relatively unscathed.

The ONS data illustrates that the impact of the pandemic on the wealth of British working age adults has been uneven. For those able to work remotely, as expenditure on activities such as travel, leisure and retail was constrained by lockdown, there has been a significant uplift in saving. In 2020, Bank of England data show that annual money flows into household deposits in banks and building societies reached £101 billion, an increase of 82% from 2019 (see Chart 45).

"A really big group, which often isn't talked about... is people whose income has stayed high, and their spending dropped dramatically so they have... more disposable income than...in their whole lives."

CHART 45: ANNUAL MONEY FLOWS TO DEPOSITS HELD BY UK BANKS AND BUILDING SOCIETIES (2005-2020)



Source: Bank of England

The money flow from UK households into deposits in 2020 is different from the pattern seen during the Global Financial Crisis, where money flowing into cash deposits dropped by a third between 2007 and 2008 and a further 50% from 2008 to 2009. The cut in the base rate from 5% to 0.5% in 2009 made it far less attractive to save into bank deposits and fund sales benefited as annual net retail sales to UK domiciled funds reached 8% of FUM, as observed earlier in Chart 42. The impact of the base rate cut to 0.1% in 2020 has come as savers are used to over a decade of low interest rates and so have not been deterred from making cash deposits as they were in 2009.

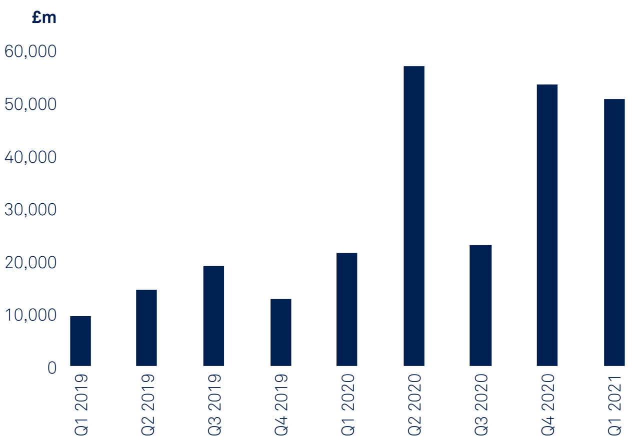
The sharp drop in cash deposits over 2008 and 2009 also reinforces the fact that the credit crunch was seen as a financial crisis by consumers and there were fears for the safety of savings as the government had to bail out some of the largest high street banks: Royal Bank of Scotland and Lloyds/HBOS. The retail funds industry benefited significantly from this distrust in the short-term.

[28] Data taken from the monthly ONS Business Impacts of Covid Survey, June 2020.

Lockdown saving patterns

The impact of lockdowns on driving up the money flow to deposits shown in Chart 46 is striking. The first UK lockdown was imposed from March 26 to June 23 2020. Money flows in 2020 peaked in Q2 during the first lockdown at £57 billion, nearly £40 billion higher than the highest 2019 quarterly inflow. When lockdown restrictions were lifted over the summer of 2020 and the Chancellor introduced the 'Eat Out to Help Out' scheme to stimulate spending, the money flow to deposits drops to £23 billion.

CHART 46: **QUARTERLY MONEY FLOW TO DEPOSITS HELD BY UK BANKS AND BUILDING SOCIETIES (Q1 2019 – Q1 2021)**



Source: Bank of England

A strong rebound in fund inflows during Q2-Q4 2020 suggests that retail funds were also seeing some flow from the increase in savings (we discuss this in detail in a later section).

Looking ahead, some of the £101 billion added to deposits over 2020 will be spent as the economy opens up and some if it will remain in cash deposits. It remains to be seen what further impact there will be on retail investment. Leaving savings in cash already risks a much poorer long-term return compared with investing in funds but rising inflation could compound this if interest rates remain low.[29]

RESPONSIBLE AND SUSTAINABLE INVESTMENT

The growth in FUM and net retail sales to responsible investment (RI) funds is one of the standout developments of 2020. Investor appetite for environmentally conscious funds has been building over recent years but the pandemic brought social concerns to the fore, as net retail sales to RI funds accelerated through 2020 to reach £11.7 billion.

From January 2020, IA data on responsible investment funds is collected and reported according to the IA's Responsible Investment Framework (See page 27 in the Survey for definitions). The data includes funds operating fund specific exclusion policies, funds with a sustainability focus and impact investing funds.

Funds under management climbed from £35 billion in January 2020 to £55 billion in December 2020. The impact of net sales on growth in industry FUM is slight compared with asset appreciation but for responsible investment funds, rising net retail sales through 2020 have made a significant contribution to the increase in RI FUM. Nevertheless, asset appreciation remains an important driver of growth and the performance of many responsible investment funds in 2020 was strong. Weak returns in sectors such as oil and gas, which most RI funds exclude, combined with strong performance in sectors such as technology and healthcare – core sectors for RI funds – benefited returns. Responsible investment has also been an active area for new fund launches, swelling the number of funds in IA data through 2020 by 17% from 193 to 226.

5

[29] EFAMA Market Insights 5, Perspective on the Net Performance of UCITS, July 2021: a ten-year investment of EUR 10,000 in a portfolio composed of equity, bond and mixed funds generated a total net performance in real terms of 61%, whereas the value of EUR 10,000 left in a bank account in 2010-2019 fell by 10% in real terms.

As illustrated by Chart 47, the percentage of UK investor FUM in responsible investment funds remains small at 3.9% in 2020 but this is up from 2.6% at the beginning of the year. Assets in responsible investment funds remain largely actively managed. FUM in responsible index trackers accounts for 7% of total RI FUM.

CHART 47: RESPONSIBLE INVESTMENT FUM (2020)

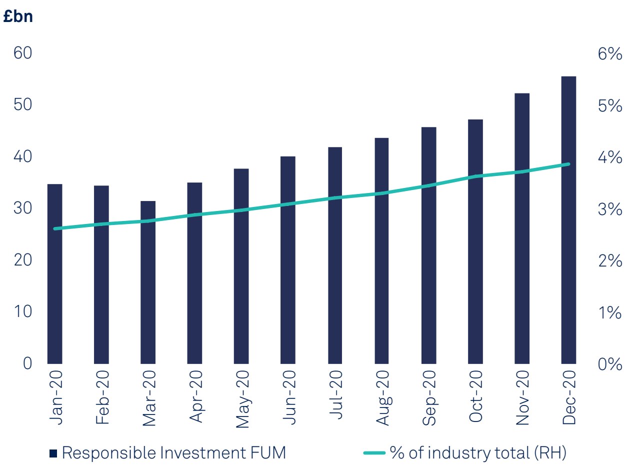


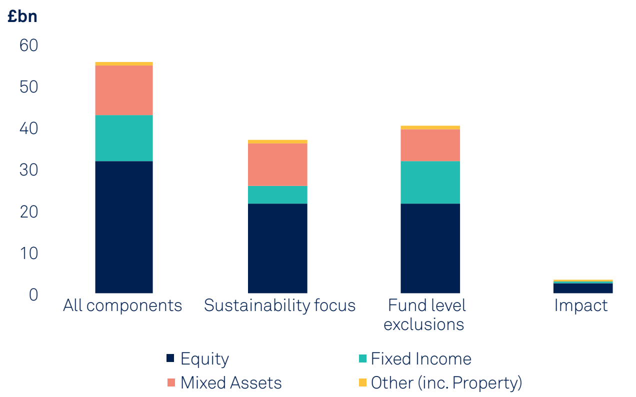
Chart 48 shows FUM in responsible investment funds split by asset class and by IA Framework component. Funds may (and often will) be categorised under more than one component and so the sum of each component's FUM exceeds the overall FUM in responsible investment funds. 2020 is the first year that fund data has been collected according to the IA Framework. It is therefore not possible to show year on year growth.

FUM in responsible investment funds with a sustainability focus (£37 billion) and fund level exclusions (£40 billion) is significantly higher than FUM in funds with an impact investing component with FUM of £3 billion or just 5% of RI FUM.

Splitting the data by asset class shows:

- In 2020, FUM in equities totalled £32 billion, representing 57% of responsible investment funds, a higher share than in the funds market overall. By comparison, equity funds are 52% of total UK investor FUM.
- The share of FUM in mixed asset funds is also greater. £12 billion in FUM represents 21% of Rl FUM compared with 17% for the wider industry.
- Fixed income funds account for 20% of responsible investment FUM at £11 billion, which is similar to overall FUM in fixed income of 19%.
- Assets in the 'Other' category are underrepresented amongst responsible investment funds. £1 billion in FUM is just 2% of FUM compared with 7% of assets in the wider retail funds market.

CHART 48: RESPONSIBLE INVESTMENT FUM BY ASSET CLASS AND COMPONENT, DECEMBER 2020



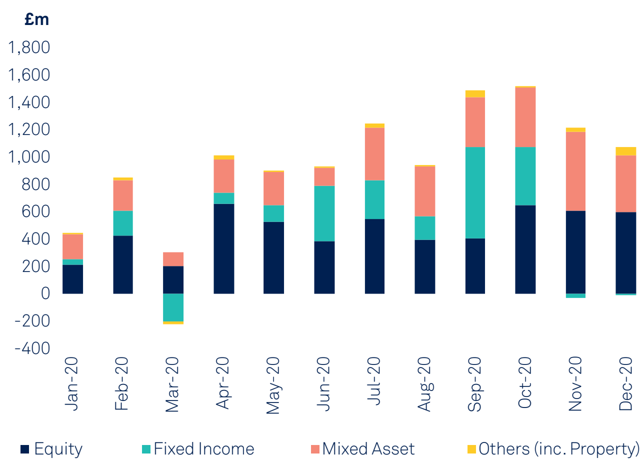
5

NET RETAIL SALES TO RESPONSIBLE INVESTMENT FUNDS

Chart 49 shows the pattern of net retail sales to responsible investment funds by asset class:

- Equity funds led sales through 2020, with a total inflow of £5.6 billion, just under half of the RI funds net sales total. For context, flows of £10.4 billion to equity funds in the wider IA fund universe were a third of 2020 inflows.
- Mixed asset RI funds received inflows of £3.7 billion in 2020, 31% of the total RI inflow at levels comparable to mixed asset sales overall in 2020 at 29% of total inflows.
- Net sales to fixed income RI funds were £2.1 billion (18%) of the total in 2020.
- Funds investing in assets such as property or pursuing outcome strategies including volatility management are represented by the 'Other' category. RI funds in this asset class are limited in number and are lower by percentage of FUM and sales were just £251 million over 2020. The recent launch of RI funds to the volatility managed sector is likely to result in higher sales to RI funds in the 'Other' category in future years.

CHART 49: RESPONSIBLE INVESTMENT NET RETAIL SALES BY ASSET CLASS, (2020)



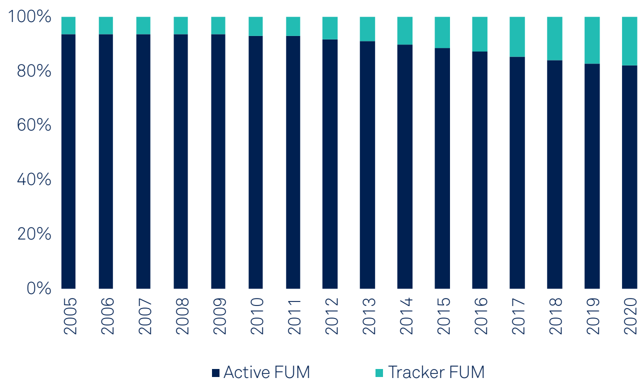
GROWTH PATTERNS IN INDEX TRACKING FUNDS

FUM in funds that track an index[30] was £257 billion in 2020 compared with £41 billion in 2010, giving tracker FUM a compound annual growth rate of 20%, which compares with 7% for active FUM over the same period.

The proportion of FUM managed through index tracking funds has been steadily climbing from 7% in 2010 to 18% in 2020 as shown in Chart 50. Asset appreciation is the most important driver of FUM growth but new fund launches and rising net retail sales have also been contributing factors over the last decade.

In 2020, the growth in tracker funds as a percentage of FUM has started to level off. The proportion of FUM in index trackers has remained consistent between 2019 and 2020 at 18%.

CHART 50: ACTIVE FUNDS AND TRACKER FUNDS AS A PROPORTION OF TOTAL FUNDS UNDER MANAGEMENT (2005-2020)

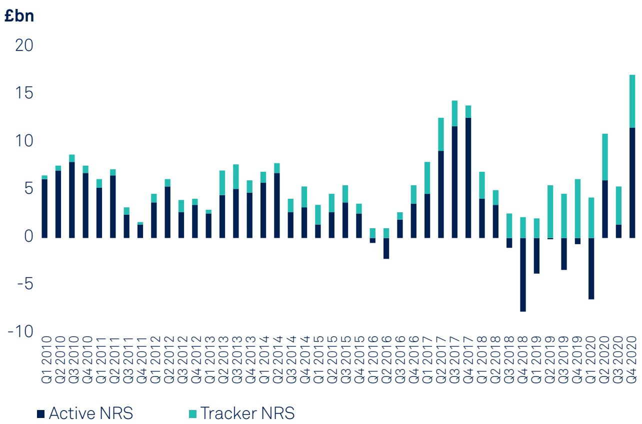


[30] IA fund data on index trackers does not currently include ETFs. Assets in ETFs are included in the AUM data.

As seen in Chart 51, net sales to active funds demonstrate greater volatility than the stable inflows to index trackers. Between 2018 and 2019, there was also a step change in the level of net retail sales to index trackers. Inflows to index trackers rose from £9.2 billion in 2018 to £18.1 billion. 2020's sales to trackers are consistent with the levels in 2019 at £18.4 billion in a strong year for net retail sales overall.

The trend to outflows from active funds has shifted during the pandemic going from an £8.1 billion outflow in 2019 to a £12.4 billion inflow in 2020. This suggests that investors are persuaded that active managers can take advantage of changing market conditions to deliver superior returns.

CHART 51: NET RETAIL SALES TO ACTIVE AND INDEX TRACKING FUNDS (2010-2020)

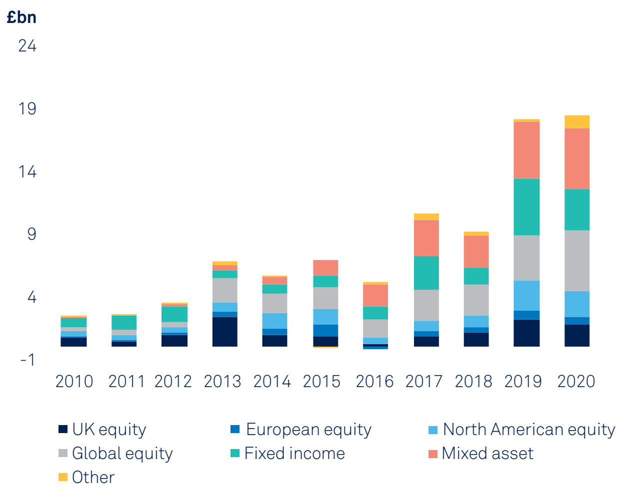


Sales to tracker funds by asset class

Sales to mixed asset (typically funds of index trackers) and global equity tracker funds increased in 2020 to £9.7 billion, up from £8.2 billion in 2019. Combined they represent just over half of all tracker inflows in 2020. Mixed asset and global equity trackers have become popular with investors, offering diversified investments at a low cost.

Sales to fixed income trackers have been increasing, peaking in 2019 at £4.5 billion. After strong sales in 2019, fixed income trackers saw reduced inflows in 2020, declining to 18% of tracker sales. Although equity and mixed asset tracker funds did not see outflows in March 2020, fixed income trackers were not immune to the market conditions that resulted in a £7.5 billion outflow from fixed income funds overall. However, fixed income tracker sales rebounded in the second half of 2020.

CHART 52: NET RETAIL SALES OF TRACKER FUNDS BY INDEX INVESTMENT TYPE (2010-2020)



SALES TRENDS BY ASSET CLASS

Over the last 15 years, retail investors have made a structural shift in preference to funds that provide a mixed asset allocation. Mixed asset funds offer a ready-made investment solution, where the fund manager makes the allocation decisions rather than the investor, and sales to allocation funds have been consistently strong year on year. In contrast, the pattern of sales to funds investing in a single asset class or strategy has been more volatile.

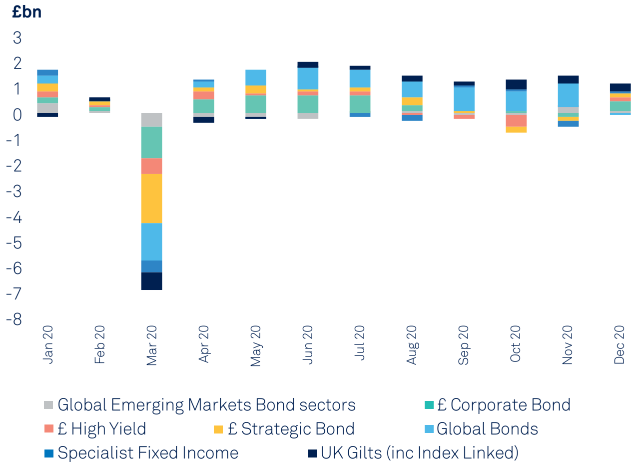
For equity and bond funds, the most consistent inflows have been to funds with a globally diverse allocation. A more diverse exposure to global stocks and bonds provides attractive risk mitigation and is also a reflection of changing investor horizons, as the preference for investing in domestic companies has been eroded over time in favour of access to broader global markets.

In this section we analyse the sales trends by the main asset classes. We take into account how investors have responded to the changing market conditions through the pandemic but also look at the long-term pattern of sales pre-Covid.

NET RETAIL SALES TO FIXED INCOME IN 2020

In March 2020, 80% of fixed income funds in IA data recorded net outflows. At £7.5 billion, the outflow from fixed income was the highest of any asset class. As shown in Chart 53, the largest fixed income outflows in absolute terms were across funds in the £ Corporate, £ Strategic and the Global Bond sectors, the three largest fixed income sectors by FUM.

CHART 53: FIXED INCOME, MONTHLY NET RETAIL SALES BY SECTOR (2020)



Assets have flowed back to fixed income funds through 2020, fully reversing the March outflow by August 2020 and total inflows for the year were £8 billion:

- Sales to the Global Bonds sector were the highest of any fixed income sector in 2020 at £4.5 billion. Many funds hold a mix of government and corporate bonds to diversify holdings. Global Bonds was also the highest selling fixed income sector in 2019 at £2.9 billion.
- Sales of £2.4 billion to the £ Corporate Bond sector made it the second highest selling fixed income sector in 2020. In 2019, the sector sustained an outflow of £426 million.
- Sales to UK Gilts reached £794 million compared with sales of £684 million in 2019.
- Not all fixed income sectors recouped the outflows sustained in March 2020, the £ Strategic (-£468 million), Specialist (-£418 million) and £ High Yield (-£169 million) sectors all ended the year with negative net retail sales.

The drivers of the March 2020 outflows

Chart 54 focuses on the outflows from the IA fixed income sectors as a percentage of FUM. The larger sectors by FUM had higher outflows in monetary terms in March but looking at sales in the context of the size of the overall sector is a better measure of the relative scale of the outflow.

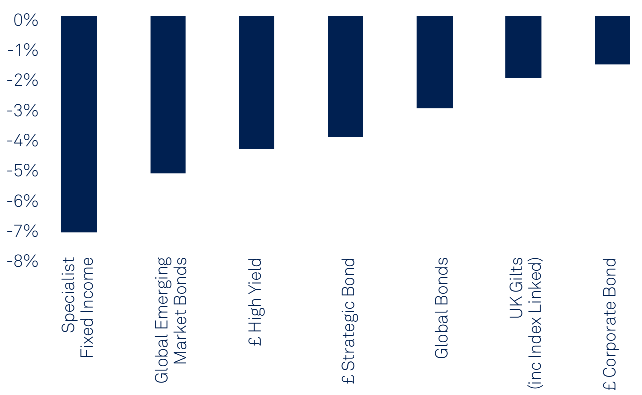
The outflow from the £ Corporate Bond sector was in fact the lowest as a proportion of sector FUM at 1.6%. Although the sector had the third largest outflow of £1.1 billion in March, it is also the largest bond sector by FUM.[31]

The highest outflows as a percentage of FUM were:

- The Specialist Fixed Income sector at 7.2%.
- Global Emerging Bond sectors at 5.2% of combined FUM.
- The 4.4% outflow as a percentage of FUM from £ High Yield.

The £ High Yield sector invests in sterling non-investment grade debt with the promise of higher yields and is therefore more vulnerable to credit defaults. However, the FUM in this sector is just a fifth of the largest sector by FUM – the £ Corporate Bond sector.

CHART 54: OUTFLOWS FROM IA BOND SECTORS AS A PERCENTAGE OF FUM, MARCH 2020



Bonds are traditionally seen as a safe asset class, so at a time of turbulence in markets, the scale of the outflow from bonds was substantial. We see three key drivers of the heavy fixed income outflows in March:

- **Re-balancing portfolios as equity valuations fell:** Equity market valuations dropped between 20% to 30% over a short period of time, reaching a low on the 23rd of March. Portfolios with a 60/40 weighting to bonds and equities shifted to circa 80/20 - a much higher weighting to bonds. In particular, discretionary managers looked to re-balance portfolios in the short-term - outflows from discretionary managers in March were the highest of any distribution channel at £2.4 billion. Selling out of equities when valuations were low would have crystallised portfolio losses, which meant that bonds were sold down. As equity markets rebounded, further adjustments back into fixed income were made.
- **Calls on cash:** Some of the activity in March must represent a need to draw on assets invested to convert them into cash, as the inflow to money market funds in March also suggests. If household income dropped significantly as a result of being furloughed or self-employed and bills or other commitments needed to be paid, drawing on investments may not have been desirable but could have been a necessity. To meet these needs, investors are likely to have sold down more liquid positions first, including mixed asset funds, at the same time as trying to avoid selling equities at low valuations.
- **Short-term risk management:** 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 opted to reduce their exposure to bonds in immediate reaction to this. The highest outflows as a percentage of FUM were from Specialist Bond funds, Global Emerging Market Bond funds and £ High Yield – high yield bonds can be less liquid and more vulnerable to default risk than investment grade corporate bonds. Appetite for emerging market debt was also affected by the rapidly strengthening dollar in March.[32] The massive scale of bond buying programmes from the Federal Reserve, the Bank of England and the European Central Bank helped to drive greater liquidity and improve price stability but this pulled through into bond markets at the end of March.

[31] FUM in the £ Corporate Bond sector was £79.6 billion in December 2020.

[32] EM debt is often paid off in dollars. The dollar is the world's reserve currency and strengthened significantly in March as many EM currencies weakened, making it harder to pay down debt and increasing the risk of default on EM bonds.

SALES TO FIXED INCOME FUNDS OVER TEN YEARS

Chart 55 shows the pattern of net retail sales to fixed income funds over the last ten years. In spite of the significant outflow from fixed income funds in 2020, annual sales were the second highest in the past decade beaten only by the £16.1 billion inflow in 2017 in a record year for net retail sales.

CHART 55: FIXED INCOME, NET RETAIL SALES BY SECTOR (2010-2020)

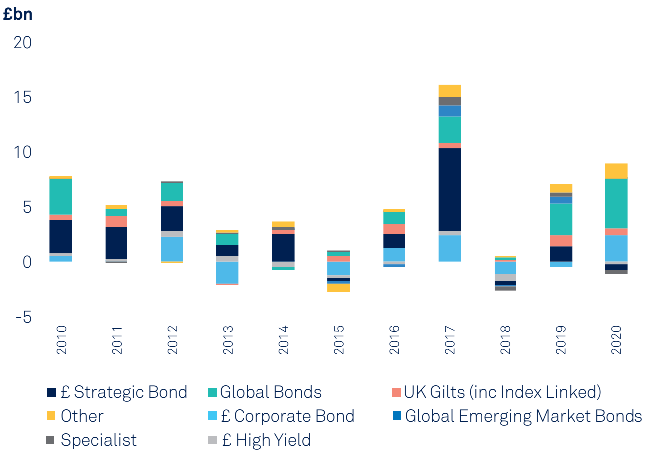
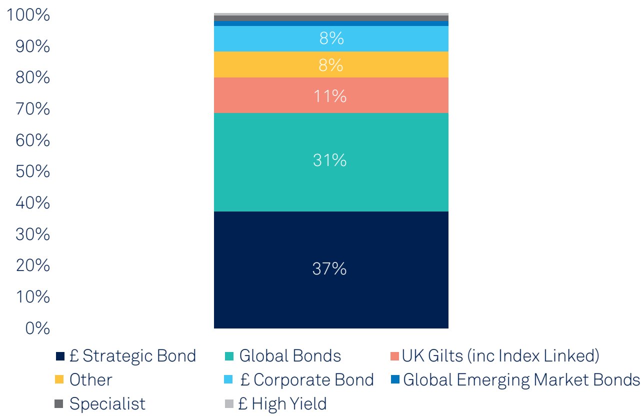


Chart 56 shows the proportion of the 10 year net retail sales to fixed income by type of bond fund, using the IA sectors as fund peer groups:

- Inflows to the £ Strategic Bond sector accounted for over a third (37%) of net sales to fixed income funds in the past 10 years, boosted by the large annual inflow of £7.5 billion in 2017, at the height of the DB transfer market. The rebound in sales to the £ Strategic sector has been comparatively weak in 2020 compared with other sectors, which runs counter to the trend of healthy inflows for most of the last decade.
- Inflows to the Global Bonds sector are 31% of total sales over 10 years. Sales to the Global Bond sector are the highest of the bond sectors in the last two years, peaking at £4.5 billion in 2020. This suggests that investors are increasingly opting for global diversification in bonds as well as equities.
- Although the £ Corporate Bond sector is the largest by FUM, it accounts for 8% of sales over 10 years and flows are less than UK Gilts (11%), where annual inflows have been more consistent year on year compared with higher sales volatility to the £ Corporate Bond sector.
- Inflows to £ High Yield made up just 1% of net retail sales. Sales to this sector have been volatile over the last decade. Inflows have also typically been much lower than the other sterling-denominated bond sectors, the highest annual inflow of £563 million coming in 2012.

CHART 56: PERCENTAGE OF TOTAL NET RETAIL SALES TO FIXED INCOME SECTORS OVER 10 YEARS



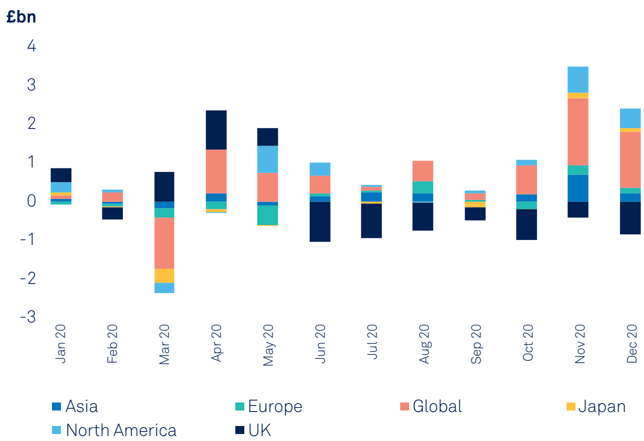
NET RETAIL SALES TO EQUITIES IN 2020

Equities were the highest selling asset class through 2020 with an inflow of £10.4 billion, in a reversal of 2019's £2.9 billion outflow from equity funds.

Alongside other asset classes, equity funds saw large outflows in March 2020 of £1.2 billion, although considerably lower than the £7.5 billion from fixed income funds. Recovering equity prices helped to drive inflows in April and May, followed by a calmer summer. The announcement of successful vaccine trials in November triggered record equity inflows of £4.1 billion as equity valuations surged.

Chart 57 shows that flows to equity funds have been volatile until the last quarter of 2020. Global equity funds attracted the most consistent inflows following the rebound from March.

CHART 57: NET RETAIL SALES BY EQUITY REGION (2020)



Global: Globally diversified funds remained popular with investors in 2020, consistent with the long-term trend to high sales to Global. Net retail sales were £7.1 billion over the last three quarters after a £1 billion outflow in Q1 2020. National governments took differing approaches in implementing measures to halt the spread of Covid-19 meaning that just as the spread of the virus affected different regions at different times, the pace of the recovery in national economies was not even. The geographic diversification offered by global funds helped investors to mitigate risk.

North America: US stocks have seen strong growth in valuations in 2020, with the S&P 500 offering a capital return of 15.8% for the year. The rapid shift to remote working and home entertainment helped drive the growth of the large technology companies, which are listed in the US. Early and decisive stimulus measures implemented by the Trump administration through the $2.2 trillion CARES Act helped smooth out the economic impact of Covid-19 and inspire investor confidence.

Europe: European equity funds saw outflows of £405 million through 2020, concentrated in the first half of the year, as shown in Chart 57. Outflows from European equities have slowed in 2020 compared with net retail sales of -£3.8 billion in 2019. As with UK equities, weak sales to European equities have been a feature following the Brexit referendum in 2016.

Asia: As Covid-19 became a global pandemic, the relative early success of Asian countries in controlling outbreaks allowed for quicker economic recovery, tempting investors back into Asian equity funds with £1.8 billion in net retail inflows since April 2020. This represents 24% of equity inflows in the last three quarters despite Asian equity funds representing only 6% of equity FUM. The Biden victory in the November US election offered some prospects for reduced Sino-US trade tensions, which may also have contributed to improved sales to Asian equity funds at the end of the year.

UK EQUITIES: THE EROSION OF HOME BIAS

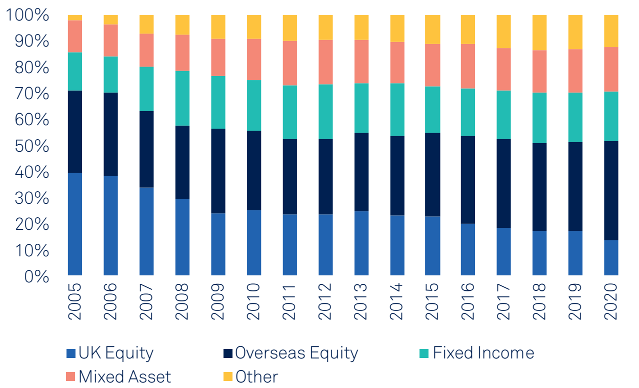
IA data show a long-term trend to overseas equities rising as a proportion of FUM and a shift away from UK equities. UK equity FUM has fallen to 14% in 2020, down from 39% in 2005, a trend that mirrors the decline in the percentage of AUM in UK equities (See Chapter 3). At the same time, assets in overseas equities have risen to account for 31% of UK investor FUM in 2020. This primarily reflects the underperformance of UK equities compared with overseas equities as shown earlier in Chart 39. Returns from the FTSE All-Share have considerably lagged the MSCI World and the equivalent US index, the Russell 3000.

Net retail sales to UK equities are a less significant driver of the decline in the proportion of FUM but have some bearing. UK equity sales have been volatile over the last 15 years, moving to more persistent outflows of £16.4 billion since 2016, the year of the Brexit referendum. Investor sentiment towards UK equities has been broadly negative over the last five years.

Chart 58 shows how the proportion of UK Investor FUM has changed since 2005, illustrating the substantial fall in UK equity FUM.

- UK equities fell to 14% in 2020 from 17% in 2019 as the FTSE All-Share failed to regain the market value lost in March 2020, ending 2020 10% down on 2019. UK equities accounted for some 40% of total FUM in 2005.
- Overseas equities rose to 38% of FUM at year-end 2020, up from 32% in 2005 and an increase of nearly 4 percent from 2019. This is the highest year on year increase in over 20 years, demonstrating the strength of the post-March rebound in global capital market performance.
- The proportion of FUM invested in fixed income ended 2020 on 19%, a small increase on 2019 (18.8%) despite the short period of bond market turbulence in March 2020. This proportion is broadly unchanged over ten years, following significant inflows into fixed income and strong market performance in the aftermath of the Global Financial Crisis.
- Mixed asset as a proportion of FUM is 17% in 2020 consistent with 17% in 2019. In 2005, the proportion of FUM invested in Mixed Asset was 12%.
- 12% of UK investor FUM is in ‘Other’, a substantial increase from 2% in 2005. Although FUM in ‘Other’ fell by 1% from 2019, this is more a reflection of the relative increase in the proportion of FUM in overseas equities than a decline in the FUM in the Other asset class, which rose slightly over 2020 in absolute terms.

CHART 58: FUM BY ASSET CLASS (2005-2020)



NET RETAIL SALES TO UK EQUITIES

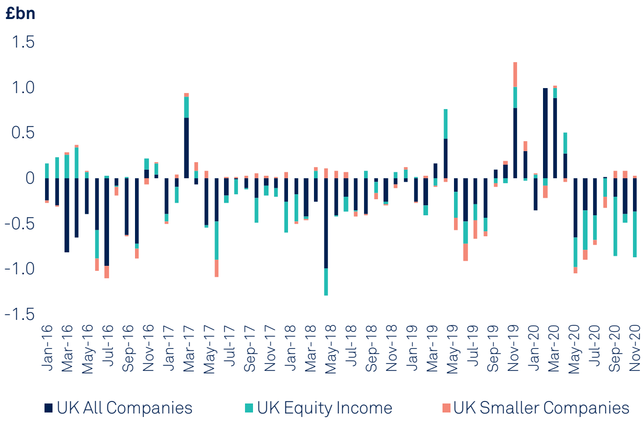
Outflows from UK equities between 2016 and 2020 are £16.4 billion (see Chart 59), suggesting that Brexit has had a broadly negative impact on investor appetite for funds investing in domestic shares. The underperformance of the FTSE relative to other global markets is another factor affecting UK equity funds as investors have looked to build more globally diverse portfolios. The performance of the FTSE through the pandemic has also been hampered by the impact of dividend suspensions on total returns and the pattern of outflows has largely persisted through 2020.

UK equity funds started 2020 on a high with strong inflows following the decisive Conservative election result in December 2019 and the promise of a concrete timeline for exiting the European Union. UK equity funds bucked the trend to high outflows in March 2020 with an inflow of £757 million, likely a reflection of contrarian investors tempted by sharply decreased UK equity prices and the prospect of future growth. Inflows continued into April and May before turning to consistent outflows from June onwards, with a total outflow of £5.1 billion from June to December. The FTSE underperformed other global markets on a capital and total return basis through 2020, in part because of a significant reduction in dividend payments that affected total return.

As shown in Chart 59, outflows from the UK Equity Income sector made up a significant part of UK equity outflows in the second half of 2020 at £2.5 billion. The Prudential Regulation Authority asked for the temporary cessation of dividend payments by banks in March.[33] This move, along with cuts in dividends from energy companies following a drop in oil prices, significantly harmed the income prospects for UK equities. UK dividend payments were cut by 44% in 2020 according to Link's Dividend Monitor.

Aside from reduced dividend payments, UK equities have suffered from the struggles to contain the Covid-19 pandemic and repeated lockdowns. Additionally, the uncertainty around protracted Brexit negotiations weighed upon investor sentiment, with the last minute signing of the EU–UK Trade and Cooperation Agreement coming too late in December to impact 2020 flows and leaving uncertainty around trading relationships going forward.

CHART 59: NET RETAIL SALES, UK EQUITY SECTORS (2016-2020)



EQUITY FLOWS OVER TEN YEARS

Investors have shown a consistent preference for globally diversified funds over the last ten years, as net retail sales to Global reached £37.3 billion for the decade. 2020's sales of £6.1 billion are the highest over this period. The Global sector's consistent inflows mean that net retail sales account for 79% of the £47 billion inflow to equities in the last decade.

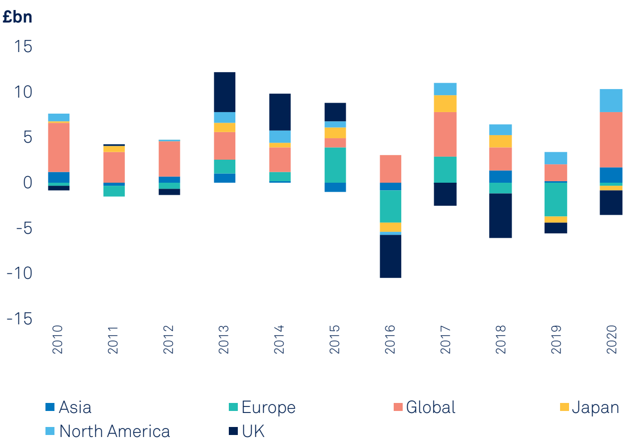
Funds investing in other regions have experienced more volatile sales over the last 10 years as capital market returns have waxed and waned. Strong sales to North American equities in the last four years, with inflows reaching £6.4 billion, have been aided by robust performance from US equities (see Chart 39 showing the performance of equity markets on a capital return basis). The US stock market has benefited from market conditions favouring growth stocks and has a high proportion of technology companies listed on it.

[33] Suspending dividend payments was a precautionary step to preserve capital in case it was needed through a challenging economic period. The PRA did not expect that banks would need the capital preserved to maintain adequate capital positions but wanted to ensure that banks had 'the extra headroom' to support the economy through 2020.

Geo-political factors have also played a part in shaping investor preferences. UK equities have been in constant outflow since the Brexit referendum in 2016 and European equities have seen net outflows in three of the last four years:

- Net retail sales to Global funds are £37.3 billion over 10 years making up 79% of total sales to equities.
- Flows of £10.3 billion to North American equities for the decade mean that the US had the second highest sales of any region. Two-thirds of the sales to North America have been in the last four years.
- Outflows from UK equities for the decade are £7.1 billion. In 2016 following the Brexit referendum, outflows reached £4.6 billion annually.
- European equities have also been in outflow over 10 years with net retail sales of -£1.8 billion over that period.
- Inflows to Asian equities strengthened in 2020 as the economic recovery from Covid-19 was swifter than in the US and Europe – total sales for the decade are £3.4 billion.
- Japanese equities have also seen net inflows overall at £4.9 billion but have moved into outflows in 2019 and 2020.

CHART 60: EQUITY FUNDS, NET RETAIL SALES BY REGION (2010-2020)



SALES TO ALLOCATION AND OUTCOME-FOCUSED FUNDS

Sales to outcome and allocation funds are less affected by the changing cycle of markets, although in recent years, targeted absolute return funds have proved more exposed to negative investor sentiment, leading to consistent outflows. Sales volatility has been a more persistent feature for the other categories of fund over the last fifteen years.

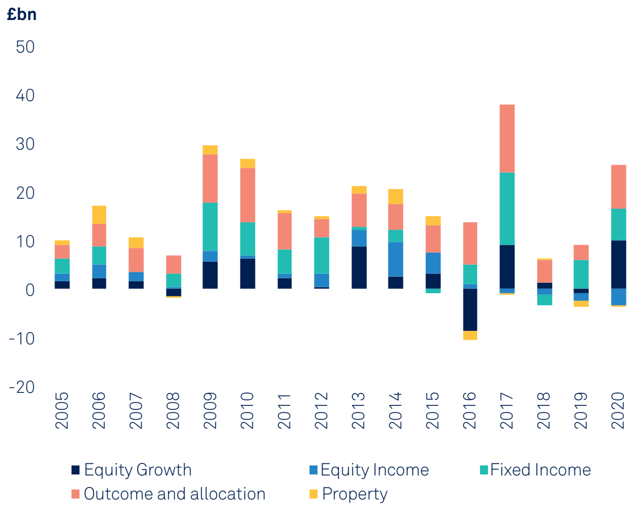
However, for the first time since 2013, equity growth funds have been the highest selling category by investor objective at £9.9 billion, beating the total inflow to equity growth funds in 2017 (£9.1 billion). As equity valuations recovered from the sharp market falls in March 2020, there has been a significant opportunity for investors to benefit from rising equity values through 2020. November's announcement of successful vaccine trials provided a further boost to markets pushing sales to equity growth funds higher in the last quarter of 2020.

- Outcome and allocation funds have maintained positive sales every year for fifteen years with a total inflow of £106.2 billion.
- Fixed income funds have also seen consistent inflows over the period with only two years of net outflows, taking total sales to £70.4 billion.
- The level of inflows to equity growth funds has fluctuated over fifteen years putting sales at £43.3 billion. Despite this, equity growth funds have maintained inflows for twelve of the last fifteen years.

5

- In the last four years, equity income funds have been in outflow and sales over fifteen years are £22.6 billion. For investors seeking income, fixed income has proved a more consistent choice. Outflows have risen again through 2020 following UK dividend suspensions and reductions.
- Total sales to property funds over fifteen years are £14.0 billion and sales have been weak since the 2016 suspensions.

CHART 61: NET RETAIL SALES BY INVESTOR OBJECTIVE (2005-2020)

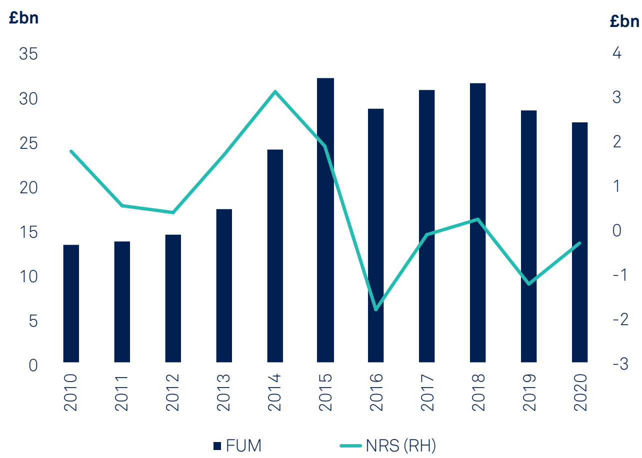


PROPERTY FUNDS

Between January 2016 and December 2020, total outflows from the property asset class were £3.2 billion. In the preceding four years from January 2012 to December 2015, sales to property funds were £7 billion. FUM in property funds in December 2020 was £27 billion. This is nearly double the FUM in property funds in 2010 (£13.2 billion) but a fall of 15% from 2015 (£31.2 billion).

The turning point in the trend to outflows from property funds occurred in June 2016, following the result of the Brexit referendum. Many daily dealing open-ended funds investing directly in UK commercial property had to suspend dealing in units and in some cases to suspend the daily pricing of units. The suspensions occurred because rising redemption requests meant that property assets could not be liquidated quickly enough and at a fair value to meet the requests. There was also valuation uncertainty. In March 2020, direct property funds suspended again but as a result of valuation uncertainty not as a result of liquidity concerns.

CHART 62: PROPERTY FUND FUM AND NET RETAIL SALES (2010-2020)

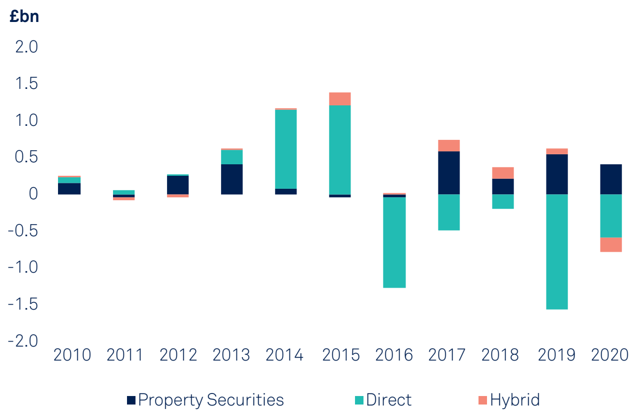


In 2018, the IA split the Property sector into UK Property Direct and Property Other,[34] which contains funds investing in property securities, a hybrid of direct and securities and global direct property funds.

Chart 63 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 outflows from UK Direct property funds between 2016 and 2020 were £4.1 billion. Outflows of £587 million in 2020 were lower than in 2019, but from March 2020 many funds were suspended owing to valuation uncertainty.
- Between 2016 and 2020, inflows of £1.7 billion to funds investing in property securities outstripped net retail sales to direct property. Over 2020, net sales reached £399 million.
- Hybrid funds investing in a mix of securities and direct property saw inflows of £242 million between 2016 and 2020. In 2020, this type of fund moved into outflow for the first year since 2012 at £185 million.

CHART 63: **NET RETAIL SALES BY TYPE OF PROPERTY FUND (2010-2020)**



2020's suspension of UK funds investing directly in property

The property net retail sales data in 2020 is affected by the widespread suspension of redemptions and subscriptions for daily and quarterly-traded open-ended property funds. These funds are investing directly in physical UK property. This is due to valuers qualifying their valuations with a material uncertainty clause meaning that fund managers could not 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).[35]

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. This 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.
- In March, it was uncertain how long the situation would last. In 2021, the majority of property fund suspensions have been lifted, although challenging conditions remain as the economy opens up.
- The UK government has extended the moratorium on evicting commercial tenants that cannot pay rent until March 2022 and introduced a mandatory arbitration process for landlords and tenants that cannot agree. This measure helped tenants to avoid a cliff-edge scenario for paying rent arrears in July 2021 but prolongs the period of uncertainty for commercial landlords seeking to recoup rents.
- Commercial offices face longer-term uncertainty. Companies have proved that they can work well remotely and are likely to need much less office space. This in turn will affect the value of offices, which will likely fall meaning material uncertainty of long-term value.

[34] In the UK Property Direct sector, 70% of the fund's portfolio must be invested in geographically diversified physical commercial property in the UK. Funds that do not meet this criteria can be found in the Property Other sector: many of these funds invest in property securities, which are more liquid than physical property, but some are hybrid funds investing in physical property and securities and others invest in residential property or in global property directly.

[35] 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 were Property Authorised Investment Funds (PAIFs) – either Non UCITs Retail Schemes (NURS) or Qualified Investor Schemes (QIS). They were all open ended.

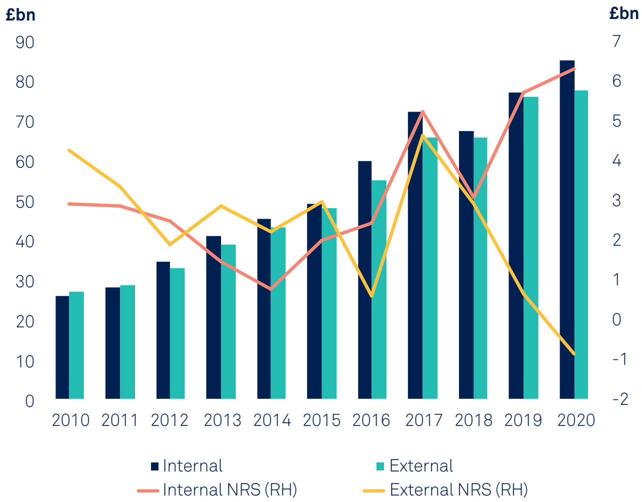
FUND OF FUNDS

The IA divides fund of funds into those that invest in in-house managers and those that are free to invest in funds managed externally. Fund of funds that invest in in-house managers often have slightly lower OCFs, making them cheaper than fund of funds investing across the spectrum of external managers.

In 2020, as in 2019, investors have shown a marked preference for internally invested funds of funds. As shown in Chart 64, the gap between internally and externally invested funds of funds has widened, with flows to in-house fund of funds rising from £5.7 billion in 2019 to £6.3 billion in 2020, while externally invested funds of funds have seen sales decline from £625 million in 2019 to an outflow of -£888 million.

In-house fund of funds sales are dominated by mixed asset funds, representing £5 billion of the 2020 inflow. Many of these funds are invested in index trackers, offering investors diversified core portfolio holdings at a relatively low cost.

CHART 64: FUND OF FUNDS, FUM AND NET RETAIL SALES (2010–2020)

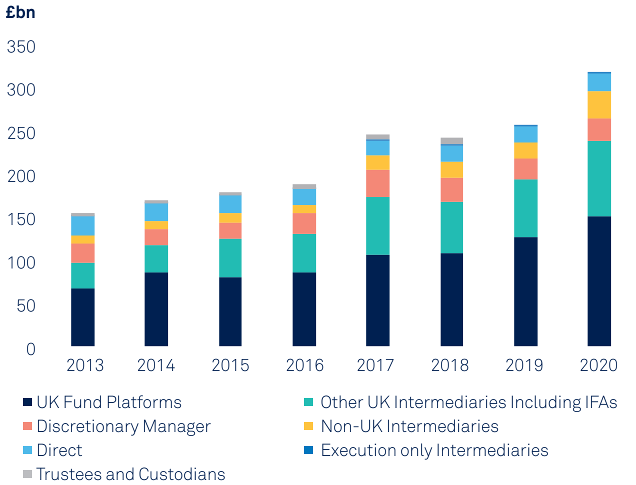


SALES BY DISTRIBUTION CHANNEL

Gross sales by distribution channel

Chart 65 shows gross sales to UK investors split out by distribution channel and illustrates the extent to which 2020 has seen increased activity in the funds market. Total gross sales for 2020 were £319 billion, 24% greater than in 2019 (£257 billion). All channels saw an increase in gross sales year on year. The proportion of gross sales through the different channels remained broadly unchanged from previous years. UK platforms continue to see the highest gross sales, which has been a consistent trend since 2013.

CHART 65: GROSS RETAIL SALES BY DISTRIBUTION CHANNEL (2013-2020)



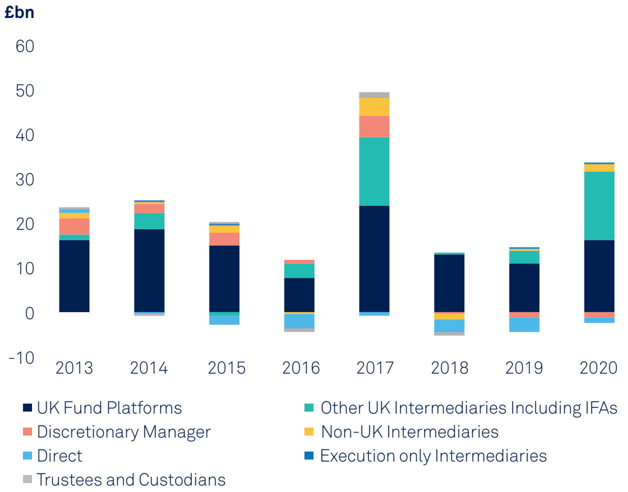
Net retail sales by distribution channel
Fund platforms are the primary distribution channel for retail investors, providing over two thirds of net retail sales post RDR (see Chart 66). The 'Other UK Intermediaries including IFAs' channel, which principally represents off-platform IFA sales, has also seen consistent, although modest, annual inflows over the last ten years. In years where there have been exceptionally strong net retail sales, flows through the IFA channel have been elevated and 2020 is no exception to this pattern. The channel has helped drive strong sales in 2020 in a repeat of patterns seen in 2017 (£15.7 billion) and 2009.[36]

Outflows through direct channels have continued for a seventh consecutive year as the industry moves away from distributing directly to investors, while the Discretionary Manager channel has seen a third year of outflows, again reflecting changing business models as more assets are managed in discretionary model portfolios on platforms – meaning that sales are counted through the UK platforms channel.

UK fund platforms remains the leading distribution channel for net sales in 2020:

- Flows to UK platforms are £16.3 billion up from £10.9 billion in 2019 (a 50% increase).
- 'Other UK Intermediaries including IFAs' saw net sales of £15.2 billion in 2020, which is five times the inflow seen in 2019 and close to 2017 net sales.
- The Discretionary Managers channel remained in outflow in 2020, as net outflows rose slightly from £1.1 billion in 2019 to £1.4 billion in 2020. The trend to outflow reflects some discretionary managers moving away from funds to implementing segregated mandate agreements with investment managers. More discretionary managers are also offering model portfolios through platforms, which is diverting sales through the platform channel. Neither of these trends represents a loss to the investment management industry. Outflows from the Discretionary Managers channel were particularly high in March at £2.4 billion, the highest outflow from any channel, indicating the speed of discretionary managers' reaction to the volatility in capital markets in March.

CHART 66: NET RETAIL SALES BY DISTRIBUTION CHANNEL (2013-2020)



INVESTOR AVERAGE HOLDING PERIODS FALL SLIGHTLY IN 2020

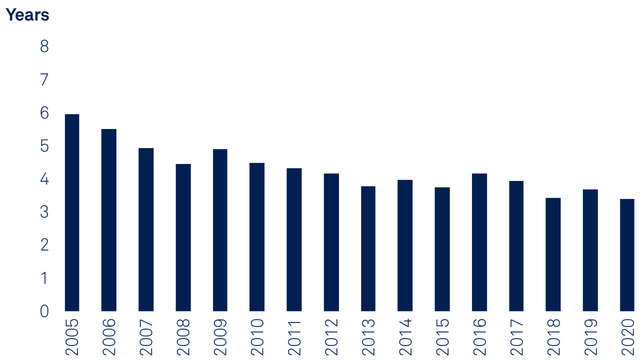
Average investor holding periods have fallen slightly during the pandemic to 3.4 years, the same average holding period as in 2018.[37] In 2019, average holding periods had risen slightly to 3.7 years. Despite the reduction in the average holding period of a retail fund, they have not fallen below 3 years, the minimum track record that advisers would typically want to see before investing in a fund. Portfolio adjustments in response to changing market conditions during the pandemic may be a factor in the slight reduction in holding periods.

The majority of fund sales in the UK are transacted through investment platforms, whether the investor is direct or advised. Since coming to prominence in the mid 2000's, investment platforms have made it substantially easier to switch assets between funds held on platform. The Retail Distribution Review in 2012 and the rise of Centralised Investment Propositions (CIPs) has also had an impact. CIPs are a standardised approach to investing that must be suitable for

[36] Changes to the distribution landscape post RDR and the IA channel categorisation mean that 2009 data is not directly comparable and not shown here in Chart 66.
[37] The IA calculates investor average holding periods using this formula: HP=(Average Retail FUM between 2 years - NS)/ REPURCHASE.

different advised client segments. They can be a multi-asset fund but many are a model portfolio of funds managed on an advisory or discretionary basis with significant FUM. Adjustments to fund allocations in model portfolios are often made on a quarterly basis and this also helps to explain the reduction in average holding periods.

CHART 67: RETAIL INVESTOR AVERAGE HOLDING PERIODS (2005–2020)

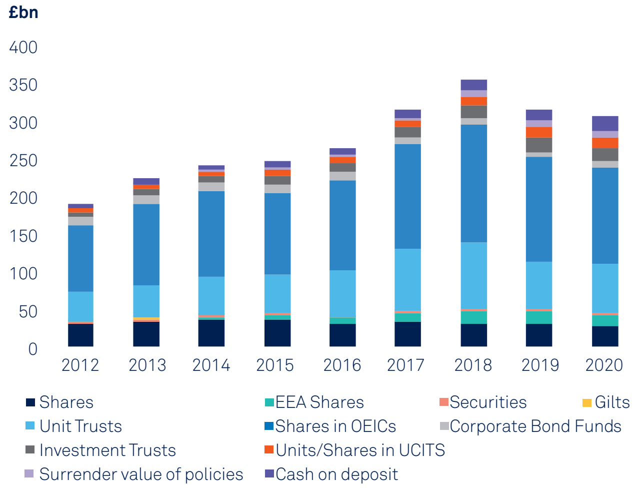


SALES TO ISAS

Net sales to pension wrappers of £4.8 billion in 2020 remain the highest of any wrapper on platforms reporting data to the IA. The rise in net sales to pension wrappers follows the introduction of the pension freedoms in 2015. However, ISAs remain one of the most accessible ways for retail investors to save tax efficiently and each year, ISA season causes a rises in inflows to funds. HMRC provides comprehensive data on the ISA market, which we analyse here.

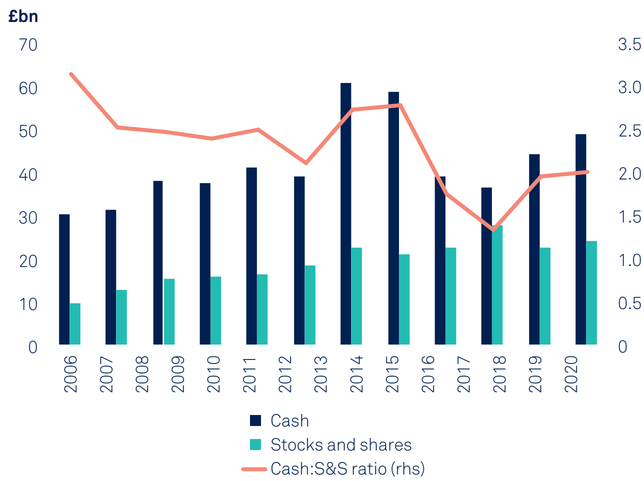
In 2020, assets in stocks and shares ISAs were £305 billion according to data from HMRC, a decrease of 3% from 2019. Assets in Shares and EEA Shares, Corporate Bond funds and OEICs in particular declined year on year. The market movements of March 2020 are likely to have had some effect. Assets in open ended funds were £207 billion or 68% of total assets in 2019/2020.

CHART 68: TOTAL ASSETS IN STOCKS AND SHARES ISAS BY TYPE OF ASSET (2012–2020)



In 2019/20, subscriptions to stocks and shares ISAs were £24 billion, an increase of 7% on the previous tax year. Despite a rise in subscriptions, the average subscription amount was down by 5% on the previous year at £8,875. The average cash ISA subscription was also 3% lower than the previous tax year at £5,024.

CHART 69: TOTAL SUBSCRIPTIONS TO CASH AND STOCKS AND SHARES ISAS (08/09–19/20)



THE UK IN THE CONTEXT OF THE EUROPEAN FUNDS MARKET

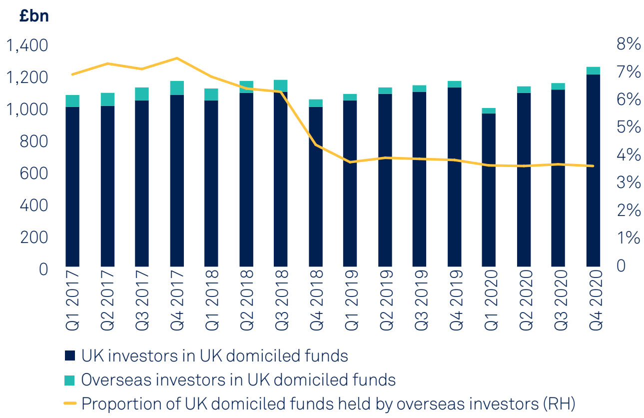
Here we examine the UK in the context of the European funds market. Whilst the UK is an international investment management centre, in the retail funds market, the vast majority of overseas investors and overseas domiciled funds in IA data are European. We look at the impact of Brexit on overseas investors in UK domiciled funds. We also analyse UK investor appetite for overseas domiciled funds post Brexit, the vast majority of which are domiciled in Europe, and look at wider market trends in European fund sales and the growth of European domiciles.

OVERSEAS INVESTORS IN UK DOMICILED FUNDS

FUM in UK domiciled funds including funds managed on behalf of overseas investors is £1.2 trillion an increase from 2019 of 8%. In Q1 2020, FUM fell by 15% to £956 billion before recovering. Overseas investor FUM in UK domiciled funds in 2020 was £45 billion, an increase of 1% from 2019.

The proportion of UK domiciled funds held by overseas investors has remained stable at 4% since the last quarter of 2018. The decline from 7% to 4% in 2018 resulted from operational decisions by firms to move overseas investors out of sterling denominated share classes in UK domiciled funds and is not the result of overseas investors responding to Brexit by withdrawing capital from UK domiciled funds on a significant scale.

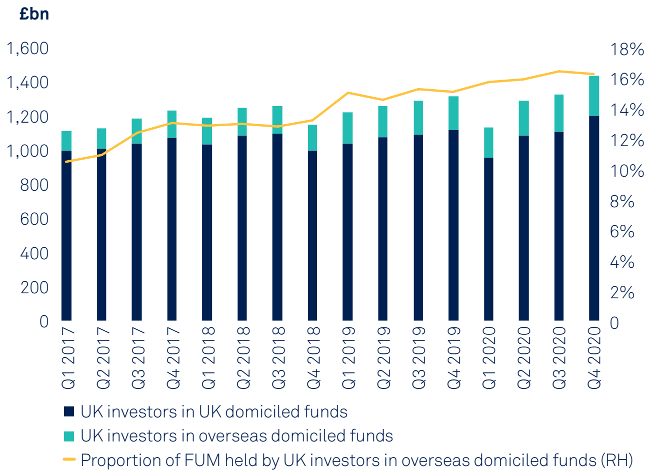
CHART 70: UK DOMICILED FUNDS BY INVESTOR PROFILE (2017-2020)



INVESTMENT IN OVERSEAS DOMICILED FUNDS POST BREXIT REFERENDUM

The percentage of FUM in overseas domiciled funds has increased from 11% in the first quarter of 2017 to 16% in Q4 2020. This tells us more about the appreciation of assets in overseas domiciled funds than UK investor preference as sales is a much smaller contributor to the growth or decline in FUM.

CHART 71: UK INVESTOR FUM IN OVERSEAS DOMICILED FUNDS (2017-2020)



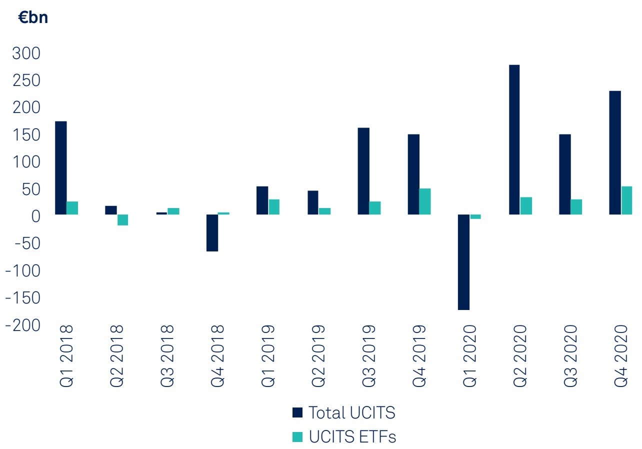
40% of the funds that report data to the IA are domiciled overseas, up slightly from 39% in 2019, and the majority are domiciled in Ireland. Whilst IA sales data is not forward looking, £7.4 billion in net retail sales to overseas domiciled funds makes up 24% of total 2020 inflows.

In March 2020, substantial outflows from overseas OEICs/ICVCs and SICAVs accounted for nearly half of total outflows that month. The scale of outflows from the fixed income asset class is the driver: 57% of bond funds in IA data are domiciled overseas. The data does not suggest that there has been a shift in UK investor sentiment towards overseas domiciled funds as a result of Brexit. The Brexit transition arrangement for overseas funds (Temporary Market Permissions Regime) ends in 2025. Whilst this is some way off, we will continue to monitor any material shift in the pattern of sales to overseas domiciled funds.

EUROPEAN UCITS SALES

The pattern of sales to European domiciled funds is consistent with the UK net sales data in 2020. After high outflows in Q1 of €186.8 billion, sales rebounded on the back of rising capital market returns to end the year on net sales of €562.2 billion overall. Inflows were strongest in the second quarter of 2020 at €301 billion. This contrasts with UK investor sales data where Q4 saw record quarterly inflows as markets climbed following the announcement of successful vaccine trials.

CHART 72: EUROPE-WIDE UCITS NET SALES (2018-2020)



Source: EFAMA

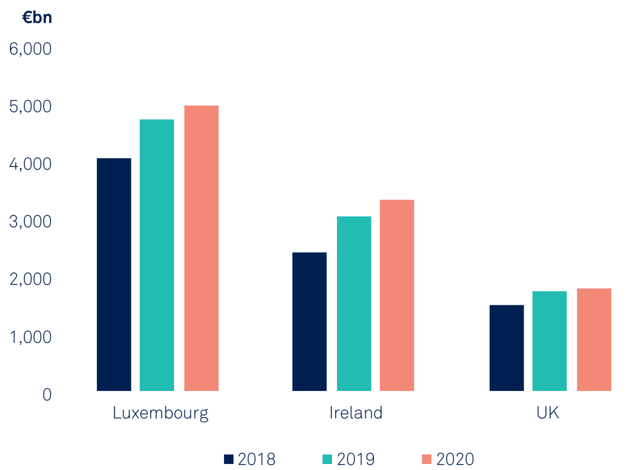
Total sales to UCITS ETFs were €95.4 billion in 2020, 9% down on the significant inflows of €104.4 billion seen in 2019 but still robust. UCITS ETFs saw a quarterly outflow in Q1 2020 of €10.6 billion. Fixed income ETFs emerged as efficient price discovery tools in the bond markets at the height of the crisis and inflows to ETFs recovered to reach €106 billion for the last three quarters of 2020 as sales through the recovery from March 2020 outstripped 2019.

FUM BY EUROPEAN DOMICILE

Funds under management in UCITS and AIFs domiciled in Luxembourg, Ireland and the UK all rose year on year from 2019 but the percentage increases are less substantial year on year, likely dampened by the impact of the steep falls in capital markets in March 2020.

- FUM in funds domiciled in Luxembourg increased to €5 trillion, an increase of 5% from 2019 (€4.7 trillion). This compares with an increase of 16% between 2018 and 2019.
- The acceleration in the increase in FUM domiciled in Ireland has slowed somewhat – in 2020 FUM was €3.3 trillion, an increase of 9% from 2019 (€ 3 trillion) but not matching the rise of 26% that took place between 2018 and 2019.
- In the UK, FUM in 2020 was €1.8 trillion with flat growth of 3% year on year. This compares with an increase of 17% between 2018 and 2019.

CHART 73: ASSETS IN UCITS AND AIFS BY DOMICILE (2018-2020)



Source: EFAMA