UK RETAIL MARKET

OVERALL EVOLUTION OF THE MARKET

> UK investor funds under management declined by 14% to £1.37 trillion over 2022, from a record £1.59 trillion at the end of 2021.

> Over the past decade investment return has played an increasingly important role as a determinant of return relative to sales growth. That remained true in 2022 as falling markets accounted for 77% of the decline in overall FUM.

> Despite monthly and quarterly volatility in net retail sales, 2022 was the first year in IA data to record an annual outflow (£25.7 billion). This was driven by a record outflow of £36.6 billion from active strategies, while indexing funds remained in inflow (£11.0 billion).

> Rising inflation and the rapidly changing monetary environment played a major role in the dislocation, which was felt strongly across both equity and fixed income markets. Pressures on household finances have clearly reduced capacity to invest for many.

> Whether temporary or permanent, the end of a long period of monetary easing has clearly had a major impact on markets and investor behaviour. Historic IA data suggests strong sensitivity of flows to significant moves in interest rates and it remains to be seen how retail behaviour evolves through 2023 and into 2024.

RESPONSIBLE INVESTMENT FUNDS

> As at the end of 2022, RI funds (the IA classification for sustainable and responsible funds) stood at 6.6% of total funds under management, after a period of significant growth through the global pandemic.

> RI funds were far from immune in the market dislocation of 2022. This reflected a range of factors, including relative performance of sectors, such as technology, that RI strategies are more exposed to. Flows slowed significantly, but remained in positive territory through the year.

INCREASING IMPORTANCE OF INDEXING FUNDS

> Over the past decade indexing strategies have grown steadily in importance as a part of the UK retail fund landscape. From 8.4% in 2012, they now account for 20.8% of total retail FUM (excluding ETF market).

> Importantly, we are seeing long-run evidence now of much greater consistency of flow relative to flows to active strategies. While inflows inevitably vary over time, there has been no negative quarter of retail sales for indexing funds in the last decade.
ASSET ALLOCATION

Both major asset classes saw outflows in 2022, disrupting the established patterns of recent years. Fixed income as a proportion of total FUM is now close to where it was in 2007 ahead of the Global Financial Crisis (GFC).

Equity funds saw outflows of £18.2 billion, the largest recorded and the first outflow since 2019. Globally diversified equities have been a popular option for investors and the Global sector was the best-selling every year from 2018 - 2021. In 2022, the Global sector turned to outflow with £2.9 billion withdrawn.

Equity investors have shown signs of adaptation however, with £2.8 billion placed into Global Equity Income funds, the first inflow since 2017, indicating a rotation in preferred investment style.

While fixed income funds saw outflows of £4.8 billion through 2022, withdrawals were concentrated to the first half of the year when the impact of changing monetary policy was most heavily felt. Investors returned to bond funds in the second half of the year with higher yields offering enhanced returns going forward.

Allocation and outcome funds saw ongoing positive inflows in 2022, albeit at a reduced level. Mixed asset funds dropped to a minimal £52 million inflow, ending a multi-year period of strong inflows. In contrast, Volatility Managed funds enjoyed consistent popularity with investors, with resilient inflows through 2022 and total inflows of £17.9 billion since the sector’s 2017 launch.

FUND OF FUNDS

2022 saw positive net retail sales for funds of funds (FoFs). Internally-invested funds of funds, which often use index tracking components, outsold externally-invested FoFs. A more persistent appetite for lower cost investment products likely explains the stronger sales to internally-invested funds of funds over recent years.

DISTRIBUTION CHANNELS

UK Fund Platforms were the only major channel through to continue to see inflows in 2023, though at a reduced £5.7 billion.

HOLDING PERIOD

Investor average holding periods continued to hold steady in 2022 at an estimated 3.5 years, with the trend of declining holding periods over the 2010s having potentially bottomed out.

UK IN CONTEXT OF EUROPEAN FUNDS MARKET

UK investor FUM is still trending towards greater exposure to overseas-domiciled funds, which accounted for 17% of total UK investor FUM in 2022.
This chapter examines the funds market and trends in Funds under Management (FUM) and net sales. The focus is on long-term trends for UK investors in both UK domiciled and overseas domiciled funds. Alongside analysis of trends in sales and allocations, the chapter examines patterns in distribution, the growth of index tracking and the development of responsible investment.

While the chapter focuses on long-term trends, it includes consideration of how the events of 2022 have disrupted those trends. A deeper examination of the funds market through just 2022 is available in our UK Fund Market 2022 Year in Review.32

UK INVESTOR FUNDS UNDER MANAGEMENT

By the close of 2022 UK investor FUM was £1.37 trillion, a 14% decrease on the £1.59 trillion figure for 2021. This is the worst year-on-year fall since the Global Financial Crisis (GFC) in 2008 which saw FUM decline 22%. As shown in Chart 36, the £218 billion decrease over 2022 is the largest seen in absolute terms.

Chart 37 shows the growth of industry funds over management from 1980 to 2022, breaking out the relative contributions from net sales (both retail and institutional) and asset appreciation:

- The chart illustrates that falling FUM in 2022 was driven by both a fall in asset values, and negative net sales.
- This was only the second year ever of negative net sales, driven by both retail and institutional withdrawals for a combined £49.7 billion.
- The only previous annual outflow had been £5.1 billion in 2018, but this was driven only by institutional outflows. 2022 is the first year of net retail outflows.

Chart 37 also serves to illustrate the extent to which the growth of industry FUM over the past decade has been driven by asset appreciation in the post global financial crisis era of extremely interest rates. In an environment of lower rates, it is uncertain what the trajectory for asset appreciation will be going forward.

CHART 36: TOTAL INDUSTRY FUNDS UNDER MANAGEMENT (2007-2022)

Source: The Investment Association

CHART 37: DRIVERS OF INDUSTRY GROWTH (1980-2022)

Source: The Investment Association

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32 Please see here for our UK Fund Market 2022 Year in Review: https://www.theia.org/sites/default/files/2023-04/UK%20Fund%20Market%202022%20Year%20in%20Review.pdf
RETAIL SALES IN A WIDER CONTEXT

While fund flows have historically displayed a certain level of volatility (see chart 38), until 2022 there had never been a calendar year in which retail flows turned negative. Previous disruptions, most notably the GFC and the Brexit Referendum result in 2016, triggered comparatively weak sales, dropping to £4.2 billion (2008) and £7.2 billion (2016) respectively. However, neither were sufficiently disruptive to cause overall annual outflows. Notably, each of these disruptions saw a strong bound back in the following years, with inflows exceeding £30 billion in each of 2009 and 2010, and a record £48.6 billion inflow in 2017. The year to date is seeing a much more modest rebound with cumulative inflows of £6.1 billion during H1 2023.

The Covid-19 pandemic stands apart from other major disruptions as not being associated with poor sales. While the outbreak of the pandemic in March 2020 did trigger record outflows of £9.7 billion, strong fiscal and monetary policy stimulus worldwide helped drive a rapid return of flows to funds within the same year, culminating in record inflows of £8.3 billion in November 2020 following successful vaccine trial announcements.

In strong contrast, 2022 saw a significant shift in the investment environment and outlook for UK retail investors who withdrew a net £25.7 billion while grappling with the rapid changes to the interest rate environment as central banks across the developed world increased interest rates to combat rising inflation. This was also notable for another reason: active funds saw record outflows of £36.6 billion, while indexing funds remained in inflow (see page 82).

The change in monetary policy through 2022 ended the era of extremely low interest rates that had been in place following the 2008 Global Financial Crisis (GFC), when rates were cut in an effort to support economic activity and QE began. Having raised rates by 0.15% in December 2021, the Bank of England implemented a series of further increases through 2022, with eight rises through the year for a combined 3.25% increase in the base rate. The combined increase through 2022 was the largest seen since 1988 when interest rates rose by 4.5% to reach 12.88%.

### CHART 38: TOTAL NET RETAIL SALES AND NET RETAIL SALES AS A PERCENTAGE OF FUM (2007-2022)

![Chart image](image-url)

- **Net retail sales**
- **Net retail sales as % of FUM (RH)**

Source: The Investment Association
As illustrated by chart 39, the sharp fall in interest rates following the GFC helped to trigger strong inflows in 2009 and 2010 as the search for returns, combined with shaken confidence in the banking system, drew investors away from cash and into funds. Following the outflows from funds as interest rates moved the other way in 2022, it remains to be seen how investors will respond should interest rates remain elevated for an extended period. Historic data from the 1990s do suggest strong impacts on flow at moments of volatility in interest rates. However, the industry has evolved and grown in both depth and breadth over the last thirty years, which makes it harder to extrapolate forward from the historic data.


Chart 40 illustrates the net flows shown in the previous chart at a quarterly level, providing more granular detail on investor responses to market disruptions. The contrast between the four quarters of heavy outflow in 2022 and previous events can be clearly seen – in both 2008 and 2016, only single quarters of mild outflow are observed.

Outflows at the end of 2018 are also observable. Prior to 2022, these included the worst quarter for sales recorded in IA data. While these outflows do correlate with an uptick in US-China tensions and the threat to global growth that posed, they are also tied to attempts to normalise monetary policy, especially in the US. Overall, chart 40 suggests that it is monetary policy, as much as economic fundamentals, that has determined the direction of fund flows in recent years.

CHART 40: QUARTERLY NET RETAIL SALES AND BANK OF ENGLAND BASE RATE (Q1 2007 - Q4 2022)
RESPONSIBLE INVESTMENT FUNDS

While we do not have the same historic data, due to successive changes in definition, some 6.6% (£90.8 billion) of total funds under management in 2022 were accounted for by responsible investment (RI) strategies, broken down here under the IA's Responsible Investment framework and referred to in this chapter as RI funds. However, as Chart 41 shows, the rate of FUM growth slowed sharply between 2021-22, with FUM up only 0.5% (£270 million), after an extremely strong 61.9% (£34.4 billion) increase in 2020-2021.33

CHART 41: RESPONSIBLE INVESTMENT FUM (Q1 2020 - Q4 2022)

Box 7: What is included in IA responsible investment data?

The responsible investment data presented here is defined according to the IA responsible investment framework as funds that have an investment policy/objective with one or more of the following components:

- Fund specific exclusions – prohibition of certain investments beyond any firm level policy, and beyond a prohibition on controversial weapons.
- Sustainability focus – An investment policy with sustainability criteria as a core part of the investment approach.
- Impact Investing – Investment made with the intention of generating a measurable positive social and/or environmental impact.

Funds employing ESG integration and/or stewardship alone without one of the components listed above are not included in IA RI data. Funds included within this data are those identified by managers as meeting the above criteria, with verification conducted by the IA.

33 There were 402 funds present in the IA responsible investment data by the end of 2022 – a 31% increase from the previous year. 56% of the new funds in IA responsible investment data were domiciled overseas.
Chart 42 illustrates the asset class distribution across different components that make up IA responsible investment funds. Equity funds have a higher weighting in each of the fund categories, most notably among impact funds where 78% of assets are in equity funds.

**CHART 42: RESPONSIBLE INVESTMENT FUND BY ASSET CLASS AND COMPONENT AS OF DECEMBER 2022**

SLOWER FLOWS THROUGH 2022

Following net retail inflows of £11.7 billion in 2020, and £15.9 billion in 2021, sales to responsible investment funds in 2022 dropped to £5.4 billion, a third of the 2021 inflow. RI net retail inflows in 2022 contrast with £31.1 billion in outflows from conventional (non-RI) funds. Even though the first two quarters accounted for most of the year’s inflows, positive flows persisted even after the industry shifted to outflow. Inflows to responsible investment funds remained strong through the first half of the year despite a challenging performance environment as natural gas and oil prices surged, investments which are often excluded by responsible investment funds.

**CHART 43: NET RETAIL SALES TO RESPONSIBLE INVESTMENT AND CONVENTIONAL FUNDS (Q1 2020 - Q4 2022)**

IN 2022

£91BN IN FUM SAT IN RI FUNDS

Source: The Investment Association
Equity and mixed asset funds drove the slowdown during 2022, falling from £13.1 billion inflows in 2021 to £2.0 billion. Fixed income was the top-selling across the asset categories in 2022, with £2.1 billion in inflows. There was a change in pattern towards the end of 2022 as responsible investment funds investing in equities and mixed assets started to move into outflows of £759 million and £477 million for the second half of the year, mirroring the move to outflows in these classes across the wider industry.

Increasing Importance of Indexing Funds

As chart 45 illustrates, an important further change over the last fifteen – and in particular – ten years has been the growth of the share of the UK fund market within index trackers, rising to a peak of 20.8% with £285 billion in funds under management by the end of 2022. Index tracking funds have seen growth in their share of FUM every year since 2008 and over the decade leading up to 2022 the growth of their market share was 10% per year.\(^34\)

\(^34\) The data presented in this section does not include ETFs which heavily tend towards being index trackers. For details on the growth of the use of ETFs please see Box 4 on page 54.
ACTIVE VS INDEX NET SALES

Overall sales trends mask some important sub-trends with respect to direction and persistence of the flows into indexing funds as part of overall industry activity. Looking back over the decade since the introduction of the Retail Distribution Review (RDR), Chart 46 shows two significant features of the market:

- The growing absolute share of sales to index trackers over the period.
- The greater consistency of inflows to indexing fund funds, contrasting with more volatile sales to actively managed funds, which saw outflows in 2018-2019 followed by a return to inflow in 2020-2021. Active outflows in 2022 reached a record £36.6 billion, while indexing funds saw an inflow of £11.0 billion.

CHART 46: NET RETAIL SALES TO ACTIVE AND INDEX TRACKING FUNDS (Q1 2012 - Q4 2022)

NET SALES BY TYPE OF FUND

Chart 47 shows annual net retail sales to index tracking funds, split by the type of index tracked:

- Global equity trackers have been the most popular index tracking funds over the past decade accounting for 28% of inflows and with consistent investor appetite.
- UK equities as a share of inflows declined from 15% between 2013 and 2017 to just 6% between 2018 and 2022. With the exception of 2022, UK equity index trackers have remained in inflow at a time when actively managed UK equity funds have been in consistent outflow.
- Fixed income index trackers have increased from 17% of net retail sales between 2013 and 2017 to 25% of sales between 2018 and 2022. This may reflect increased availability of fixed income index trackers, or an increased focus on the cost of fixed income funds in a period of lower interest rates when bond returns were lower.
- Mixed asset index trackers have likewise seen a growth in their share of sales, rising from 17% of net retail sales between 2013 and 2017 to 25% of sales between 2018 and 2022.

CHART 47: NET RETAIL SALES OF TRACKER FUNDS BY INDEX INVESTMENT TYPE (Q1 2012 - Q4 2022)

Source: The Investment Association
ASSET ALLOCATION

Illustrating trends in total funds under management over the past fifteen years, chart 48 shows the progression since the Global Financial Crisis. A number of key trends are evident:

- Having become a more significant part of the fund universe in the aftermath of the GFC, fixed income funds as a share of assets dropped to a 15-year low of 17.4% in 2022. As we explore later in this section, there has been a combination of outflow and asset depreciation as markets and investors adjusted to rising yields.

- The share of assets in UK equity funds has declined throughout the period, but much faster since 2016. By the end of 2022, the share of UK equity funds as a proportion of total UK FUM had dropped to 12.8%. This came despite a relatively strong year in performance terms, as investors accelerated withdrawals. While the share of funds in UK equities have fallen, UK investors as a whole do remain overweight on UK equities. Some 24% of UK investor equity funds are in UK specific sectors, while UK equities make up just 4% of a typical global equity index.

- Over the past 15 years, the ‘Other’ category has become much more significant. While growth through 2022 was driven by infrastructure and commodities, long-term flow has come from a move towards outcome focused funds, namely Targeted Absolute Return funds up to 2017, and Volatility Managed funds since the sectors 2017 launch.

CHART 48: FUM BY ASSET CLASS (2007-2022)

Source: The Investment Association
Turning to 2022 asset class analysis, UK investors in equity funds reacted strongly to the uncertainty of the year. Withdrawals reached record levels at £18.2 billion during 2022, accounting for 71% of the industry annual retail outflow; £23.0 billion was withdrawn from active equity funds while equity index trackers still saw inflows of £4.9 billion.

Looking back at the historic data collected by the IA over the last two decades, illustrated in chart 49, we make the following observations:

- Before 2022, there had been three annual equity fund outflows recorded in IA data (2008, 2016, 2019). The 2022 outflow is by far the highest outflow both in nominal and relative terms (£18.2 billion and 1.9% of equity FUM vs £8.8 billion and 1.6% in 2016)
- Until 2017, income investors had accounted for over half of the flows to equity funds since 2002. However, in the five years to 2021, UK retail investor flows to equity income sectors have been negative. 2022 saw the first annual inflow to equity income sectors in five years.

Despite industry outflows, the Global Equity Income sector attracted net retail sales of £2.8 billion as part of a wider shift towards income investing. 2022 marks the first annual inflow to the sector since 2017. Dividends in 2022 rose by 8.4% to a record £1.29 trillion according to the Janus Henderson Global Dividend Index. This inflow ranks as the second highest of the year across all sectors in nominal and relative terms.
European equities
European equity funds experienced a record £5.5 billion outflow in 2022, a substantial increase on both the £305 million outflow in 2021 and the previous highest outflow of £3.8 billion in 2019. Outflows in 2022 accelerated following the Russian invasion of Ukraine in February, which exerted significant inflationary pressures on European economies, particularly those heavily reliant on Russian natural gas, such as Germany.

While outflows were particularly exacerbated in 2022, they do continue a now five-year trend of outflows from European equity funds with £11.4 billion withdrawn since 2018. In an environment that has favoured growth stocks investors have shown a preference for higher growth regions – Asia and North America, or a broad geographic diversification.

UK equities
Despite better relative performance by the UK stock market, UK equity funds experienced a significant acceleration in outflows during 2022, reaching a record level of net withdrawals amounting to £12.0 billion. This seventh consecutive year of outflow surpassed the previous highest figure of £5.3 billion recorded in 2021. A combined total of £33.6 billion has been withdrawn by retail investors since the beginning of 2016.

North American equities
In 2022, the North American equity region saw net retail inflows of £687 million after a net retail outflow of £863 million in 2021. Despite US equity market underperformance compared to other markets, the North America sector attracted net inflows in the second and final quarters. Q4 in particular saw a recovery with £1.6 billion inflows, driven by early indications of US inflation peaking and expected Federal Reserve interest rate moderation, easing equity valuation concerns.

While other developed market funds in the European and UK sectors have seen continuous outflows over the past five years, North American funds have averaged £982 million annually in inflow, with only 2021 recording a net outflow. This would suggest investors are responding to the outperformance of US equities and that while the general trend is towards diversification, localised strong returns can still tempt investors.

Asian equities
Asian equity funds experienced significant outflows of £1.2 billion, representing the first annual outflow from the region since 2017. This outflow surpassed the previous highest outflow of £1.0 billion in 2015.

Following an extended period of inflow since 2016, Investors in Asian equity have faced headwinds through 2022 resulting from the pursuit of a zero Covid policy in China, restricting economic activity, and an increase in geopolitical tensions.

Japanese equities
Japanese equity funds experienced record outflows in 2022, with investors withdrawing a net £1.2 billion, following an inflow of £445 million in 2021. Japan’s economic performance has tended to differ from other major developed economies due to a long period of deflation, but joined in 2022 outflows. The cautious approach to Covid lockdowns, similar to China, has led to a slower reopening of the economy after the pandemic, impacting economic output. These near and long-term factors may have influenced investor sentiment, along with a preference for more globally diversified funds over single-market funds.
UK investors withdrew a record net £4.8 billion in 2022, more than double the previous record outflow of £2.0 billion in 2018. Outflows were heavily concentrated to the first quarter of the year as central banks across developed markets rapidly pivoted to tightening monetary policy to combat rising inflation.

Chart 51 illustrates the long-term trend of sales to fixed income funds. Owing to the large number of fixed income sectors run by the IA, a number of sectors have been grouped together for the purposes of this chart. There are a number of observations offered by the data:

- UK Gilt funds were among the few fund types to remain in inflow through 2022. Investor appetite for UK Gilts have been remarkably consistent over the past 15 years, with only one minimal outflow recorded in 2013, despite low interest rates pushing down returns and quantitative easing (QE) elevating prices.

- £ Strategic Bond funds saw outflows of £1.6 billion in 2022 continuing and exacerbating a period of weaker sales to the sector from 2018 to 2021. This contrasts with 2009 to 2017 when strategic bond funds enjoyed strong sales and took in 42% of bond fund inflows.

- The spike in inflows to unclassified and unallocated funds seen in 2021 as ‘Other’ was not sustained in 2022, although there were no outflows either. These funds are primarily those with vertical integration/restricted distribution and do not wish the wider visibility of the IA sectors system.

OUTCOME AND ALLOCATION

While funds in either equity sectors or fixed income sectors continue to dominate investor assets, the past 15 years have seen increasing uptake of outcome and allocation funds by UK investors. As Chart 52 shows, outcome and allocation have remained in inflow throughout the period, including in 2022, mainly driven by the Volatility Managed sector.

Allocation funds, also referred to as mixed asset funds, offer investors a diversified mix of equities and bonds, kept by the fund manager within a defined range and rebalanced as appropriate.

Outcome funds are those whose primary objective is to provide the investor with a set outcome, with freedom to select the best asset classes and investment strategy to achieve this. Within the IA sectors the Targeted Absolute Return sector and Volatility Managed sector are the primary examples.
Overall sales in the mixed investment sectors during 2022 were only marginally positive, driven by the Mixed Investment 40-85% Shares sector. The Mixed Investment 20-60% Shares sector (with a roughly even mix of equity and fixed income) saw accelerating outflows in 2022 as these funds struggled to shield investors from losses in a year with challenges for both equity and fixed income. As illustrated in the more granular chart 53, 2022 built upon the transition seen in allocation funds over the past 15 years. Investment shifted over the 2010s from primarily going to the Mixed Investment 20-60% Shares sector to Mixed Investment 40-85% Shares, which leans more heavily towards equities. In a decade where returns have been dominated by equity growth, investors have adjusted to favour equity-heavy funds.

Outcome funds meanwhile have seen a clear rotation from Targeted Absolute Return to Volatility Managed:

- Targeted Absolute Return funds enjoyed strong investor interest from 2008 to 2017, during which time they took in a net £27 billion. Since 2018 however there have been consistent outflows from the sector with £14.6 billion withdrawn from 2018 to 2022 amidst concerns over the long-term performance of these funds.

- Volatility Managed funds have enjoyed consistent popularity with investors, maintaining annual inflows even through the industry level outflow of 2022 and taking in a total £17.1 billion since the sectors 2017 launch.

Source: The Investment Association

**BOX 9: THE DIFFERENCE BETWEEN TARGETED ABSOLUTE RETURN AND VOLATILITY MANAGED FUNDS**

**Targeted Absolute Return** – funds target a positive return over all market conditions, within a set timeframe.

**Volatility Managed** – managers target returns within certain volatility parameters, ordinarily offering a range of risk appetites for investors or advisors to select from.
Property Funds

As can be observed in chart 54, property fund FUM amounted to £21.6 billion in 2022, falling by 23% from 2021 and registering a 32% decrease from the peak of £32 billion in 2015. The 2021-2022 fall was the second largest in the last fifteen years, behind a steep 36% year-on-year decrease in 2008 during the Global Financial Crisis. While sales are a factor, performance has been the primary driver of shifts in FUM.

Valuation uncertainties in property funds during the pandemic, persistent outflows and liquidity mismatch perception following post-Brexit referendum suspensions, and trends such as the long-term decline of the UK high street or the adoption of remote working have contributed to the decline in property FUM post 2015. Moreover, UK property funds, with higher weightings to retail and office commercial real estate, were additionally adversely affected by the negative outlook for UK economic growth which has affected consumer demand and constrained company growth.

Chart 54 shows that net retail sales for the property sector registered £633 million in outflows in 2022, contributing to 16% of the total negative balance from 2016 (−£4 billion). The series of outflows registered after the Brexit referendum contrasted with a positive trend that recorded £12.6 billion in inflows from 2007 to 2015, with a peak of £3.1 billion invested in property funds in 2014, and the only exception of £500 million withdrawn back in 2008.

However, the overall flow data disguises a more nuanced picture across different kinds of property fund. Chart 55 illustrates a breakdown of net retail sales by type of property funds in the last decade:

- Direct property funds have been facing challenges since 2016, contributing to a total outflow of -£5.3 billion over 2016-22. Following Brexit, large redemption requests led to the suspension of dealing. In March 2020, dealing was again halted due to valuation uncertainty brought on by lockdowns. Commercial property values depend on rental income, and lockdowns made it difficult to value properties due to limited commercial activity. As a result, property funds faced significant redemptions in late 2020 and early 2021 after suspensions were lifted, but this decreased by late 2021. In 2022, there has been a rise in outflows from UK Direct Property funds once again.

- As chart 55 shows, funds investing in more liquid property securities, which were not forced to suspend in 2016 or 2020, have seen consistently positive net retail sales totalling £2.5 billion since 2016. This suggests that the outflows from direct property funds are the result of the liquidity issues rather than negative sentiment towards property as an asset class, which continues to remain a popular source of income.

Chart 55: Net Retail Sales by Type of Property Fund (2012-2022)
**BOX 10: DIFFERENT TYPES OF PROPERTY FUNDS**

**Direct property funds** invest in physical property, typically of a commercial nature. The less liquid nature of physical property poses challenges for daily dealing funds.

**Property security funds** invest primarily in property securities through equities, which are more liquid than physical commercial property but whose valuation will reflect wider sentiment towards the individual security and the market.

**Hybrid funds** take a mix of direct and listed property and are therefore seen as having more liquid underlying assets. Additionally, they often have a global investment universe with greater diversification across geographies, helping to mitigate concentration risk.

**FUNDS OF FUNDS**

2022 saw a continuation of the recent trend of preference for internally-invested funds of funds (FoFs), with inflows of £3.4 billion, outselling externally-invested FoFs, which saw an outflow of £783 million. Internally-invested FoFs are frequently able to offer diversification through internal index tracking funds (i.e., funds run by the same investment manager), although coming at a trade-off in terms of a more restricted range of underlying investments. A more persistent appetite for lower cost investment products, mirrored in the more persistent inflows to index trackers in the wider market, likely explains the stronger sales to internally invested funds of funds over recent years.


Source: The Investment Association

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36 Internally invested funds of funds are funds that invest in other funds run by the same asset manager, whereas externally invested funds of funds invest in funds run by other asset managers.
**DISTRIBUTION CHANNELS**

Chart 57 illustrates the net retail sales across the UK funds industry, divided by distribution channel:

- The long-term trend of outflows through Direct channels continued and accelerated in 2022, as the industry continues to move away from the model of investors accessing funds directly via the fund manager.

- UK Fund Platforms, though appearing less dominant in the distribution landscape than a decade ago, remain central to fund distribution, with UK Fund Platforms the only major distribution channel to have seen inflows continue through 2022.

- Discretionary Managers, through whom there were consistent inflows from 2013-2017, have continued to see outflows over the past few years. At least part of this movement to outflows is the result of a structural shift as Discretionary Managers move away from portfolios of funds towards a greater use of segregated mandates.

- Flows through ‘Other Intermediaries including IFAs’ have becoming increasingly significant in recent years, helping to drive strong sales in 2017, 2020 and 2021, but also being the lead driver of outflows in 2022.

**HOLDING PERIOD**

Investor average holding periods continued to hold steady in 2022 at an estimated 3.5 years, with the trend of declining holding periods over the 2010s having potentially bottomed out. Increased use of fund platforms have likely been key in reducing barriers to buying, selling and switching funds, reducing average holding period over time.

Another factor contributing to the fall is the move to centralised investment propositions (CIPs). Following RDR, the FCA has encouraged financial advisers to introduce a standardised approach to investing by using CIPs. These are often provided through advisory or discretionary ‘model portfolios’ of funds, with an investment committee advising on the allocation of the portfolio to cater for clients with different risk tolerances. Model portfolios are adjusted on a quarterly basis, which has also contributed to lowering average holding periods.

As shown in chart 58 there has been an apparent levelling off of the decline in holding periods from 2018. With funds typically promoted as medium to long-term investments, this may represent a natural floor to how short holding periods will get.

**CHART 57: NET RETAIL SALES BY DISTRIBUTION CHANNEL (2013-2022)**

**CHART 58: RETAIL INVESTOR AVERAGE HOLDING PERIODS (2007–2022)**

Source: The Investment Association
THE UK IN THE CONTEXT OF THE EUROPEAN FUNDS MARKET

Whilst the UK is an international investment management centre managing assets on behalf of clients all over the world, in the UK retail market funds are predominantly domiciled in the UK and Europe. Overseas investors in UK domiciled funds have traditionally been principally European. Since the Brexit referendum, we have analysed how the profile of investors in UK domiciled funds is changing. We also assess the share of UK Investor FUM in overseas domiciled funds (which are mainly Ireland and Luxembourg domiciled) and track net retail sales by different types of fund structure including SICAVs and ICAVs to see if there is a material shift in sales patterns ahead of the end of the Temporary Permissions Regime.

OVERSEAS INVESTORS IN UK-DOMICILED FUNDS

As of the end of 2022, the total amount of money managed by UK-based funds, both on behalf of UK and Overseas investors, fell to £1.20 trillion from £1.39 trillion a year earlier (see chart 59). This was mainly caused by asset depreciation, with a lesser impact from investor outflows:

- Total FUM on behalf of UK investors in UK-domiciled funds fell to £1.14 trillion from £1.33 trillion in 2021.

- Total FUM in UK-domiciled funds from overseas investors increased by 9.6% to £58 billion in 2022, reaching almost 5% of the total investments in UK-domiciled funds, but still far from the record £87 billion figure registered in 2017. 2018 saw a sharp drop in overseas clients in UK domiciled funds, ahead of the original Brexit date.

CHART 59: UK AND OVERSEAS INVESTORS IN UK DOMICILED FUNDS (2012-2022)

<table>
<thead>
<tr>
<th>Year</th>
<th>£bn</th>
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<td>2018</td>
<td>900</td>
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<td>2019</td>
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<td>2020</td>
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<td>2021</td>
<td>600</td>
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<td>2022</td>
<td>500</td>
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Source: The Investment Association
UK INVESTORS AND OVERSEAS-DOMICILED FUNDS

The UK’s total investment in funds domiciled overseas stood at £228 billion as of the end of 2022. Although this was a decrease of 12% from the previous year, it still comprises the highest proportion of total UK investor FUM seen in the past decade, with a share of 17%. This means that UK-domiciled funds stand at 83% of FUM, declining from 90% in 2016.

A fall in allocation to fixed income funds since 2020 has acted against the trend towards growth in the overseas share – just under a third of fixed income FUM is in overseas funds, against 15% in overseas funds for the industry overall.

SALES TO UK AND OVERSEAS FUND TYPES

In 2022, all fund types but Overseas Unit Trust funds registered record outflows in net retail sales. Outflows from ICVCs dominated the net outflows of 2022, however SICAVs played an outsized role making up 15% of outflows despite accounting for just 3% of UK investor FUM. This follows the established pattern of investors favouring overseas ICVCs over SICAVs with SICAVs struggling to attract sales even in periods of overall inflows (see chart 61).

Outflows from overseas OEIC/ICVC funds in 2022 were largely driven by net withdrawals from fixed income funds, reversing some of inflows to overseas fixed income funds between 2017 and 2020. In contrast outflows from UK domiciled OEIC/ICVC funds were predominantly from equity funds.