5 UK RETAIL MARKET

KEY FINDINGS

MARKET OVERVIEW

- In 2023, UK investor funds under management (FUM) increased by 4%, rising to £1.43trn from £1.37trn in 2022. However, FUM remained 10% below the 2021 peak of £1.59trn.
- Net outflows (institutional and retail) continued for the second consecutive year, reaching £57.8bn, up from £50.3bn in 2022.
- Net retail sales were -£24.3bn in 2023 as retail investors grappled with the impact of higher interest rates. Higher cash savings rates drew some capital away from funds and for many investors, monthly expenditure on paying off mortgages and credit cards increased affecting the ability of some to save and invest.

ASSET ALLOCATION

- Equity FUM has remained relatively stable dropping from 57.7% of total FUM in 2008 to 53.6% in 2023. The shift toward overseas equities has continued and allocations have increased from 28.1% in 2008 to 42.0% in 2023, while UK equity allocations have declined sharply from 29.6% to 11.5%.
- Over the long-term, FUM in fixed income has been broadly stable fluctuating between 18% and 22% from 2008 to 2021. However, the 2022 depreciation in bond prices saw fixed income FUM drop below 18% for the first time to 17.4% at the end of 2022, rising slightly in 2023 to 17.7%.

RETAIL INVESTORS IN 2023

- In 2023, 39% of UK adults actively invest, according to IA & Ipsos survey data. Of these investors, around a third began investing during the pandemic.
- UK investors are younger than the wider population with just under half (42%) aged 18-35 years old compared with 35% of all UK adults. A higher proportion of investors are men (63%) compared with women (37%). 17% of investors are from ethnic minorities: 18-24 year olds are the most diverse group with 32% of investors from non-white backgrounds.
- Younger investors (18-24) are more likely to hold cryptocurrencies: 46% report holding cryptocurrency, compared with just 7% of investors aged 55-65. Younger investors view cryptocurrencies as a core part of their portfolios and peer influence plays a key role in adoption. However, 38% of young investors also invest in funds and a further 44% hold a stocks and shares ISA.
- The average fund holding period for retail investors is 3.6 years in 2023.

INDEX TRACKERS

- In 2023, 22.7% of UK investor FUM was in index tracking funds (excluding ETFs). FUM in index tracking funds has grown every year for the past fifteen years, with average annual growth of 9.1%.
- Over 2023, net retail outflows from active funds were £31.8bn and inflows to index trackers were more resilient at £13.8bn. In the last decade, net retail sales to actively managed funds were £21.1bn whereas index tracking funds attracted £116.5bn in inflows.

RESPONSIBLE INVESTMENTS

- FUM in responsible investment funds was £102bn in 2023 - 7.2% of industry FUM. Equity funds make up 63% of responsible FUM and bond funds account for 15%.
- Investors pulled £3bn from responsible investment funds in 2023 as more challenging performance conditions for equities combined with the outperformance of funds investing in oil and gas stocks through 2022, which most sustainable and responsible funds exclude.

NET RETAIL SALES BY INVESTOR OBJECTIVE

- In the period following the Global Financial Crisis, sales to **equity growth funds** benefited from low interest rates and strong market performance. As market conditions have shifted, equity growth funds account for the majority of outflows in 2023 at £15.4bn.
- **Equity income strategies** were popular through the early 2010s but demand for equity income fell between 2017 and 2021. Equity income funds saw a brief return to inflow in 2022 (£1.3bn) but in 2023 retail investors pulled £1.9bn from funds pursuing this objective.
- Appetite for **fixed income** funds remained broadly strong through the 2010s with the highest inflow of £14.0bn recorded in 2017. In 2022, rapidly rising interest rates hit bond prices and investors withdrew £4.8bn but in 2023 bond prices stabilised and fixed income funds saw inflows of £2.4bn.
- **Outcome and allocation** funds have attracted strong sales over the last decade as investors have increasingly opted for funds providing investment solutions and diversification across asset classes. Between 2012 and 2021 they accounted for 46% of all fund inflows. In 2023, however, outcome and allocation funds recorded their first annual outflow of £6bn following weak sales of £2.1bn in 2022.

DISTRIBUTION TRENDS

- Investment platforms, which have historically dominated fund distribution, saw their first outflow in 2023 as UK investors withdrew £2.4bn, following inflows in 2022 of £5.7bn. Platform outflows in 2023 are only a tenth of the total outflow for the year, however. The discretionary managers channel saw net withdrawals rise to £6.4bn and other intermediaries including IFAs saw net retail outflows of £12.7bn.

THE UK IN THE CONTEXT OF THE EUROPEAN FUNDS MARKET

- UK domiciled FUM was £1.26trn in 2023, incorporating assets managed on behalf of both UK and overseas clients. This is up 5% on 2022. UK investor FUM in overseas domiciled funds was £228bn in 2023 – unchanged year on year.
- In 2023, FUM for funds domiciled in Luxembourg was €5.8trn and €4.1trn for Irish domiciled funds according to data from EFAMA. FUM in UK domiciled funds was €1.9trn. Of the three domiciles, only Ireland ended 2023 with higher FUM than at the end of 2021, following 12% growth in 2023.

Chapter 5 explores the UK funds market, focusing on trends in funds under management and net sales, with a particular focus on sales through retail investment channels. The data in the chapter differs from the rest of the report in that it represents UK investor funds under management in UK authorised and recognised funds that are domiciled both in the UK and overseas.

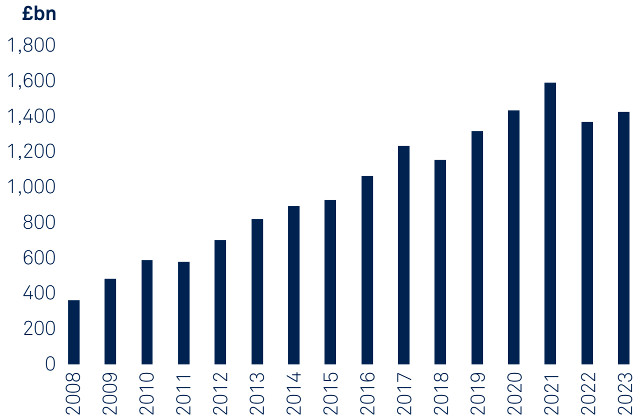
The chapter examines UK investor patterns of asset allocation across the major asset classes over the long term and how net retail sales have been affected by more challenging market conditions through 2022 and 2023. It also considers the evolution of sales to index trackers and sustainable investment funds and looks at sales by the major distribution channels. Lastly, it places UK funds in a European context assessing how the UK's growth as a fund domicile compares with the cross-border centres of Luxembourg and Dublin.

This year, we also look at how the UK investor base is changing, using data from a comprehensive study of UK investors conducted with Ipsos in 2023. The focus of the Investment Management Survey is on long-term trends in the retail funds market over the last 15 years. For a more detailed exploration of trends in the retail funds market through 2023, please see our report, "UK Funds Market – 2023 Year in Review."[29]

FUNDS UNDER MANAGEMENT

UK investor FUM partially recovered in 2023, reaching £1.43 trillion by the end of the year[30]. This is up 4% on FUM of £1.37 trillion at the end of 2022, a £56 billion increase in absolute terms, and is a similar percentage increase to AUM, which grew by 3%. However, FUM remained 10.2% below the 2021 peak of £1.59 trillion . Over the course of 2022, FUM fell by 13.8%, in line with the 12% fall in AUM.

CHART 36: TOTAL INDUSTRY FUNDS UNDER MANAGEMENT (2008-2023)



Source: The Investment Association

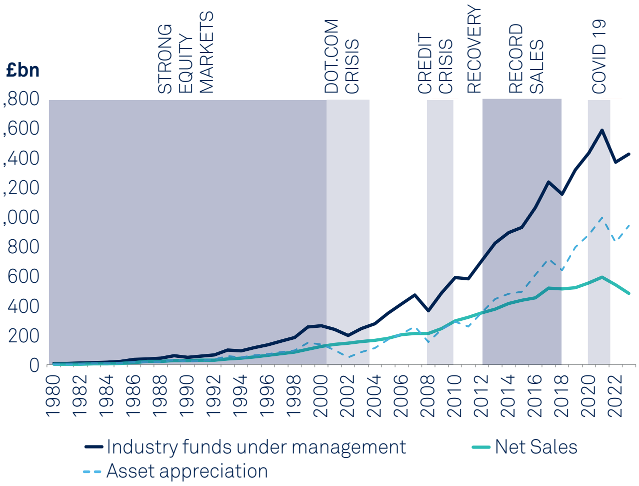
[29] Please see here for our UK Fund Market 2022 Year in Review: https://www.theia.org/sites/default/files/2024-09/market-insight-commentary-2023-and-q1-2024.pdf

[30] Investment Association funds under management data includes both retail and institutional assets.

Chart 37 shows the growth of the UK funds market since 1980 and demonstrates the role played by both asset appreciation and net sales showing that since 2012, asset appreciation has been the largest contributor to FUM growth. For this chart, net sales includes both retail and institutional flows:

- Over the longer term when markets perform well, driving asset appreciation, net sales also increase. In the high growth years of 2017 and 2021 assets appreciated by 10.0% and 8.1% and sales rose by 6.3% and 2.6%. However, in 2023, whilst markets recovered, outflows continued. This is the first time that we see this trend in the data.
- When markets performed poorly in 2008, as a result of the Global Financial Crisis, sales helped to support FUM growth because a significant cut in interest rates made cash savings relatively unattractive and capital flowed back to funds. In 2018, while assets depreciated by 6.1%, net sales were flat with only minimal outflows.
- 2023 saw a disconnect between asset appreciation and net sales. While market performance meant asset appreciation resumed the pre 2022 upwards trend, outflows continued at a similar pace to 2022. With institutional flows included, outflows rose from £50.3 billion in 2022 to £57.8 billion in 2023. 2023 is only the third year of negative net sales[31] and the first time we have seen two consecutive years of outflow.
- The impact of higher interest rates on investor behaviour in 2023 is a significant factor. For retail investors, this meant higher cash savings rates drawing capital away from funds and for many investors, the cost of paying off mortgages and credit cards rose in 2023. Higher interest rates also meant that investors were adjusting to a new market cycle after nearly 15 years, which favours different types of asset and investment strategies. Yet, whilst inflation was beginning to calm it remained persistent, presenting an uncertain outlook.

CHART 37: DRIVERS OF INDUSTRY GROWTH (1980-2023)



Source: The Investment Association

[31] In 2018, institutional and retail sales combined were also in net outflow at £5.8 billion.

BOX 7: A NEW RETAIL AGENDA

While just a quarter of all UK managed assets are managed on behalf of retail investors, this proportion has been rising steadily since 2020 and there continues to be a push among policy makers in the UK and Europe towards encouraging greater retail investor participation in capital markets.

Given the growing prominence of retail investor assets in a heavily intermediated market, it is becoming ever more important to understand the profile of UK investors, including the demographics of the investor base, their appetite for different products, investment goals and potential barriers to entry. In 2023, the IA commissioned Ipsos to carry out a survey to provide some insights on UK retail investors.

RETAIL INVESTOR PARTICIPATION RATES IN THE UK

Much comparison has been made between capital market participation rates in the UK and US. The perception of a more active culture of investing in the US stems from data that suggests that two thirds (61%) of American adults have money invested in the US stock market according to Gallup. While many older UK adults were introduced to share ownership through the privatisation of nationalised industries in the 1980s, this failed to convert the majority of adults into becoming more active investors. The IA survey found that as of 2023, less than half (39%) of the adult UK population were actively investing in products such as individual stocks and shares, stocks and shares ISAs, investment funds and trusts, individual investment bonds and cryptocurrencies. Of these investors, about a third began investing in the period following the start of the COVID-19 pandemic in early 2020.

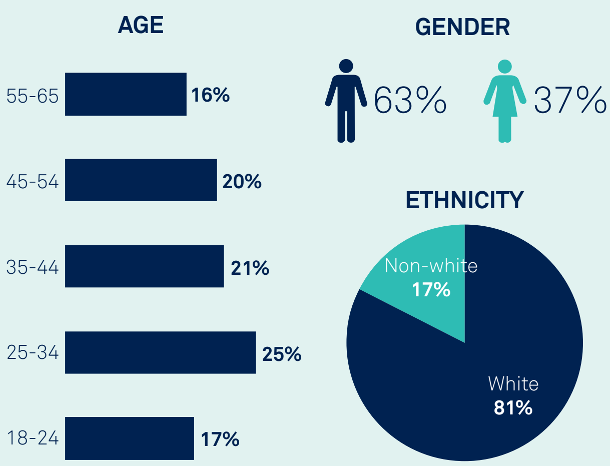
DEMOGRAPHICS OF THE UK INVESTOR BASE

Figure 10 provides a more detailed snapshot of the UK investor base in2023, with a focus on age, gender balance and ethnicity.

We find that:

- UK investors are younger than the wider population with just under half (42%) of the investor base aged 18- 35 years old compared with 35% of all UK adults under the age of 65.
- The investor base in the UK is dominated by male investors, who account for 63% of all investors compared with 37% of female investors. Research by Boring Money finds that the gender investment gap in the UK stands at £567 billion as of January 2024. Our survey suggests a slightly improved balance among those who began investing post-pandemic (41% of new investors being women) but there needs to be a bigger push to encourage more female participation if we want to see greater gender parity in investing.
- Overall, non-white investors are a slightly higher proportion of UK investors compared with the UK adult population, accounting for 17% of investors compared with 14% of the general UK population. The youngest cohort of investors (18-24 year olds) is the most diverse, with 32% of investors from non-white backgrounds and this compares with just 5% of the 55-65 year old group of investors.

FIGURE 10: DEMOGRAPHIC SNAPSHOT OF THE UK INVESTOR BASE (2023)

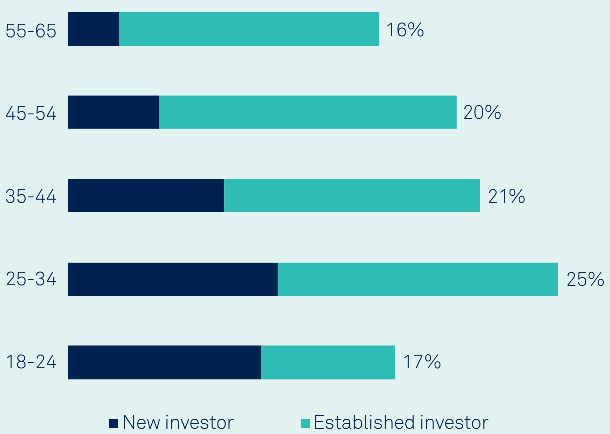


Source: The IA and Ipsos

A NEW GENERATION OF INVESTOR – RETAIL INVESTORS ARE GETTING YOUNGER

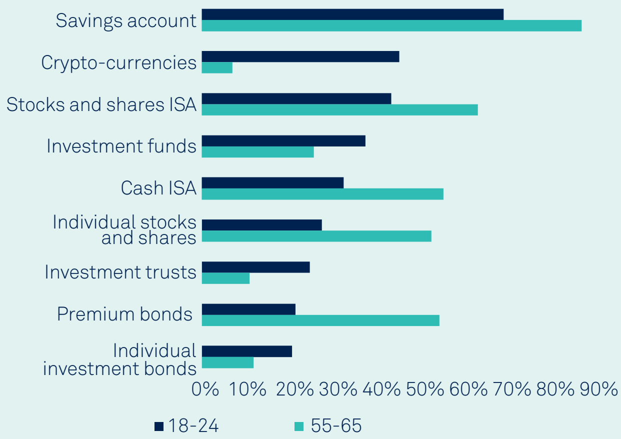
During the COVID-19 pandemic, many young working adults were able to build up their savings pots over successive lockdowns. The rise in savings, combined with time and increased focus on investing via a number of different social media channels, were key drivers of the growing interest in investing over that period. Today, this has contributed to a younger investor profile, with over half (58%) of post-pandemic first time investors falling in the 18-34 year old bracket. It is therefore important to investigate the differences in attitudes towards investing among older investors, who currently account for the majority of wealth, and the younger investors who are set to become the biggest inheritors of wealth.

CHART 38: THE PROPORTION OF UK INVESTORS IN DIFFERENT AGE GROUPS SPLIT BY NEW AND ESTABLISHED INVESTORS (2023)



Source: The IA and Ipsos

CHART 39: THE PROPORTION OF 18-24 YEAR OLDS HOLDING DIFFERENT SAVINGS AND INVESTMENT PRODUCTS COMPARED WITH THE 55-65 AGE GROUP (2023)



Source: The IA and Ipsos

The survey finds that the products younger investors use to save and invest are changing compared with those of older investors aged 55 to 65. Chart 39 contrasts the products held by the youngest investor segment by age, the 18-24 year olds, with the oldest age group, the 55-65 year olds. Cryptocurrencies are held by 46% of 18-24 year olds compared with just 7% of investors aged 55 to 65. This is higher than the percentage of younger investors who hold a cash ISA (33%). Premium bonds are the third most popular savings and investment product for the over 55's (55%) but are not on many younger investors' radar – 22% hold them. Among the oldest age group, ownership of individual stock and shares is high, with over half (53%) of investors in this cohort directly owning shares in companies compared with 28% of young investors.

Young investors (38%) do invest in funds and a further 44% hold a stocks and shares ISA. Indeed, tax efficient investing through ISAs is the most popular choice of product across all age groups except the youngest cohort of investors, who have a slight preference for cryptocurrencies.

BOX 7: A NEW RETAIL AGENDA (CONTINUED)

MAINTAINING MOMENTUM: MAKING INVESTING MORE ACCESSIBLE TO YOUNGER INVESTORS

Our research suggests that younger investors see cryptocurrencies as a standard product in their investment toolkit and that investor take-up of cryptocurrencies accelerated through the pandemic. In aggregate, in 2023 over a third (37%) of UK investors hold cryptocurrencies within their portfolios. The majority of investors holding cryptocurrencies (65%) made their first investment at some point after the COVID-19 pandemic and two-thirds hold the asset alongside other savings and investment products.

The survey shows that 41% of investors who are educated to Master's degree level or above hold cryptocurrencies compared with 36% who hold investment funds, although 59% of the best educated group hold a Stocks and Shares ISA. We also found that 41% of investors earning over £45,000 hold cryptocurrencies, classed as higher earners based on national average earnings, suggesting that cryptocurrency investors are often highly educated and relatively high earners. They are also more likely to be men as 40% of male investors hold cryptocurrencies compared with 30% of female investors. This compares with 41% of male investors holding investment funds and 56% holding S&S ISAs. Although over half (55%) of young investors (aged 18-34) are invested in crypto, the survey suggests that the asset is not, as is often perceived, predominantly the domain of the young, with 41% of investors aged 35-54 also investing in the asset class.

By analysing some of the reasons that younger investors are opting for cryptocurrencies, we can think about ways to improve access to investment funds:

- It is easy to set up accounts and start investing through neo brokers that take a digital/mobile first approach. The ability to access and manage investments through a mobile app is key to attracting investment from the younger and middle cohort of investors. Over half of investors below the age of 44 invest primarily through a mobile app, which drops to 20% among investors aged 55-65.
- Younger investors often want to invest small amounts more frequently and can build up their investments in cryptocurrencies with low, or no trading fees. Over half (53%) of investors in cryptocurrencies invested less than £500 at the time of making their first investment (of which 28% started off with less than £100). Investors in cryptocurrencies are aware of the risks of losing it all but once they start to build up meaningful investment portfolios, they think about protecting their investments and may look to funds or ETF model portfolios to diversify their assets and to manage their investment risk. We find that direct fund investors typically make their first investment with significantly larger pots, with over half investing at least £1000, and a third investing at least £5000 on their first investment.
- Cryptocurrencies are the most likely savings and investment product to be recommended by other people at 36% compared with 23% for a S&S ISA and 27% for investment funds. Investors trust peer recommendations and social media amplifies positive messaging about cryptocurrencies. For funds and investments the lack of clarity over the line between advice and guidance has created an advice gap and hampers the industry's ability to create a conversation about investing and funds.

We believe that there are four important measures that need to be implemented to help us to engage younger investors to drive better long-term investment outcomes:

- Focus on genuinely decision-useful information for customers as part of digitally and likely AI-enabled delivery.
- Work towards building a simpler but still fully accountable and transparent system and leave behind the focus on complex issues such as MiFID costs and charges.
- Create more opportunities to have a different kind of conversation with customers to nudge behaviours.
- Clarify the boundary between advice and guidance.

5

NET RETAIL FLOWS IN CONTEXT

Chart 40 shows net retail sales annually from 2008 to 2023, demonstrating that the long term trend of healthy inflows to funds through retail channels has been disrupted in the past two years. Over time, funds under management have grown and the industry in 2023 is considerably larger than it was in 2008. To better compare the scale of net sales in 2008 with 2023, the line on the chart shows net sales as a percentage of industry size (FUM), tracking the right-hand axis.

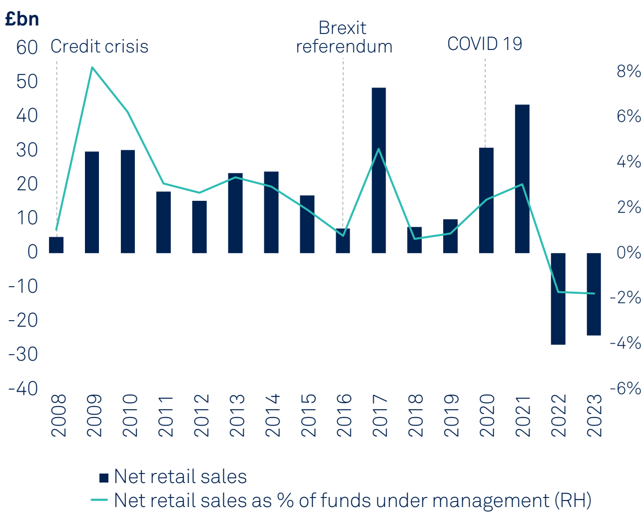
Following the Global Financial Crisis in 2008, the funds industry saw strong sales in 2009 and 2010 of £30 billion annually, as low interest rates on cash savings products and weakened trust in the banking system among some investors helped draw investors to place their capital into funds. Net retail sales in 2009 equate to 8.2% of FUM and to 6.2% in 2010. This demonstrates the strength of the recovery in net retail sales following the Global Financial Crisis. Although net retail sales were higher in 2017 and 2021, they accounted for 4.6% and 3.0% respectively of industry FUM.

Inflows again surged to £44 billion (3.0% of FUM) during the COVID-19 pandemic as in the UK, the US and Europe, central banks cut interest rates further to kick start stagnant economic growth following lockdown. The announcement of a successful vaccine trial in November 2020 saw market performance recover globally, while households forced to curtail discretionary spending by lockdown measures were able to save more and many chose to invest, boosting inflows.

The pattern of inflows changed in 2022, as persistently high inflation towards the end of 2021 triggered a cycle of interest rate rises from central banks. Then in February 2022, the Russia-Ukraine war caused a market shock, sending inflation soaring amid an energy price spike in Europe due to Russia's influence over gas supply. This market turbulence and the monetary policy response to raise rates further caused the price of equities and bonds to fall in tandem, meaning that cautious investors holding a high percentage of bonds in their portfolios saw steep falls in performance. In 2022, investors pulled a record £26.9 billion from funds – 1.7% of FUM. Despite the market disruption seen following the September 2022 gilt crisis, particularly among pension funds employing LDI strategies, the impact on retail investors was muted with only one month of modest outflows from the UK Gilts sector in October 2022 (of £339 million) before a return to inflow to the sector in November.

2023 saw other factors at play that contributed to the second consecutive year of outflows. Outflows have eased slightly compared with 2022 (£26.9 billion to £24.3 billion) but make up a slightly increased percentage of a smaller industry FUM (1.7% to 1.8%). Rather than being directly linked to performance, outflows in 2023 will have been more heavily influenced by alternative draws on investor capital such as high rates on cash savings and the increased costs of paying off debt.

CHART 40: TOTAL NET RETAIL SALES AND NET RETAIL SALES AS A PERCENTAGE OF FUM (2008-2023)



Source: The Investment Association

THE FACTORS INFLUENCING THE 2023 OUTFLOW

Capital markets began to recover through 2023 and the long-term trend, as shown in Chart 40, is to a recovery in sales when market performance rebounds. This did not happen in 2023 and here, we examine why. Higher interest rates had a significant impact on retail investor behaviour, the Bank of England (BoE) continued to raise the base rate incrementally until August 2023 reaching 5.25%, the highest rate since February 2008. In the US and Europe, we saw a similar pattern of rate rises from the Fed and the ECB through 2023.

There are three important ways that this may have influenced net retail sales in 2023:

- **Equity market performance:** higher interest rates can negatively affect company earnings (apart from in the financials sector) and companies that are valued on their future earnings or cash flows (so-called growth-stocks) see their valuations fall further because their future cash flow is discounted at a higher rate. In 2023, outflows from equities were the highest of any asset class at £22.4 billion.

- **Higher cash savings rates:** fixed rates for new cash ISA customers peaked at 5.35% in October 2023 and according to BoE data, inflows to cash ISAs in 2023 were £47.2 billion. This drew some investors away from funds into cash.

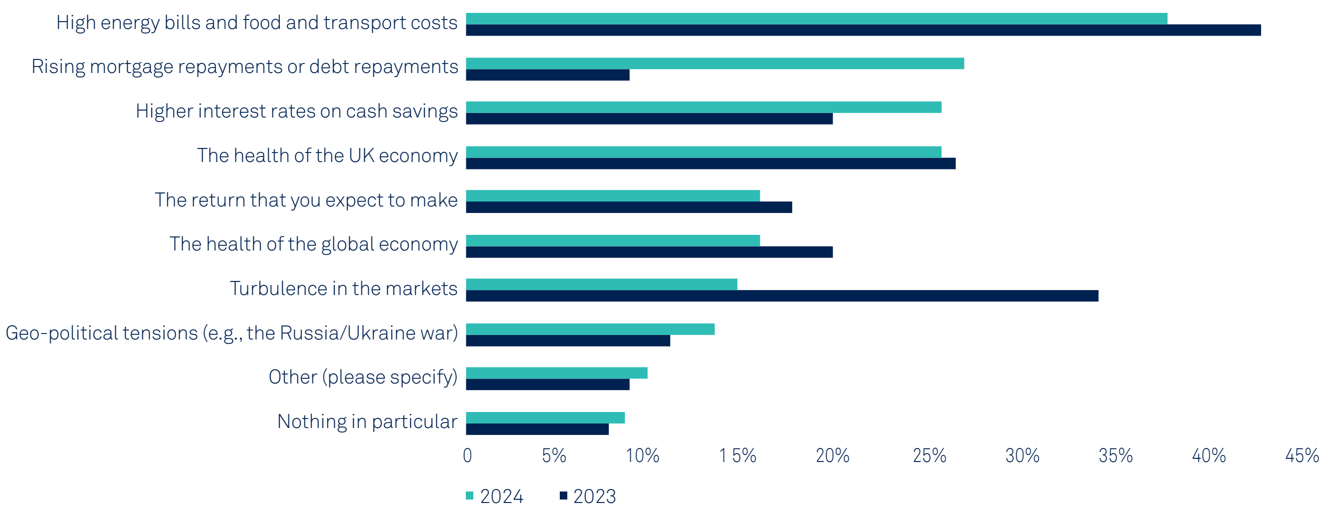
- **Higher interest rates on debt repayments:** Investors now have higher repayment rates, which could make it harder for them to put money aside to invest. In the UK, the gilts crisis in September 2022 also had a significant impact on pushing up available mortgage rates. Bank of England data show that 1.43 million people re-mortgaged in 2023 and 57% were re-mortgaging from rates of 2% or less and were likely to experience a significant increase in monthly repayments.

THE FACTORS INFLUENCING INVESTORS WHO INVESTED LESS IN THE 2023/24 TAX YEAR

Chart 41, taken from investor research conducted by the IA alongside Opinium, shows the reasons given by investors decreasing their allocations to stocks and shares ISAs in the tax year ending in April 2024. It is important to note that only a minority (14%) of investors stated they were decreasing their allocations.

- For those who were cutting back on investment, higher bills and household expenses remained the top concern, though slightly less so than in 2023.

CHART 41: FACTORS AFFECTING INVESTORS WHO HAVE REDUCED STOCKS AND SHARES ISA ALLOCATIONS (2023-2024)



Source: The Investment Association, Opinium

- Turbulence in the markets has fallen away significantly as a source of investor concern as the impact of the rapid cycle of interest rate rises fades and as we move further away from the February 2022 market shock following the start of the Russia-Ukraine war.

- Rising mortgage or debt repayments have become increasingly important for some investors. Many mortgage holders have fixed term mortgages, meaning that the effective interest rate on the outstanding stock of mortgage debt of UK households (£1.7 trillion) continues to rise. According to Bank of England data the effective rate rose 0.86% over 2023, to 3.36%.

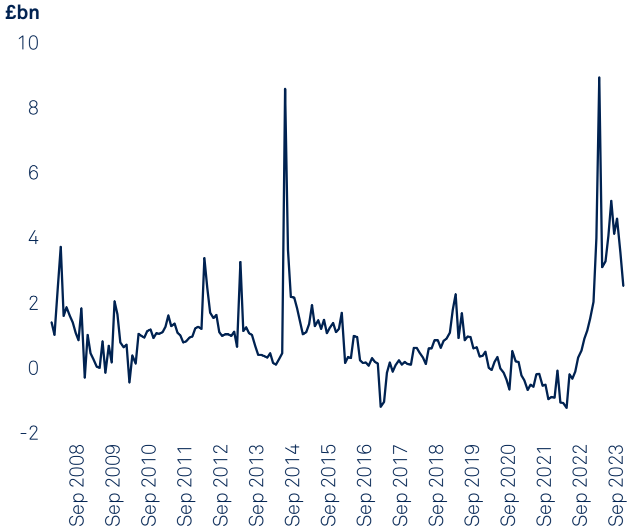
- Higher rates on cash savings are increasingly drawing investors away from funds. As interest on cash savings have increasingly caught up with the Bank of England base rate, cash has become a more attractive alternative to investment in funds.

THE IMPACT OF HIGHER CASH SAVINGS RATES ON NEW INVESTORS

According to Bank of England data, illustrated in Chart 42, cash ISAs received inflows of £47.2 billion in 2023, more than the total inflows of the previous eight years and surpassing the previous record of £28 billion in 2001. Alongside the improved rates on cash savings, cash also offers investors liquidity and a fixed return against the more variable short terms returns of investment funds. Investors anticipating changes in circumstances within a couple of years might therefore be inclined to opt for cash. However, over the medium to long term (5+ years) investments in funds traditionally outperform cash. According to our analysis, over the ten years from 2013 to 2023, investing £10,000 in a cash ISA would have left the cash saver with £8,448 at the end of the period adjusting for inflation. If the £10,000 had been invested in a mixed portfolio of stocks and bonds, it would have been worth £10,686 over the same period and investing into a typical global equity fund would have netted the investor £18,140.

When we asked 1000 investors in our survey with Opinium about their primary motivation for investing in a stocks and shares ISA, 50% said that it was because they believed that investing would deliver them a better return than cash over 5 years and 77% agreed that they take a long-term view of investing irrespective of the rise and fall of markets. However, there were differences in the data. 62% of seasoned investors with 10 years or more experience used a stocks and shares ISA because they believed that investing would beat cash over 5 years. For new investors with one year's experience or less, this fell to 38%. Just 29% of 18-34 year olds chose investing beating cash as a major motivation for using a stocks and shares ISA compared with 61% of over 55s. Younger or inexperienced investors may be less prepared to experience short-term investment volatility if they can get a decent, stable return on cash and so it is important to reinforce the message that investing will deliver better returns over five years or more.

CHART 42: NET MONTHLY CASH ISA DEPOSITS (2008-2023)

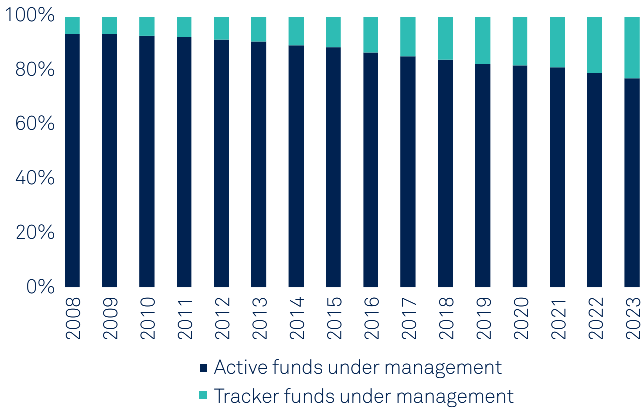


Source: The Bank of England

INDEX TRACKERS

Chart 43 illustrates the share of funds under management in index tracking funds. By the end of 2023, 22.7% of industry funds under management was in index tracking funds, growing from 20.8% at the end of 2022.[32] The chart shows a steady growth in the market share of index tracking funds, which has increased every year for the past fifteen years, with an average year on year growth of 9.1%.

CHART 43: ACTIVE FUNDS AND TRACKER FUNDS AS A PROPORTION OF TOTAL FUNDS UNDER MANAGEMENT (2008-2023)

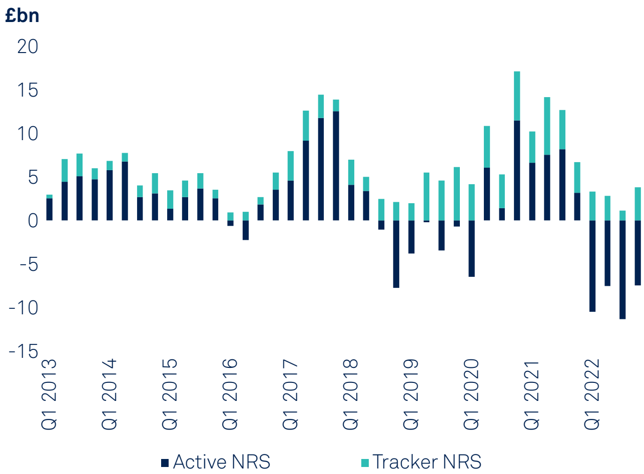


Source: The Investment Association

Underneath the headline retail outflows of 2022 and 2023, inflows to index trackers have continued as active funds have seen substantial net outflows, a key driver of the steady growth of index tracker market share. Chart 44 shows net retail sales to active and index tracking funds:

- Over 2023, outflows from active funds were £31.8 billion and sales to index trackers were far more resilient with a £13.8 billion inflow. This compares with -£37.9 billion from active and £11.0 billion into index trackers in 2022.
- The strongest sales to index trackers occurred in 2020 (£18.4 billion) and 2021 (£18.3 billion), also years of high inflows to active funds. The data suggest that index trackers do well in periods of strong performance, as do active funds, but sales are more resilient through challenging periods of market performance when active funds move into outflow.
- Over the longer term, the past decade has seen net retail sales of £21.1 billion to actively managed funds, whereas index tracking funds have seen £116.5 billion in inflows. The average annual inflow to trackers between 2013 and 2021, at the peak of the last market cycle, was £10.9 billion.

CHART 44: NET RETAIL SALES TO ACTIVE AND INDEX TRACKING FUNDS (2013-2023)



Source: The Investment Association

[32] The data in this chapter does not include Exchange Traded Funds, which tend heavily towards index tracking. The data therefore underestimates the full usage of index trackers by UK investors.

Chart 45 provides additional detail on investor preferences for different indices, with flows broken out into asset classes, and in the case of equities, by geographic region:

- Demand for Global equity index trackers recovered in 2023 with net inflows of £6.1 billion. Global equity index trackers have seen consistent demand over the past decade from investors seeking exposure to diversified equites at a low cost.

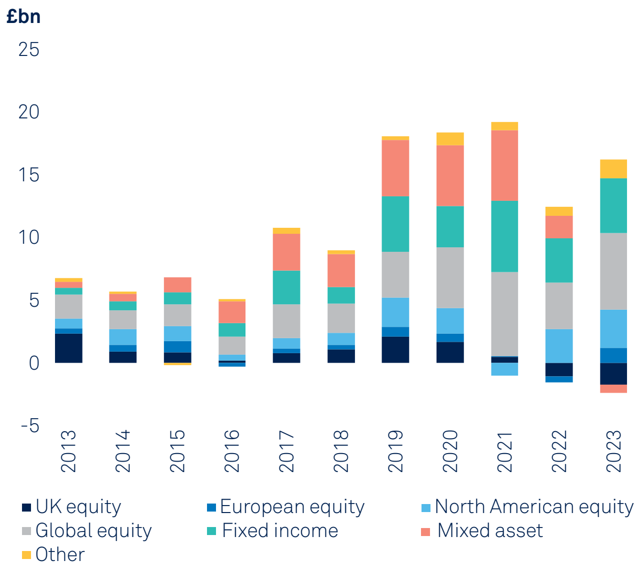
- North American equity index trackers benefited from a second year of strong sales in 2023, with net retail sales of £3.0 billion, up from £2.7 billion. As one of the most developed regions for index tracking with 55% of FUM in index trackers, long term demand for North American index trackers partly reflects demand for US equities overall. Over the past decade US equities have outperformed, with the MSCI USA returning 303% against 213% for the MSCI World.

- Although overall flows into equity index trackers in 2023 were £8.6 billion, UK equity index trackers remained in outflow. Outflows accelerated in 2023 to £1.7 billion, from £1.1 billion in 2022. Net outflows from UK equity index trackers were far more modest than from actively managed UK equity funds however - outflows reached £11.9 billion in 2023. While actively managed UK equity funds have seen consistent yearly outflows since 2016, funds tracking UK indices continued to attract inflows until 2021.

- Inflows to bond index trackers remained strong through 2023 with net inflows of £4.3 billion. Bonds was the second bestselling asset class for index trackers, as was the case in 2022 when inflows were £3.6 billion. Fixed income trackers have enjoyed sustained popularity with investors, accounting for 27% (£21.4 billion) of tracker inflows over the past five years from 2019-2023, against 18% (£6.6 billion) for the preceding five years.

- In 2023, there were outflows from mixed asset trackers of £704 million. This compares with a £1.7 billion inflow in 2022. Over the last five years, inflows are £16 billion.

CHART 45: NET RETAIL SALES OF TRACKER FUNDS BY INDEX INVESTMENT TYPE (2013-2023)

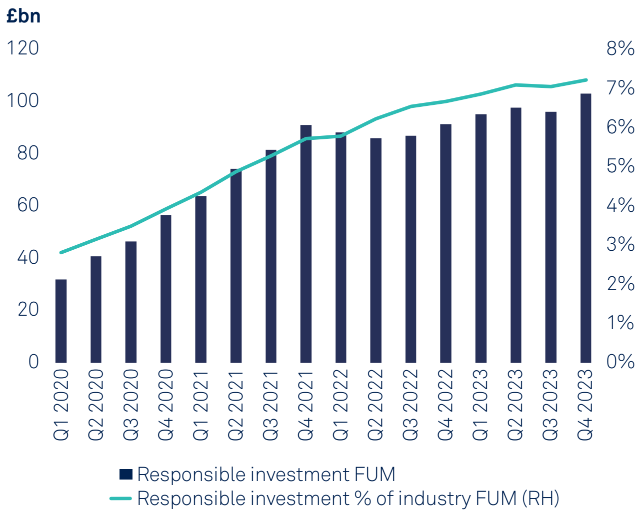


Source: The Investment Association

RESPONSIBLE INVESTMENT

Responsible investment funds within the IA universe had a combined FUM of £102 billion as of the end of 2023, accounting for 7.2% of industry FUM. Chart 46 shows the growth of sustainable and responsible investment funds between 2020 and 2023, when the IA started collecting data according to the IA's Responsible Investment Framework (see Box 8). Following a period of rapid growth in responsible investment FUM in 2020 and 2021, driven by strong sales and fund launch activity, growth in FUM has flattened as flows have turned negative and fund launch activity has slowed. Over 2023, there were 58 responsible investment fund launches, down from 83 in 2021 and 100 in 2022. Fund launches have also slowed as managers wait for the introduction of SDR in the UK. As of the end of 2023, there were 458 responsible investment funds within the IA universe across UK and overseas domiciled funds.

CHART 46: RESPONSIBLE INVESTMENT FUNDS UNDER MANAGEMENT (2020-2023)



Source: The Investment Association

BOX 8: 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:

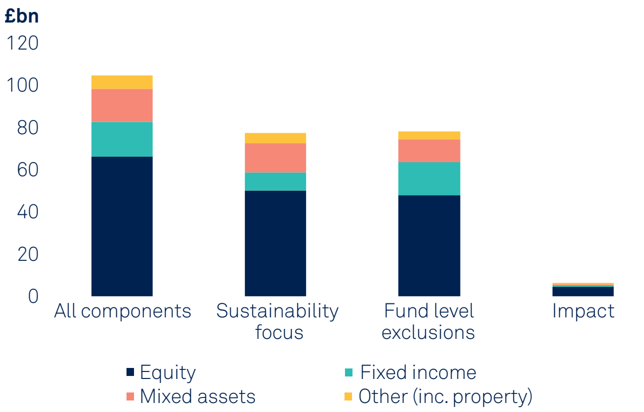
- Fund specific exclusions – prohibition of certain investments beyond any firm level policy, and beyond a prohibition on controversial weapons.
- Sustainability focus – An investment policy with sustainability criteria as a core part of the investment approach.
- Impact Investing – Investment made with 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 responsible investment data. Funds included within this data are those identified by managers as meeting the above criteria, with verification conducted by the IA.

Chart 47 shows the asset allocation across funds applying exclusions, funds with a sustainability focus and impact funds. As more than one component can apply to each fund, the sum of each component is greater than all components combined.

- Across all responsible investment funds, equity funds make up 63% of FUM, rising to 70% of impact investment funds. For context, 54% of FUM in the wider industry is in equity funds.
- Bond funds account for 15% of responsible investment FUM, compared with 18% in the wider industry. They are more prominent among funds employing fund level exclusions however, where they make up 20% of assets.

CHART 47: RESPONSIBLE INVESTMENT FUNDS UNDER MANAGEMENT BY ASSET CLASS AND COMPONENT (2023)

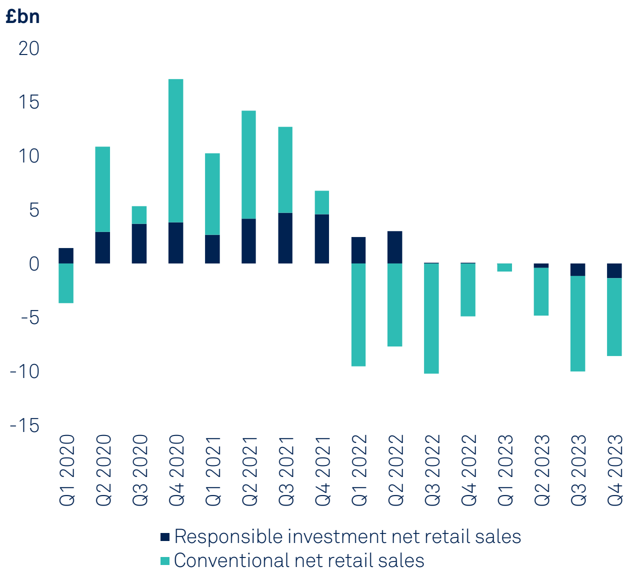


Source: The Investment Association

Investor sentiment towards responsible investment funds was positive when markets were performing well through 2021 and sales were £16 billion, a third of net retail sales in a record year. We saw a peak in monthly inflows in September 2021, in the run up to COP 26 in November 2021, held in Glasgow, as positive news about the path to net zero transition and significant coverage combined with strong performance conditions. However, investors pulled £3 billion from responsible investment funds in 2023 as more challenging performance conditions for equities overall combined with the outperformance of funds investing in oil and gas stocks through 2022. As funds moved into outflow at the beginning of 2022 as interest rates began to rise, responsible investment funds initially remained in inflow, and even as inflows dried up in the second half of the year, responsible investment funds avoided outflows.

84% of responsible investment funds are actively managed and sales in 2022, though low, were far more resilient than outflows from the broader active fund market. However, the challenging performance conditions for responsible investment funds, which typically exclude oil and gas sectors, which were the strongest equity sector performers through 2022, mean that they moved into an outflow of £2.6 billion in H2 2023.

CHART 48: NET RETAIL SALES TO RESPONSIBLE INVESTMENT AND CONVENTIONAL FUNDS (2020-2023)



Source: The Investment Association

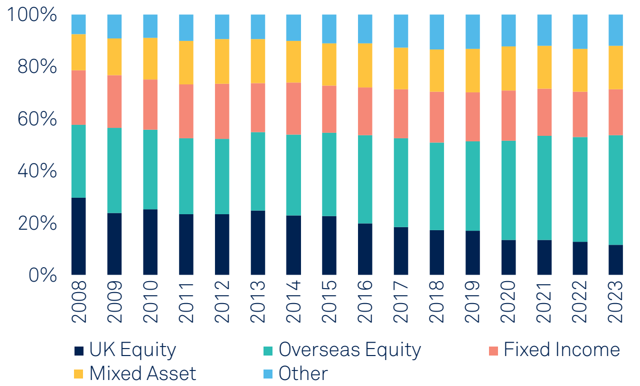
ASSET ALLOCATION

Chart 49 shows how asset allocation by UK investors has evolved over the past fifteen years by looking at the percentage of UK investor FUM held in the major asset classes. It breaks equities into UK and overseas equities to show how UK investors have shifted from a bias to holding funds invested in the domestic market to a more global outlook for equities:

- There is an ongoing shift away from UK equities. UK equity funds have declined from 29.6% of assets at the end of 2008 to 11.5% in 2023. The drop in UK equity allocations has been largely matched by increased allocations to overseas equities, which now account for 42% of FUM compared with 28.1% in 2008. Overall, equity FUM has remained relatively stable as a proportion of total FUM, dropping by 4.2% from 57.7% in 2008 to 53.6% in 2023. The drivers behind the shift from UK to overseas equities reflect a long-term investor preference for managing equity risk using more globally diversified funds rather than allocating to the UK, which is a single country.

- Over the long-term, fixed income allocations have been broadly stable fluctuating between 18% and 22% from 2008 to 2021. However, the 2022 depreciation in bond prices saw allocations drop below 18% for the first time to 17.4% at the end of 2022. Fixed income allocations have stabilised in 2023, with the percentage of FUM held in bonds remaining steady at 17.7%. The cycle of interest rate rises through 2022 hurt bond performance as higher interest rates meant higher bond yields, which move inversely to prices, resulting in capital losses for bond fund investors. However, as rates were kept steady in the second half of 2023, this helped to stabilise bond prices.

CHART 49: FUNDS UNDER MANAGEMENT BY ASSET CLASS (2008-2023)



Source: The Investment Association

INVESTORS HAVE FAVOURED OUTCOME AND ALLOCATION FUNDS, WITH

£104bn

OF NET RETAIL INFLOWS FROM 2008-2023

5

NET RETAIL SALES BY INVESTOR OBJECTIVE

Chart 50 (overleaf) shows long term sales trends grouped by investor objective and asset class. Sales to equities are split into funds with a growth objective and funds delivering equity income to investors. Over the long-term, investors have favoured outcome and allocation funds (see Box 9), with £104 billion of net retail inflows from 2008-2023. Rather than traditional single asset class funds, these funds offer investors either a diversified mix of assets in the case of allocation funds (also referred to as mixed asset), or a targeted outcome in either return or volatility, with more discretion given to the fund manager. Fixed income funds have also been popular with net inflows of £62 billion in the last fifteen years. Equity growth funds, which had seen inflows of £47 billion from 2008 to the end of 2021, have seen heavy outflows in 2022 (£24 billion) and 2023 (£15 billion), reducing the inflow to just £8 billion between 2008 and 2023.

Looking in more detail at sales trends by investor objective, we see that:

- In the period following the Global Financial Crisis, sales to **equity growth funds** generally benefited from low interest rates and strong market performance seeing inflows in all but three years (2008, 2016 and 2019) between 2008 and the peak of the last market cycle in 2021. In 2021, UK interest rates fell to their lowest rate at 0.1% and inflows to equity growth funds made up 47% of annual sales, the highest proportion of inflows since 2001. The most significant outflow of £8.6 billion came in 2016 as UK and European equity sales were affected by uncertainty surrounding the Brexit referendum. As the market cycle has shifted following higher interest rates and the unwinding of quantitative easing, withdrawals from equity growth funds account for the majority of outflows in 2023 at £15.4 billion, down from 2022's £23.9 billion but still making up the largest outflow by investment objective. The change to a higher interest rate environment has weakened the outlook for equity growth strategies through a combination of higher borrowing costs for companies, lower economic growth and a higher discount rate on the value of future earnings.

BOX 9: OUTCOME AND ALLOCATION FUNDS

Allocation funds, also referred to as mixed asset funds, offer investors a diversified mix of equities and bonds. Allocations to equities and bonds are maintained 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 the 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 of funds pursuing a specific outcome.

- **Equity income** strategies were popular through the early 2010s, with net retail sales peaking at £7.3 billion in 2014. However, equity income fell out of favour from 2017 to 2021 as market conditions and the long period of low interest rates favoured equity growth strategies. Additionally, during the pandemic many companies cut dividends or, in the case of UK banks, were forced to suspend dividends, which affected the performance of equity income funds. Equity income funds saw a brief return to inflow in 2022 with net sales of £1.3 billion. These funds saw interest from investors during volatility in the equity and bond markets when many industry sectors were able to pay dividends even if share prices were more volatile, making dividends an important component of total return. However, equity income funds returned to outflow in 2023 as retail investors pulled £1.9 billion.

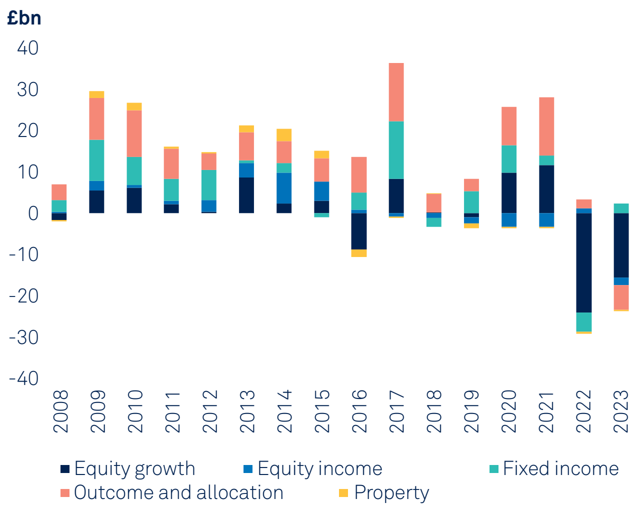
- The immediate aftermath of the Global Financial Crisis saw strong fixed income funds sales boosted by investors seeking income, with inflows as high as £10.0 billion in 2009. Appetite for bond funds remained broadly strong through the 2010s with the highest inflows of £14.0 billion recorded in 2017. When interest rates rise, so do bond yields, which are based on the bond's coupon payments divided by its market price. As coupon payments are fixed for bonds, bond prices move inversely to yields, so a steep rise in bond yields causes a corresponding fall in prices.

We saw this in 2022 as rapidly rising interest rates hit bond valuations and investors withdrew £4.8 billion from fixed income funds through the year. However, in 2023 bond prices stabilised and fixed income funds saw inflows of £2.4 billion. With rates having settled in 2023, bonds are now more attractive for income investors looking for a predictable rate of income and for investors who prefer less volatile portfolio performance especially as we continue to see some volatility in the performance of equity markets.

- **Outcome and allocation funds** enjoyed strong net retail sales through the 2010s and into 2021 as investors increasingly opted for funds providing investment solutions, where the investment manager makes the asset allocation decision within the fund. Between 2012 and 2021 these funds accounted for 46% of all fund inflows with the peak inflow of £14.1 billion in 2017. In 2023, outcome and allocation funds recorded their first annual outflow within IA data. Outflows of £6.0 billion followed weak sales of £2.1 billion in 2022. Recent outflows over 2022 and 2023 have been driven largely by mixed asset funds, particularly funds from the mixed investment 20-60% shares sector. Equity and bond valuations fell in tandem in 2022, negatively affecting the performance of these more balanced strategies and this has continued to impact investor sentiment through 2023.

We have also seen a shifting investor preference for different types of outcome funds over the last fifteen years. Targeted Absolute Return funds saw strong sales from 2013 to 2017 totalling £18.3 billion as investors were attracted by the promise of seeing a return irrespective of market conditions. From 2018 onwards Targeted Absolute Return (TAR) funds have been in consistent outflow with investors pulling £17.9 billion as some TAR funds have struggled to deliver on their investment objectives. In 2023, TAR fund outflows were £3.3 billion. Volatility Managed funds, the other major category of outcome fund, have seen consistent inflows since the sector's 2017 launch with net retail sales totalling £20.6 billion between 2017 and 2023. In 2023, inflows to Volatility Managed funds were £2.7 billion. These funds, which invest in a mixture of equities and bonds and manage returns within set volatility parameters, are popular with advisers as they map to client risk profiles.

CHART 50: NET RETAIL SALES BY INVESTOR OBJECTIVE (2008-2023)

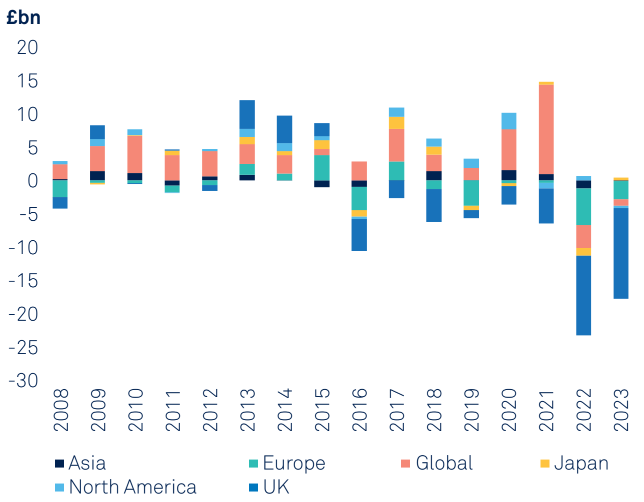


Source: The Investment Association

EQUITY FUND SALES BY REGION

Chart 51 shows the long-term sales trends to equity funds by geographic location. Over the last fifteen years, investors have shown a strong preference for geographic diversification opting for funds that invest in global companies that are spread across different countries and regions of the world. This helps to reduce the risk of high exposure to single countries or industries. Over the long term, there has been an ongoing shift away from UK equity funds as investors have reduced their allocations to funds investing in single countries. The move away from a UK home bias has also been driven by the performance of the UK market, which has substantially lagged the US market following the Global Financial Crisis. US companies make up a significant proportion of many global equity funds and the MSCI World index now has a 72% weighting to the US.

CHART 51: EQUITY FUNDS, NET RETAIL SALES BY REGION (2008-2023)



Source: The Investment Association

Global:[33]

Over the decade from 2012 to 2021, equity funds with a global mandate enjoyed strong net sales of £42.0 billion, only slightly below the £46.0 billion total retail inflow to equity funds. Sales to funds with a global mandate have likely been boosted by investor demand for diversification. By opting for geographically diversified funds, investors can mitigate country specific risk, as well as accessing a broader investment universe. 2022 marked the first outflow from global equity funds with investors pulling £3.4 billion. Outflows continued into 2023 as investors pulled £907 million. In a very challenging environment for equity sales, these outflows have been relatively modest, however.

Asia:[34]

Equity funds investing in Asia saw flat net sales in 2023, with a minimal outflow of £73 million, following a sharp £1.2 billion outflow in 2022. Asian equity funds saw annual inflows between 2018 to 2021 – barring a modest outflow in 2019 – and this corresponds with a period of strong economic growth for China. Investors in Asian equities faced headwinds through 2022 however, with the prolonged pursuit of a zero COVID policy in China restricting economic activity as other regions opened up. While the zero COVID policies were lifted at the start of 2023, sustained geopolitical tensions, notably US China trade tensions, negatively impacted sentiment, while an ongoing crisis in the Chinese property sector has weighed upon China's domestic economy.

We observe continued investor movement away from Chinese equities with a £287 million outflow for 2023. The performance of Chinese equities continues to struggle with the MSCI China index returning -16.2% over 2023 compared with 16.8% for the MSCI World.

As flows to Chinese equities wane, we have seen positive sales to Indian equities. In 2023, Indian equity funds have seen net retail inflows of £259 million into a relatively small sector by FUM of £4.6 billion. The 2023 inflow equates to 6% of FUM. India's GDP grew 7.6%[35] in 2023 compared with global GDP growth of 2.7%[36], making it among the fastest growing major economies of 2023.

[33] Sectors included are: Global, Global Equity Income, and Global Emerging Markets, alongside the industry specific sector of Financials and Financial Innovation, Healthcare, and Technology and Technology Innovation.
[34] Sectors included are: Asia Pacific excluding Japan, Asian Pacific including Japan, China/Greater China and India/Indian Subcontinent. Japan focused equity funds and considered separately.
[35] Source: World Bank.
[36] Source: World Bank.

Europe:
Sales to European equities have struggled in recent years with heavy outflows in 2016 (£3.5 billion) and 2019 (£3.7 billion). Outflows may reflect investor disappointment in performance, with the MSCI Europe ex UK index returning 259% over the past fifteen years, against 462% for the MSCI World. European equity funds saw a record annual outflow of £5.5 billion in 2022. The Russian invasion of Ukraine and the subsequent sanctions regime placed significant pressure on European economies, especially those with a heavy dependency on Russian natural gas, hurting stock market performance. European equity outflows did ease in 2023 but investors still pulled a net £2.8 billion, exceeded only by the outflow from UK equities.

Japan:
Japan was the only equity region to see inflows in 2023, with net sales of £466 million coming after record outflows of £1.2 billion in 2022. Over the longer term, Japanese equity funds have seen modest inflows of £4.2 billion from 2008 to 2023. Sales have been volatile as Japan has grappled with deflation and lacklustre economic growth. However, the outlook for the Japanese economy is improving as it shakes off its prolonged period of deflation and moves into strong nominal GDP growth of 3.5% in 2023 beating the US (2.5%) and this helps to explain the 2023 inflow.

North America:
Over the past fifteen years, North American equity funds have seen inflows of £11.3 billion – only global equity funds have seen higher sales over the same period. North American equity growth has far outstripped other developed markets, with the S&P 500 returning 702% over this period. Strong market performance has been driven by rising valuations in the US tech sector and the superior performance of the magnificent seven tech stocks, which weathered the market downturn in 2022 as the Fed responded to escalating US inflation by raising interest rates. The US was also relatively cushioned from the impact of energy price rises in Europe and the UK following the Russia/ Ukraine war with energy self-sufficiency supported by access to shale gas and oil. More recently, in 2023 North American equities have seen mild outflows of £379 million despite the MSCI USA returning 19.3% in sterling terms over the year. Investor caution in 2023 has affected equity inflows across every region – only Japan saw positive sales in 2023.

UK:
As shown in Chart 51, since 2016, UK equities have seen continuous net outflows with a combined £47.2 billion withdrawn between 2016 and 2023. Uncertainty over the long-term consequences of Brexit on UK economic growth and trade relations have been coupled with a period of political change with five Prime Ministers from Cameron to Sunak overseeing the UK's withdrawal from the EU. Investors' have found it challenging to navigate this uncertainty, preferring to diversify using global equity funds. The scale of the outflows has also been driven by a preference from UK discretionary fund managers for global equity strategies – we have seen a rise in the proportion of advisers outsourcing model portfolio investment strategies to discretionary managers and according to data from Platforum, model portfolios account for just over a quarter of advised assets in 2024. Over the longer term, the performance of the UK stock market has struggled to keep up with the US. Looking at the FTSE All-Share on a capital return basis over the last fifteen years, which strips out the impact of dividends and share buybacks on total returns, the price return has been 92% compared with the US Russell 3000 at 495%. Returns have been affected by the types of company listed on the FTSE: the percentage of technology companies listed on the FTSE All-Share is just 2% and the UK has struggled to ensure that technology start-ups developed in the UK list on its capital markets. The US markets have attracted a significant proportion of the highest growth tech company listings. Despite ongoing outflows from UK equities, however, UK equities still account for 21% of equity FUM. The MSCI World index weighting to the UK isjust 3.7%. This suggests that UK investors do retain a reasonable exposure to their domestic market.

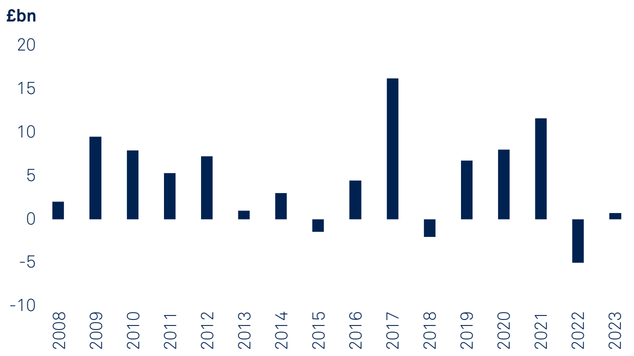
5

FIXED INCOME

In 2023, inflows have returned to bond funds with net retail sales of £647 million as investors have opted for lower risk investment strategies. This follows a challenging 2022, when UK investors withdrew a record £4.8 billion, over twice the previous record outflow of £2.0 billion in 2018.

Bonds are sensitive to interest rate changes because as interest rates rise, bond yields go up and bond prices fall. This is because newly issued bonds have a higher yield making existing bonds issued at a lower rate less attractive. In 2022, central banks responded to high inflation with a cycle of rapid interest rate rises: the Bank of England raised rates 8 times in 2022 from 0.5% to 3.5% and consequently bond prices fell. In 2022, outflows were highest in the first quarter at £6.0bn, as the rate hiking cycle began. The return to inflow to fixed income funds in 2023 was dominated by government bond funds, which saw net retail sales of £4.0 billion. Government bond funds had already seen resilient sales through 2022, maintaining a £1.1 billion inflow, indicating that for some investors at least, security was the primary concern. Debt issued by governments in developed markets is traditionally considered the lowest risk type of bond given the low risk of default.

CHART 52: FIXED INCOME FUNDS, NET RETAIL SALES (2008-2023)



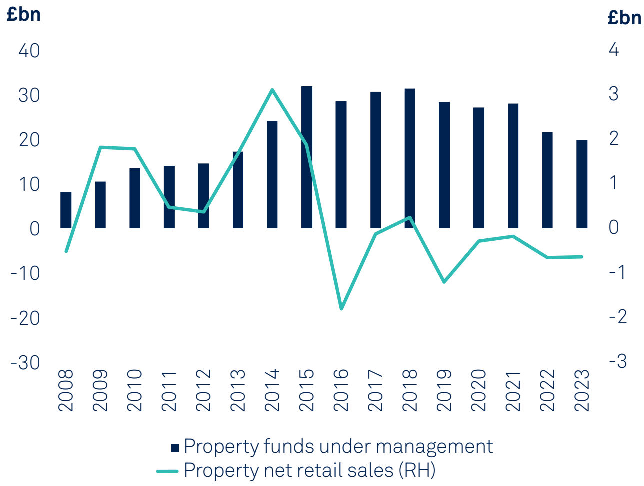
Source: The Investment Association

PROPERTY FUNDS

Chart 53 shows the pattern of FUM and net retail sales for property funds. From a peak of £32.0 billion in 2015, FUM has declined to £19.8 billion in 2023. In 2023, FUM dropped 9% from £21.6 billion, easing on the 23% decline in 2022.

The beginning of the consistent decline in property FUM started in 2016 when many funds investing directly in UK property were forced to suspend withdrawals because of rising redemption requests from investors following the result of the Brexit referendum. Retail investors are able to deal open ended property funds daily. To meet redemption requests, property funds needed to sell property to generate cash but wanted to ensure that they would receive a good price for the property sale, which led to suspensions to effectively manage the process. Whilst falling FUM is affected by asset performance, open-ended direct property funds have seen fund suspensions followed by outflows, which have contributed to Property FUM nearly halving since the end of 2015.

CHART 53: PROPERTY FUNDS UNDER MANAGEMENT AND NET RETAIL SALES (2008-2023)



Source: The Investment Association

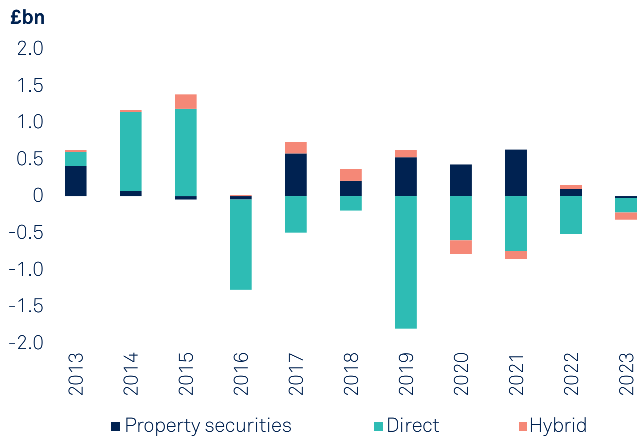
Direct property funds were again forced to suspend during the pandemic because of valuation uncertainty caused by lockdown, which affected the outlook for commercial property as many people worked from home and could not travel to city centres to shop or eat out. The long-term decline of the UK high street and the adoption of remote working have impacted the decline in FUM of UK direct property funds, which have higher weightings to retail and office commercial real estate. When funds were suspended during the pandemic, outflows from the UK Director Property Sector were £582 million – two thirds of outflows came in the last quarter of 2020 when property funds began to lift suspensions.

Sales to property funds have been negative since 2016, with combined outflows of £4.7 billion from 2016 to 2023. This contrasts with strong sales and growth from 2008 to 2015, between the Global Financial Crisis and the Brexit referendum, which saw property FUM increase fourfold to peak in 2015 at £32 billion.

The overall flow data hides a more detailed picture across different types of property funds. As shown in Chart 54, outflows have primarily hit direct property funds, with a total outflow of £5.7 billion since 2016.

Funds investing in more liquid property securities (rather than directly owning physical property), were not forced to suspend in 2016 or 2020. Listed property funds have seen consistently positive net retail sales through 2017 (£587 million) with high sales coming in 2021 as economies returned to growth and low interest rates continued to support the value of property. Since 2021 we have seen net sales fall to £99 million in 2022 and a £23 million outflow in 2023 as economic growth has cooled and higher interest rates have hit property valuations. This suggests that the outflows from direct property funds are due to liquidity issues rather than negative sentiment towards property as an asset class. Additionally, securitised property funds tend to have a more diversified geographic allocation, with most being exposed to global property rather than focused on just the UK. As of the end of 2023, 96% of funds under management in property security funds was in funds with a global investment approach.

CHART 54: NET RETAIL SALES BY TYPE OF PROPERTY FUND (2013-2023)



Source: The Investment Association

FUNDS OF FUNDS

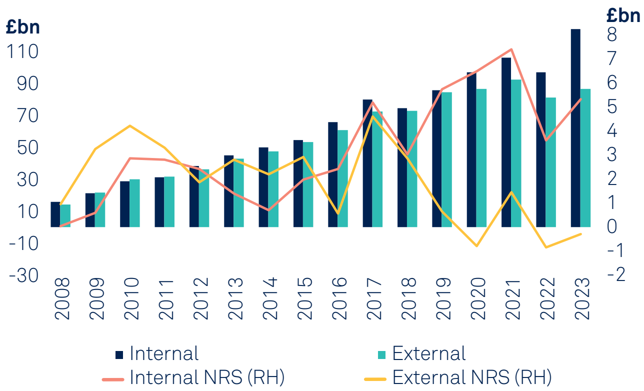
Chart 55 illustrates the growth of the funds of funds market. FUM in funds of funds overall is £211 billion in 2023, a sevenfold increase from 2008. Funds of funds are divided between internal, which invest primarily into funds run by the same asset manager, and external, which invest primarily into funds run by other asset managers. FUM in externally managed fund of funds was £87 billion in 2023 – it has not yet recovered to 2021 levels. In contrast, FUM in internally invested fund of funds has seen significant growth year on year rising by 28% to £124 billion in 2023. This is higher than FUM of £106 billion in 2021 and a significant increase of 682% over the last fifteen years.

Investors have consistently favoured internally invested funds of funds for five years, helping to drive the proportion of FUM to 59% of fund of fund FUM.

In two extremely challenging years for net retail sales overall, investor demand remained robust. Net retail sales to internally invested funds of funds through 2023 were £5.4 billion, up from £3.6 billion in 2022. Externally invested funds of funds saw flows remain negative at -£290 million in 2023, improving from a £835 million outflow in 2022.

Internally invested funds will frequently make use of internal index tracking funds to bring down costs. The consistent appetite for lower cost investment products, mirrored in the ongoing demand for index trackers, has supported higher sales to internal funds of funds.

CHART 55: FUND OF FUNDS, FUNDS UNDER MANAGEMENT AND NET RETAIL SALES (2008-2023)

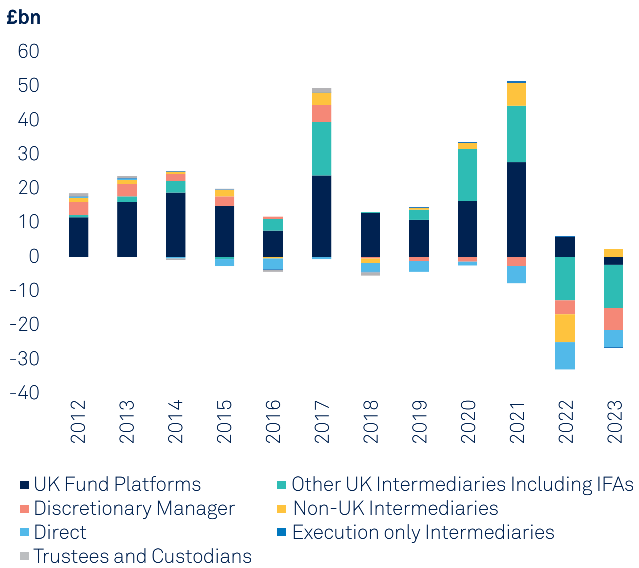


Source: The Investment Association

DISTRIBUTION CHANNELS

Chart 56 shows the pattern of net flows for UK investors through the main retail distribution channels over the past decade.

CHART 56: NET RETAIL SALES BY DISTRIBUTION CHANNEL (2012-2023)



Source: The Investment Association

- Investment platforms, which have historically dominated fund distribution, saw their first outflow in 2023 as UK investors withdrew £2.4 billion, following weak sales in 2022 of £5.7 billion. Platform outflows in 2023 are only a tenth of the total outflow for the year, however. Whilst the IA does not split adviser and direct platform sales, a higher proportion of retail assets are held on adviser platforms. Platforum estimated adviser platform assets under administration at £721.7 billion at the end 2023 compared with £325.9 billion on D2C platforms (September 2023).

- The discretionary managers channel sustained a sixth consecutive year of outflows as net withdrawals rose to £6.4 billion. Part of the outflow from discretionary managers may stem from a trend towards these firms making greater use of segregated mandates with investment managers to use their scale to negotiate competitive fees. These assets would be counted under AUM. A greater percentage of assets in discretionary model portfolios are also being managed on platform and so sales would appear through the platform channel.

- Other intermediaries including IFAs saw strong inflows in 2017 (£15.7 billion), 2020 (£15.2 billion) and 2021 (£16.6 billion) but have now been a significant driver of outflows over the past two years with net retail outflows of £12.9 billion and £12.7 billion.

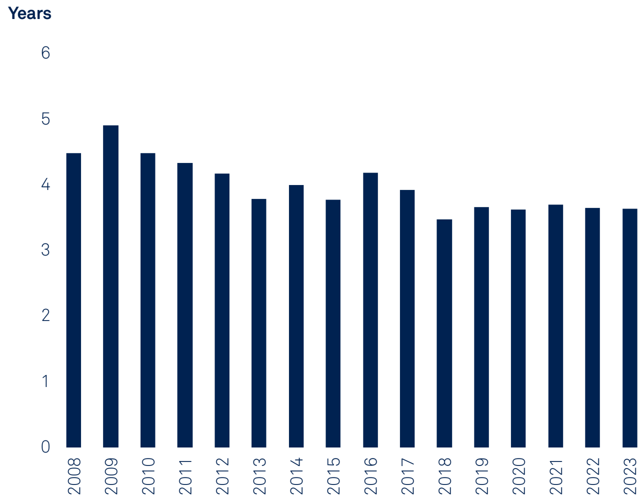
- The direct fund channel, where investors interact directly with fund companies, has been in persistent outflow over the past decade as the former model of investors buying funds directly from a fund manager has faded in favour of intermediation through either advisers or platforms. This channel continues to see net outflows with £4.9 billion withdrawn in 2023.

RETAIL INVESTOR HOLDING PERIODS

Implied investor holding periods for funds remained steady at 3.6 years in 2023. As shown in Chart 57, following a fall in holding periods over the early 2010s, holding periods have remained stable over recent years. The increased use of fund platforms will have reduced barriers to buying, selling, and switching, reducing average holding periods. Additionally, the use of model portfolio services may have acted to bring down holding periods. Model portfolios see investor assets placed across a range of different funds and are typically rebalanced quarterly, increasing turnover and so decreasing holding periods.

However, holding periods have stabilised in recent years and this suggests that there may be a floor of three years.

CHART 57: RETAIL INVESTOR AVERAGE HOLDING PERIODS (2008–2023)



Source: The Investment Association

THE UK IN THE CONTEXT OF THE EUROPEAN FUNDS MARKET

UK domiciled funds make up a higher percentage (84%) of UK investor FUM than funds domiciled overseas. Following the Brexit referendum, we have analysed the evolving profile of investors in UK domiciled funds to gauge if the number of overseas investors in UK domiciled funds continues to fall. We also track the UK's growth as a fund domicile compared with the two largest European centres of fund administration, Ireland and Luxembourg.

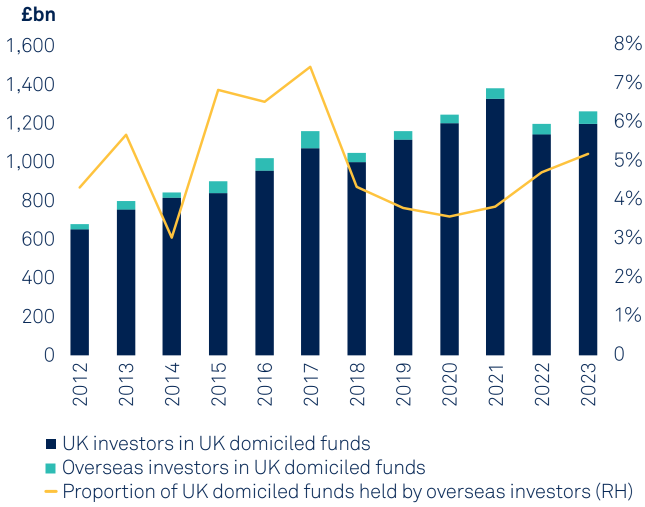
OVERSEAS INVESTORS IN UK DOMICILED FUNDS

UK domiciled funds under management was £1.26 trillion in 2023, incorporating assets managed on behalf of both UK and overseas clients. As shown in Chart 58, this is up 5% on £1.20 trillion in 2022, with the increase driven by asset appreciation as capital markets partly recovered from 2022.

- FUM held on behalf of UK investors within UK domiciled funds increased to £1.20 trillion in 2023, from £1.14 trillion in 2022.

- Assets held in UK domiciled funds on behalf of overseas investors increased by 16% over 2023, from £57 billion to £66 billion. As a result, the share of UK domiciled fund assets held by overseas investors climbed to 5.2%, from 4.7% the previous year. The sharp drop in the percentage of assets held by overseas investors in 2018 occurred as firms moved overseas clients to predominantly Luxembourg domiciled funds ahead of the initial Brexit deadline in 2018. Although recent years have seen some increase in the share of FUM held by overseas clients, it remains below the 7.5% peak of 2017.

CHART 58: UK AND OVERSEAS INVESTORS IN UK DOMICILED FUNDS (2012–2023)



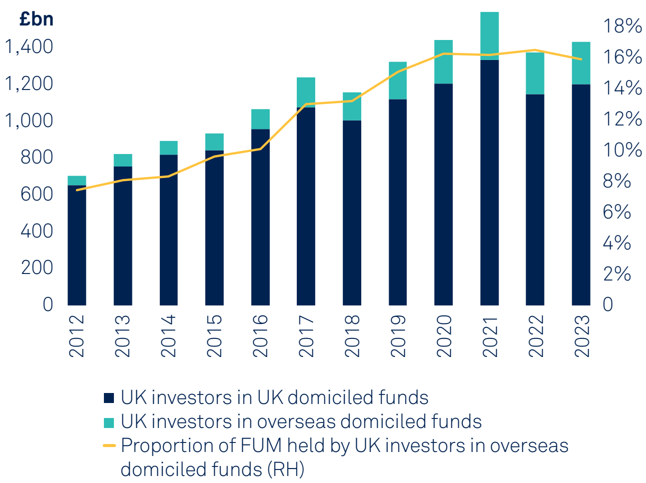
Source: The Investment Association

UK INVESTORS AND OVERSEAS DOMICILED FUNDS

UK investor FUM in overseas domiciled funds was £228 billion in 2023 and was unchanged year on year. In contrast, UK investor FUM in UK domiciled funds increased 5% over 2023 to £1.2 trillion. Consequently, the share of assets in overseas funds fell to 16%, from a 17% peak in 2022. Up to the end of 2020, we observed steady growth of the share of funds domiciled overseas, averaging 11% growth per year. However, from 2021 that growth appears to have stalled.

It is worth reiterating that the data in Chart 59 does not include assets in ETFs, which are entirely domiciled overseas, mainly in Ireland. Given the growth of the ETF market (see Box 4 on page 48), it is likely that UK investor assets in overseas domiciled funds are higher than illustrated in Chart 59. We do not include ETF assets as we cannot isolate the country of origin of ETF investors to make a like-for-like comparison with mutual funds.

CHART 59: UK INVESTORS BY FUND DOMICILE (2012-2023)

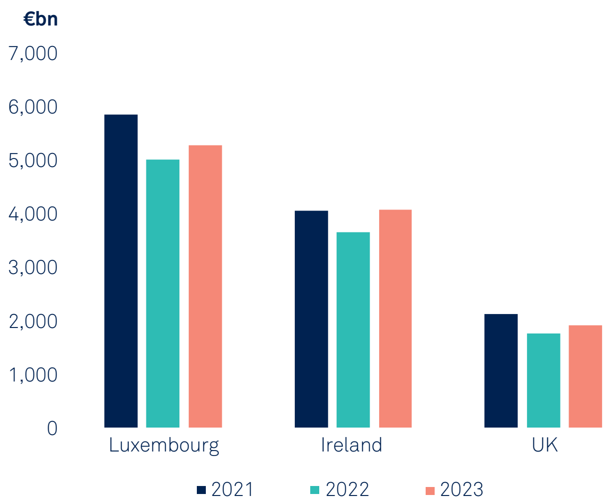


Source: The Investment Association

Chart 60 looks at recent developments in funds under management by domicile for the UK and the two largest European fund domiciles, Luxembourg and Ireland. While funds domiciled in the UK are mainly distributed to UK investors, funds domiciled in Luxembourg and Ireland see extensive cross border distribution.

All three domiciles saw a sharp drop in assets in 2022, ranging from the 18% fall in UK domiciled funds under management to a 10% drop in Ireland domiciled FUM. While all three domiciles saw recovery in in 2023, Ireland was the only country to end 2023 with higher FUM than at the end of 2021, following a 12% growth in assets. Ireland is an important European ETF domicile and the growth of Ireland as a fund domicile partially reflects the increasing use of ETFs. As of the end of 2023, funds domiciled in each jurisdiction were €5.8 trillion in Luxembourg, €4.1 trillion in Ireland and €1.9 trillion in the UK.

CHART 60: ASSETS IN UCITS AND AIFS BY DOMICILE (2021–2023)



Source: EFAMA