

# UK RETAIL FUND MARKET INSIGHTS

2023 and Q1 2024

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# INTRODUCTION

An illustration on a dark blue background showing several stylized human figures interacting with a large, glowing globe. The globe is surrounded by various icons representing business, technology, and data, such as a laptop, a smartphone, a document, a person, a gear, and a lightbulb. The figures are depicted in various poses, some looking at the globe, others at their devices, suggesting a collaborative data analysis or business strategy session.

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## Introduction

2023 saw a second year of challenging sales conditions for investment funds in the UK, though conditions have moderated slightly in the first quarter of 2024. In this report, we examine key recent behaviours in the funds market putting the pattern of sales in 2023 and Q1 2024 in the context of investor behaviour over the last three years as they experienced soaring inflation, the impact of the Russia/Ukraine war on energy prices and a cost of living crisis. To combat these conditions, central banks have chosen to raise the base rate and from 2022, markets have been operating in a very different climate from the fourteen years following the financial crisis.

In this report, we consider the impact of the rise in interest rates and the consequent increased appeal of cash savings on fund flows. We also look at the longer term trends of the continued shift of assets from active to index tracking funds and outflows from UK equities. There are more recent developments in investor behaviour too: recently we have seen sustained outflows from responsible investment funds. At an asset class level, investors have returned to North American equities and shifted investor attention from Chinese to Indian equities. We also examine patterns in fixed income fund sales, with a rotation from government debt in 2023 to corporate debt in Q1 2024.

Whilst 2022 was a very difficult year for fund flows globally, in 2023 we have seen some jurisdictions fare better than the UK. We examine the potential drivers for this in the report and then look ahead to how fund flows might behave in H2 2024 as speculation intensifies over when and how far Central Banks may cut rates.

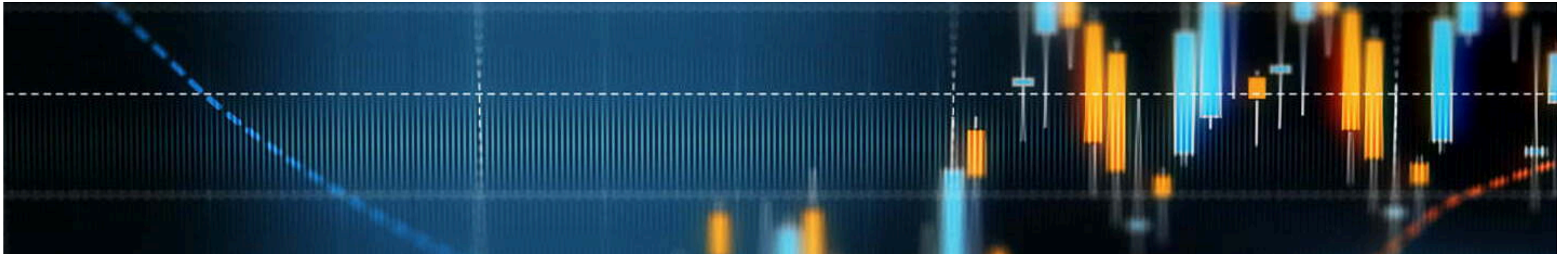
# 2023 AND Q1 2024 KEY NUMBERS



# KEY NUMBERS

## **2023**

- The UK investment fund market faced a challenging year in 2023, with net retail outflows of £24.3 billion, mainly from equity funds. This marks only the second year of net outflows, albeit outflows were slightly lower than 2022's £26.9 billion.
- The first quarter of 2024 saw net retail outflows of £3.3 billion, an improvement on the £8.6 billion outflow in the final quarter of 2023, as equity outflows eased amid hopes of loosening monetary policy.
- In a higher interest rate environment, funds are increasingly having to compete with the return investors can make on cash savings. Investors placed £47.2 billion into cash ISAs in 2023, a record annual total and a greater inflow than the previous 8 years combined.
- Investors showed an ongoing preference for index trackers over active funds, as index trackers saw continued inflows of £13.8 billion through 2023, against an outflow of £38.1 billion from active funds.
- Through 2023, investors preferred safer assets such as government bonds and money market funds. However, in Q1 2024 investors have returned to other assets, notably corporate bonds and North American equities. A decline in yields on government bonds at the end of 2023 and a strong rally in US equities has helped drive this shift in allocation.
- Inflows to Indian equity funds were among the few bright spots in 2023, attracting sales due to their strong performance and growth prospects. Chinese equities, meanwhile, have seen consistent outflows over the past 15 months amid concerns over weaker growth and ongoing geopolitical tensions.
- Responsible investment funds have seen consistent outflows over the past three quarters. Investors pulled a net £3.3 billion over this period as concerns over performance persisted following the severe headwinds felt in 2022 when oil and gas stock prices rose sharply.



## **FIRST QUARTER 2024**

- In Q1 2024, net retail sales are -£3.3 billion, which is an improvement on the £8.6 billion outflow seen in Q4 2023 but demonstrates the challenging conditions that are still facing the funds industry.
- Sales to funds typically receive a boost during ISA season across March and the first 5 days in April. March's inflow was a weak £446 million but we could see this rise coming through in the April sales data.
- Equity outflows eased substantially in Q1 down to £1.6 billion, from £5.9 billion in Q4 2023, with inflows to North American and Global equities. Fixed income funds meanwhile returned to inflow, of £137 million, the first quarterly inflow since Q2 2023. Mixed asset funds remained in outflow with £1.5 billion withdrawn, a marginal improvement on the £2.3 billion withdrawn in Q4 2023.
- The outlook for the rest of 2024 remains uncertain, as expectations of interest rate cuts remain unclear amidst Central Bank concerns over cutting rates too early. Headline UK annual CPI has now fallen to 2.3%, which may prompt the Bank of England to make an incremental rate cut in the summer but the Bank remains cautious about service sector inflation.
- If the base rate remains close to 5% for longer, it will make debt repayment for companies and individuals harder. Attractive cash savings rates will continue to draw some people away from investing into cash.
- A high base rate also affects the outlook for markets and for equity growth strategies in particular.

# OVERVIEW

# OVERVIEW

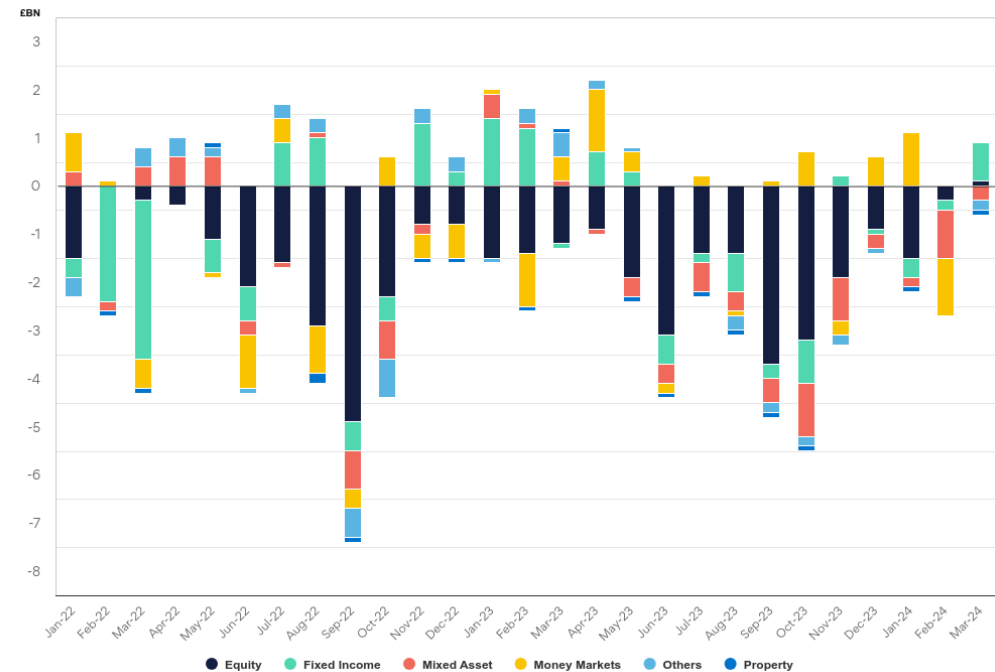
## 2023

2023 witnessed another challenging year for the UK funds market, with net retail outflows of £24.3 billion, only slightly down on the record outflow of £26.9 billion in 2022. Equity funds made up the majority of outflows at -£22.4 billion, of which £13.6 billion was from UK equities.

Despite outflows through the year, funds under management rose by 4% in 2023 driven by asset appreciation. This compares with a 14% drop in 2022 as rising interest rates hit asset values. While 2022's outflows occurred during challenging performance conditions, fund performance in 2023 was broadly positive, indicating outflows were instead driven by a combination of uncertainty and increased rates on cash drawing assets away from funds. Cash ISAs saw record inflows of £47.2 billion in 2023, higher than the previous 8 years combined, as rates on new cash ISAs climbed as high as 5.35% in October.

UK investors maintained a continued preference for index trackers through 2023, with inflows of £13.8 billion to index tracking funds, while £38.1 billion was pulled from active funds. Actively managed equity bore the brunt of 2023's outflows with £31.1 billion withdrawn. This was only partially offset by inflows of £8.7 billion into equity trackers as net outflows from equities reached £22.4 billion.

Chart one: Monthly net retail sales by asset class, January 2022 - March 2024



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UK equity funds continued to see outflows accelerate even as equity outflows began to soften in the last quarter of 2023. Following record outflows of £12.0 billion in 2022, net retail outflows from UK equity funds increased to a fresh record of £13.6 billion in 2023.

Fixed income funds saw inflows through 2023, though muted at just £720 million. Investors strongly preferred fixed income with low credit risk favouring UK Gilts and other Government Bond sectors, which took in a net £4.6 billion over the year. This suggests a level of caution among investors, though improved yields compared to historic levels may have drawn investors in.

Mixed asset funds saw outflows of £4.0 billion through 2023, as outflows from the balanced funds of the 20-60% Shares sector combined with weak sales and intermittent outflows from the 40-85% Shares sector. In contrast, sales remained steady to the Volatility Managed sector which took in a net £2.7 billion to place as the best-selling sector for 2023.

Money market funds were the best-selling asset class through 2023, with inflows of £2.2 billion. These funds are broadly used as a cash equivalent by retail investors, with low volatility and similar performance to cash. They can also be used in a more sophisticated way by advisers and DFMs acting on behalf of investors in times of market uncertainty where investment strategists are waiting for their next tactical opportunity and want to retain a highly liquid portion of the portfolio. For this reason money market funds have a volatile sales pattern and flows for these funds are not driven by the same factors as other asset classes. The pattern of sales to money market funds is in line with the IA's historic flow data and their status as the asset class best-selling also reflects the substantial outflows from other asset classes.

Responsible investment funds saw consistent outflows over the second half of 2023 with £2.6 billion pulled by retail investors for a total outflow through the year of £3.0 billion. Outflows from Responsible Investment funds contrast with strong inflows in 2020 and 2021 of £11.7 billion and £15.9 billion. Investor attitudes to responsible and sustainable investing may be coloured by poorer performance of sustainable investments through 2022 when oil and gas stocks performed well, industries that are typically screened out by responsible and sustainable funds. Responsible investment strategies are also predominantly (62%) equity, with a smaller proportion of FUM (15%) in fixed income strategies, which did better overall in 2023.



### **First Quarter 2024**

Outflows eased to £3.3 billion in the first quarter of 2024 from £8.6 billion in the last quarter of 2023, aided by inflows of £446 million in March, the first since April 2023. The softening of outflows was driven by reduced equity outflows, particularly in comparison with 2023.

FUM climbed 11% from the end of October 2023 to the end of March 2024, largely driven by improved equity performance. The continuing market rally was fuelled by optimism that inflation was coming under control and that central banks would be able to cut interest rates early in 2024. However, expectations that central banks will cut rates imminently have since proved to be too optimistic.

Inflation is approaching target in the UK and annual CPI has fallen to 2.3% in May, and as we move through 2024, investors are becoming more confident that inflation is stabilising. Investors are also well sighted on the cautious approach from Central Banks to rate setting, which means that any rate cuts are likely to be incremental rather than dramatic in 2024 – markets have been less successful at gauging the timing of rate cuts, however. The market shocks of February 2022 haven't been repeated and although we have seen a tragic war in the Middle East in 2024, the impact on the performance of markets has been negligible compared with the beginning of the Russia Ukraine war.

The long-term trend to favouring passive investing strategies has continued into Q1 2024, with inflows of £6.6 billion into index trackers and £10.0 billion of outflows from active funds.

Investor sentiment towards equity funds has become more favourable with net retail outflows dropping to £1.6 billion in Q1, from £5.9 billion in Q4 2023. UK equities remained the primary drag in Q1 through withdrawals of £3.4 billion. US equities are the net gainers as North American equity funds saw inflows of £625 million in Q1, entirely to index trackers. This is a mature and well researched market and US equity index trackers have long been favoured by investors over active funds. The US has benefited from stronger growth, the magnificent seven mega cap technology stocks continue to perform well and the US stock market is underpinned by a robust tech sector.

Indian equity funds having enjoyed consistent inflows and strong performance in 2023 saw inflows accelerate to record levels of £388 million in the first quarter of 2024. Consistent inflows to Indian equity funds have come as Chinese equity funds have suffered steady outflows for 14 consecutive months. Q1's outflow of £119 million comes after a period of poor performance for Chinese stocks and investor wariness over the outlook for growth for the Chinese economy compared with the period pre-pandemic.



More negatively, steady outflows from UK equity funds have continued through Q1 2024, with retail investors pulling a net £3.4 billion. Sustained outflows from UK equity continue the pattern of the previous 8 years. Arguably UK company valuations are cheap, which might be a buying signal to some and has led to M&A interest in UK listed companies such as Anglo American and the distribution arm of Royal Mail but in equities, investors continue to allocate outside the UK in 2024 to US and global equity funds.

In the fixed income space investors, shifted their preference from government bonds in 2023 to corporate bonds in Q1 2024. Bond yields have stabilised after surging in 2022, corporate bonds remain relatively cheap as the price of bonds move inversely to the yield but as cuts to the base rate from the major central banks seem certain at some point in 2024, bond yields are almost certainly going to fall and prices will therefore rise driving up returns. Retail investors placed a net £1.2 billion into corporate debt funds in Q1, against just £41 million through 2023. With expectations that interest rates will be cut later in the year, the risk of default will also reduce for corporate debt.

Responsible Investment funds remained in outflow through the first quarter, though withdrawals showed some signs of softening as investors pulled £725 million over the quarter, compared with £1.4 billion in the final quarter of 2023.

# IMPACT OF CASH ISA RATES ON RETAIL INVESTING

# IMPACT OF CASH ISA RATES ON RETAIL INVESTING

One factor behind challenging fund sales through 2023 is the increased appeal of cash savings as higher interest rates filtered through to savings products. In 2023, Bank of England data show inflows to cash ISAs totalling £47.2 billion, higher than the inflows of the previous eight years combined and beating 2001 the previous record year, which attracted inflows of £28 billion.

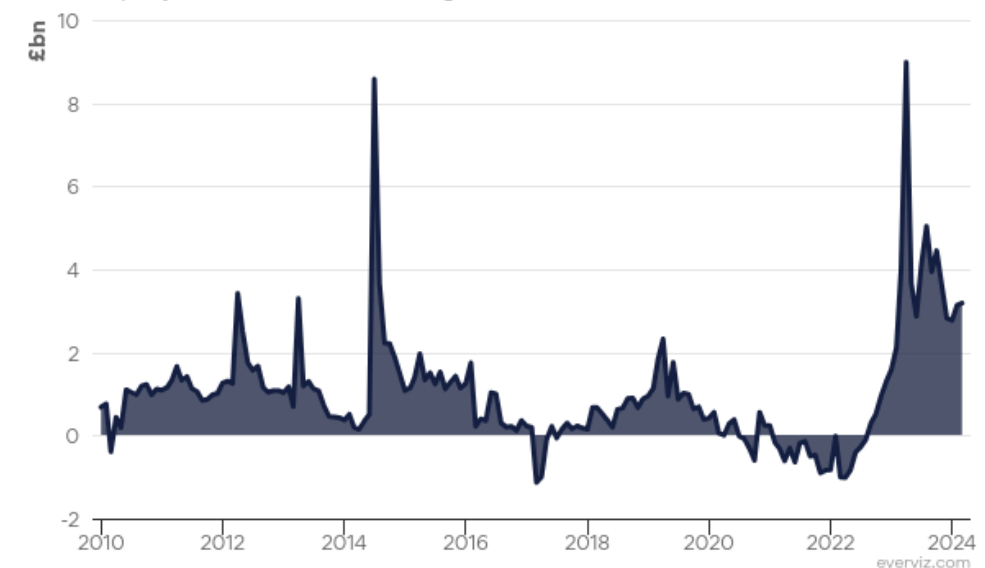
Following the cycle of Bank of England interest rate rises starting at the end of 2021, the interest received on cash savings has steadily increased. Fixed rates for new cash ISA customers peaked at 5.35% in October 2023 but have since fallen to 4.35% in March 2024 (the latest BoE data). The opposite chart shows net movements of assets to cash ISAs, illustrating the scale of the flows in 2023. This has continued into 2024 with a further £9.1 billion inflow to cash ISAs in the first quarter. While outflows from funds and inflows into cash ISAs are not necessarily the same money, the higher flows to ISAs are indicative of the increased appeal of cash.

Alongside higher rates than have been available in recent history, cash savings also offer a greater certainty of return, which may be especially important to investors uncertain over their own near term financial outlook, or facing concerns over a possible recession.

Using Bank of England and Morningstar data, we investigated how investors would have fared if they had placed £1,000 into a fixed rate cash ISA in 2023 or if they had invested the £1,000. Whilst one year is far shorter than the minimum recommended holding period for most funds of five years, it helps us to understand the experience for savers and investors through 2023.

**Chart two: Monthly changes of cash ISA deposits**

Seasonally adjusted (Source: Bank of England)



**Chart three: Return on £1,000 invest a year previously**

(Sources: Bank of England and Morningstar)

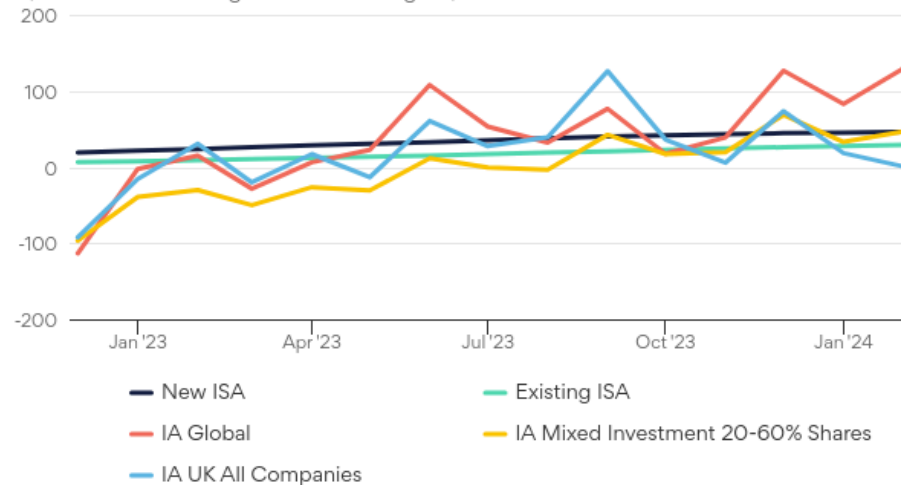


Chart 3 shows that a saver putting £1000 into a new cash ISA on the 1st of January 2023 would have a balance of £1045 by the 31st of December. If the saver had remained in the same cash ISA that they had used the previous year, on average they would have added £26 over 2023. This compares with £127 if they had invested in a global equity fund and £69 in a balanced portfolio of stocks and bonds. They would have received a return of £74 if they had invested the £1000 in a typical UK equity fund.

But the January to December window was particularly kind to investors in funds. Chart 3 illustrates the volatility of returns that investors experienced compared with the steady and predictable returns on cash ISAs. For nine out of the 14 months we analysed, the average fixed ISA rate for new customers would have given a better return over the previous year than a global equity fund.

Investing brings the risk of loss and volatility of returns can foster a view that investing is riskier than keeping assets in cash. Investment fund returns also have to be higher than 5% to convince savers that the rewards of investing are worth the risk compared with cash: this was not the case in a low interest rate environment. This reinforces the importance of communicating to investors that investing must be over the long-term. Investing over five years or more helps to smooth out the volatility of returns as well as providing superior returns on cash.

Many investors fully grasp the importance of long-term investment horizons. When we asked 1000 investors about their primary motivation for investing in a stocks and shares ISA, a healthy 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.

# SALES TO INDEX TRACKERS CONTINUE TO DOMINATE

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Inflows to index trackers across all asset classes climbed to £13.8 billion in 2023, up from £11.0 billion in 2022 though remaining below the c. £18 billion a year from 2019-2021. Index tracking funds have continually outsold actively managed funds since the end of 2021 and have remained in near continuous inflow, whereas actively managed funds have seen persistent outflows of £86 billion since the beginning of 2022 to the end of March 2024.

The ongoing popularity of index tracking funds forms part of a long-term trend, with the share of the funds market in trackers having more than doubled from 10.5% in 2014 to 22.7% at the end of 2023.

- In 2023, inflows to tracker funds were dominated by equity sales of £8.6bn and we reflect on the drivers behind equity tracker sales in the next section.
- Fixed income tracker sales were £4.3 bn in 2023. Investor preference for government bonds has also fuelled inflows to trackers as index trackers are heavily represented in the Government Bond sectors (82% of FUM in trackers) and the UK Gilts sector (72% of FUM in trackers).
- Mixed asset funds using trackers as building blocks were less popular with investors in 2023 with an outflow of £704 million.

In the first quarter of 2024, index tracking sales have made a strong start with inflows £6.6 bn - equity funds accounted for nearly 80% of sales.

**Chart four: Net retail sales to major equity sectors, 2023 to Q1 2**



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**Investors favour index tracking equity over active**

The above chart shows that equity outflows have been from active funds and investors have continued to place money into equity trackers over the past 15 months with the notable exception of UK equities. Equity funds make up 64% of tracker FUM.

**UK equities:** Active UK All Companies funds saw an outflow of £8.6 billion through 2023. Outflows from UK All Companies index trackers were more modest at £1.7 billion. Outflows from UK equities also form part of a long running structural change with an ongoing erosion of home bias. Investors in the UK are increasingly embracing global diversification, with UK equities comprising a smaller portion of total equity funds under management (FUM). However, UK equities still hold a significant weight, accounting for 20% of the equity portion of industry FUM, which remains high when compared with the weighting to the UK of 3.8% in the MSCI World benchmark.

**North American equities:** Actively managed North America funds saw outflows of £3.3 billion in 2023, almost counteracted by inflows of £3.0 billion to North America Index trackers. The inflows to North American equities in Q1 2024 were almost entirely driven by index trackers, though outflows from North American actively managed funds did dry up. Inflows to North American equities have been boosted by the strength of the US economy, signs of earlier low inflation and a much heavier weighting to technology stocks which saw strong performance in 2023 amidst excitement around the possibilities of Artificial Intelligence. Over 2023 the US Russell 3000 index returned 18.9%, outperforming both Europe (MSCI Europe ex UK – 15.8%) and the UK (FTSE All Share – 7.9%).

**Global equities:** Global sector index trackers remained popular, with inflows of £4.3 billion through 2023, jumping to £2.4 billion in the first quarter of 2024. Actively managed Global funds saw outflows through the period however, with £4.0 billion net retail outflows.

In a period of weaker economic growth with lower return prospects, investors may be focusing more heavily on controlling the cost of investment as a way of supporting returns by opting for index trackers.

Record outflows of £13.6 billion for UK equities in 2023 present a stark picture, and the influence of adviser and wealth manager re-allocation away from the UK to the US and Global is a clear driver of outflows from the UK. However, our polling of UK investors in March 2024 suggests that individual investor sentiment towards UK companies is not wholly negative. 55% of stocks and shares ISA investors that we polled in March were confident that investing in UK companies would meet their investment goals. Admittedly this was less favourable than the 72% who were confident in investing a diverse range of global companies but was still positive. 62% of the youngest age group of 18-35 year olds were confident in the UK compared with 67% for global companies suggesting the gap in confidence is closer for the young who may not have the wisdom of experience.

# ASIAN EQUITY FOCUS

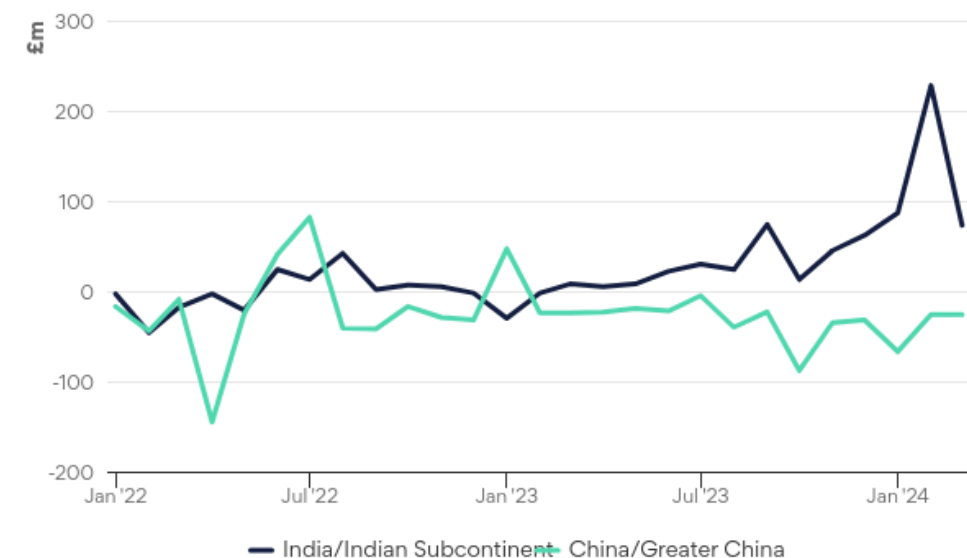
# ASIAN EQUITY – INDIAN EQUITY GROWTH AS FLOWS TO CHINA FALL

China has been a significant driver of global growth accounting for 35% of nominal GDP growth over the past 15 years according to the IMF and UK investors looked to investment opportunities as net retail sales to funds investing in China grew. However, since the pandemic, the fortunes of the Chinese economy have been much more mixed and IA data show that since 2023, retail investors have been turning to India as confidence in the performance outlook for India has been building.

Over the 15 months to the end of Q1, Indian equity funds under management grew 43% and net retail sales are £647 million, compared with 2022 when sales to the India/Indian Sub-continent sector were flat with £1 million outflow. In contrast, Chinese equity funds faced steady outflows that have extended into the first quarter of 2024. Over the 15 months to the end of March 2024 investors pulled a net £406 million from the IA China/ Greater China sector.

Indian equities have benefitted from the country being the fastest growing major economy through 2023, with GDP increasing 8.4% year on year. Manufacturing continues to play a significant role in Indian growth, supported by concerted government efforts. With increased attention to the risk geopolitical conflicts can have for global supply chains India is, as the world's largest democracy, positioned to benefit from 'friendshoring' – the relocation of supply chains to friendly states. Whatever the outcome of the Indian election, Modi's policies have been pro-business and attracting foreign investment. Over the longer-term India also benefits from youthful demographics and an expanding middle class.

Chart five: Net retail sales to India and China equity funds, 2022 - Q1 2024



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Although China has not had to grapple with the escalating inflation that has hampered other markets, economic growth has still weakened since 2021 and this has affected investor sentiment. The impact of strict and long COVID-19 lockdowns affected the speed of the Chinese economic recovery and contributed to the slowdown in consumer spending. Weaker demand from overseas consumers for Chinese products has not been helped by war in the adjacent Middle East. Supply chains have also started to diversify – which has loosened supply chain dependency on Chinese exports. The Chinese property market slump has been a well-publicised challenge to growth.

The performance of Chinese stocks since 2021 shows cumulative returns for the MSCI China index of -41.8 over the last 3 years and in the Chinese tech sector we have seen falling valuations in contrast to the US-listed Magnificent 7 stocks that over 2023 have shown strong performance.

If Chinese equities are to return to favour, investors will be looking for consistent and supportive fiscal policy, a stable and fair regulatory environment, and a supportive stance towards overseas investment in Chinese companies. China's planned fiscal stimulus package for 2024 of 11.1 trillion yuan is welcome in helping to meet China's 5% economic growth target for 2024 but investors are also looking to see that China can manage the budget deficit and ease its local government debt risks.

# FIXED INCOME

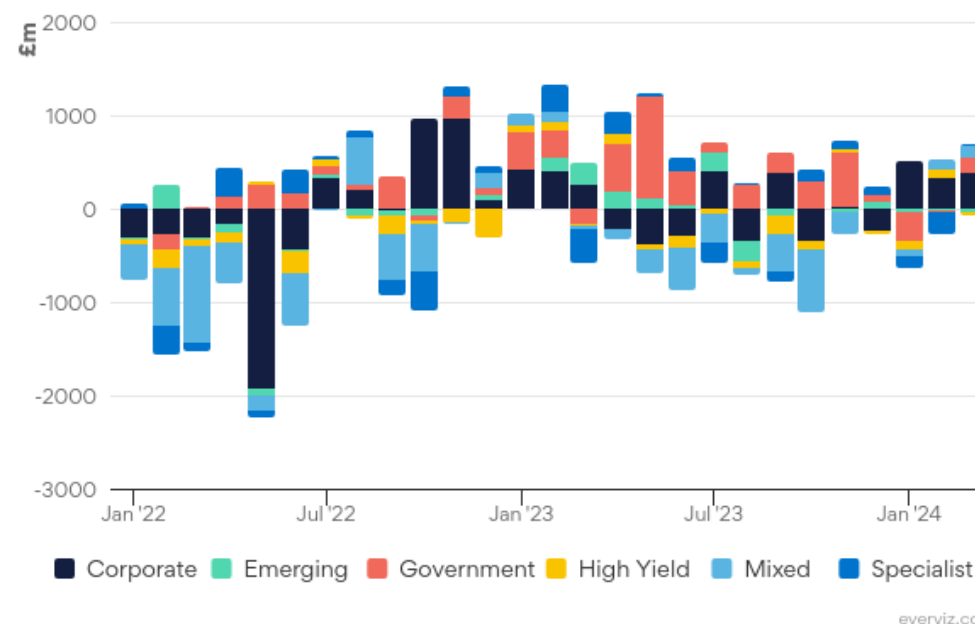
# FIXED INCOME

In 2023, the money market and fixed income asset classes saw inflows whilst every other asset class was in outflow. Bond funds attracted £720 million - the most attractive sectors were government bonds and UK gilts. To simplify the wide array of bond funds, in chart 6 we have grouped the net retail sales of the IA fixed income sectors by credit risk,

Government bond funds, including the UK Gilts sector, alongside the Global, USD and Euro Government Bond sectors took in a combined £4.0 billion from retail investors over 2023 making them the most popular fixed income funds. The preference for government bonds in 2023 suggests a level of risk aversion amongst investors and may also have been driven by high yields. Government bonds are seen as being among the safest assets and although they did lose value in 2022 as interest rates rose rapidly (bond prices moving inversely to yields/interest rates), that concern faded in 2023 as interest rates reached their apparent peaks. Corporate bond funds meanwhile saw inconsistent flows month-on-month for a minimal £41 million inflows through 2023, while mixed bond funds saw heavy outflows of £2.3 billion.

Emerging markets funds saw inflows of £691 million, through the year, though these were heavily concentrated to the first half, while the more niche funds in the high yield sectors saw outflows of £369 million. With attractive yields available on corporate and government debt, and with concern over a 'hard landing' - a recession triggered by higher rates, High Yield funds with a higher chance of defaults have not appealed to investors.

Chart six: Net retail sales to fixed income by credit grade, 2022- Q1 2024



Inflows to fixed income funds have continued in the first quarter of 2024 with net retail sales of £163 million. We do observe a shift in investor preferences, however.

Towards corporate bonds. Inflows to funds across all currency denominations has been £1.2 billion in Q1, after a flat 2023 where inflows were just £41 million. To the extent that 2023 preferences for government debt suggest a risk-off attitude, the shift towards corporate bonds in 2024 suggests increasing investor confidence, and therefore willingness to take on more risk. Additionally, a slight reduction in yields on bonds towards the end of 2023 may have increased the relative appeal of corporate bonds.

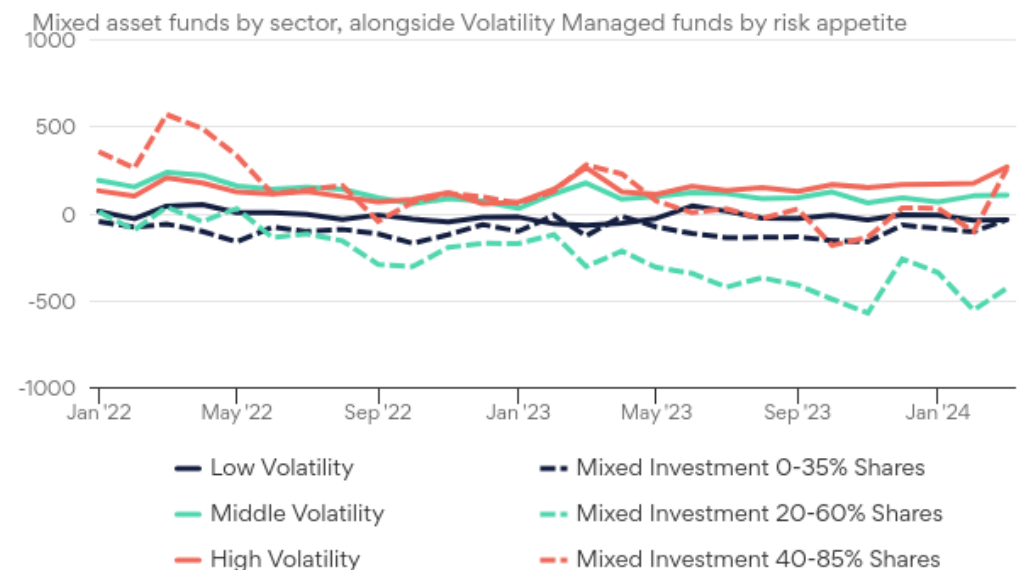
# VOLATILITY MANAGED AND MIXED ASSET

# VOLATILITY MANAGED AND MIXED ASSET

Outflows from mixed asset funds rose to £4.0 billion in 2023, up from £233 million in 2022. The Mixed Investment 20-60% shares sector bore the brunt of outflows after challenging performance in 2022, however, all the mixed investment sectors struggled to attract retail investor inflows, which is a marked contrast from the trend of the 10 years leading up to 2022 when flows averaged £7.7 billion annually. In contrast, the Volatility Managed sector remained in steady inflow through 2023, with net retail sales of £2.7 billion placing it as the best-selling IA sector for the year. Volatility managed funds typically map to the adviser risk profiling process. Less wealthy clients are often placed in a fund structure, which is cheaper because it does not include a discretionary fee, and shows a single line of stock so can be perceived as less compelling to clients than a portfolio of different funds. Even if advisers are using volatility managed funds for a specific client segment, we have seen remarkable sales consistency to the sector through a tough year for sales to the wider mixed sectors.

We can look under the surface of the volatility managed sector to see if there is a difference in sales to funds managed to high, middle or low volatility targets. The below chart shows flows to each of the three mixed investment sectors, alongside different strands of the Volatility Managed sector. While there is not a standard measure of volatility, funds within the Volatility Managed sector are sold as fund ranges and the data here has been subdivided according to – low, middle and high volatility. There has been a shift within the sector however as investors have increasingly opted for higher volatility funds.

**Chart seven: Net retail sales to mixed asset and Volatility Managed funds, 2022 - Q1 2024**



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Whereas previously investors had favoured the middle volatility funds within ranges, throughout 2023 and into 2024 the higher volatility funds have consistently been best-selling. Typically, the higher volatility funds within a range would be expected to have higher equity allocations with equities ordinarily expected to offer higher long term returns but with greater volatility. The preference for higher volatility matches the pattern seen in the mixed investment sectors, with the higher equity 40-85% shares sector remaining the long-term investor favourite. Often, we expect investors to show a middling tolerance for volatility but if advisers are using these funds for less wealthy clients, they may also be younger and building up their investment pots. This could mean that longer investment horizons and a higher appetite for risk is driving up sales to the higher volatility banded funds. Or simply that to generate a return above cash, investors and advisers are having to make judgments that are driving investors into higher risk rated portfolios.

The other notable trend in the mixed asset data is outflows from the balanced funds of the 20-60% shares sector, with a roughly equal mix of equities and bond. Funds in the sector have seen heavy outflows with £4.0 billion withdrawn in 2023 and a further £1.3 billion in Q1 2024. These funds have traditionally been used to shield investors from losses across market cycles but struggled in 2022 when both asset classes lost value in tandem as interest rates went up.

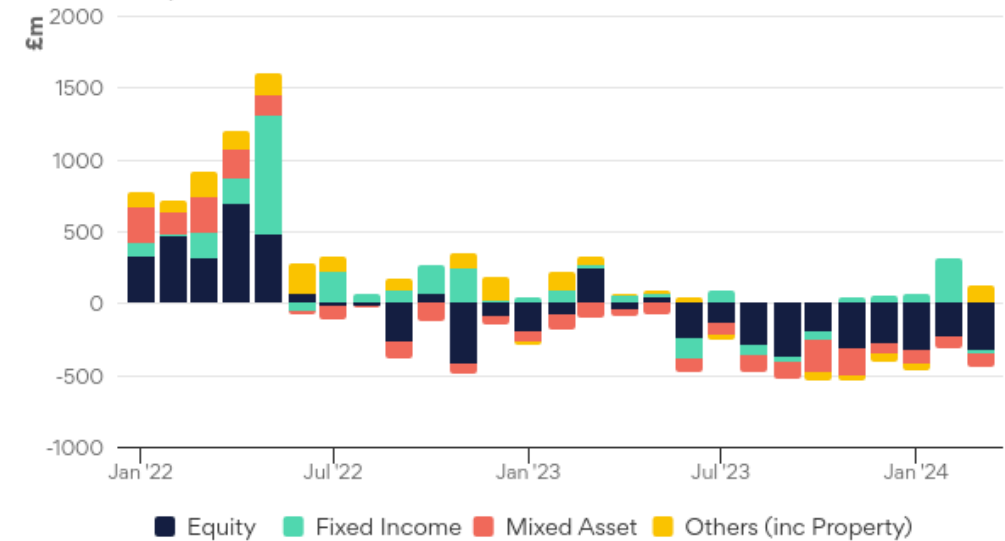
# RESPONSIBLE INVESTMENTS

# RESPONSIBLE INVESTMENTS

Responsible investment funds have seen continued outflows through the first quarter of 2024, maintaining the trend seen in the second-half of 2023. Investors pulled £725 million in the first quarter of 2024, slightly below the average quarterly outflow of £1.3 billion in the second half of 2023.

Equity and mixed asset responsible investment funds have continued to suffer the highest of outflows, with investors pulling £1.9 billion and £1.3 billion respectively through 2023. Meanwhile there have been some moderate inflows to responsible investment bond funds, with a net inflow of £88 million in 2023. Despite outflows however, responsible investment funds under management grew over 2023, from £91 billion at the start of the year to £102 billion by the end of the year. As a share of the industry, responsible investment funds went from 6.6% to 7.2% over the year.

**Chart eight: Net retail sales to Responsible Investment funds by asset class, 2022 - Q1 2024**



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Various factors are likely to have contributed to poor flows for responsible investment funds in 2023;

- Investor memories of underperformance in 2022, when fossil fuel producers (often excluded by responsible investment funds) in particular saw strong performance.
- Minimal representation among the best-selling sectors – money market funds, UK Gilts, and other government debt. Risk and return would appear to be the primary considerations for investment choice, with sustainability characteristics playing a secondary role.
- U-turns on green policy by both the Labour and Tory parties, with public discourse moving away from sustainability and politicians scaling back green ambitions amid tighter financial conditions.

# FLOWS TO UK DOMICILED FUNDS IN A GLOBAL CONTEXT

# FLOWS TO UK DOMICILED FUNDS IN A GLOBAL CONTEXT

UK domiciled funds were in outflow in 2023 – in contrast with the recovery in sales to funds domiciled in the US, Europe, and Ireland. The FUM in US domiciled funds dwarfs the UK market at over \$32 trillion so to analyse sales data on a like for like basis, Chart nine shows sales as a proportion of FUM for the US, Ireland and Luxembourg as key fund domiciles and compares the data with the UK and the rest of Europe. This data represents institutional and retail sales data.

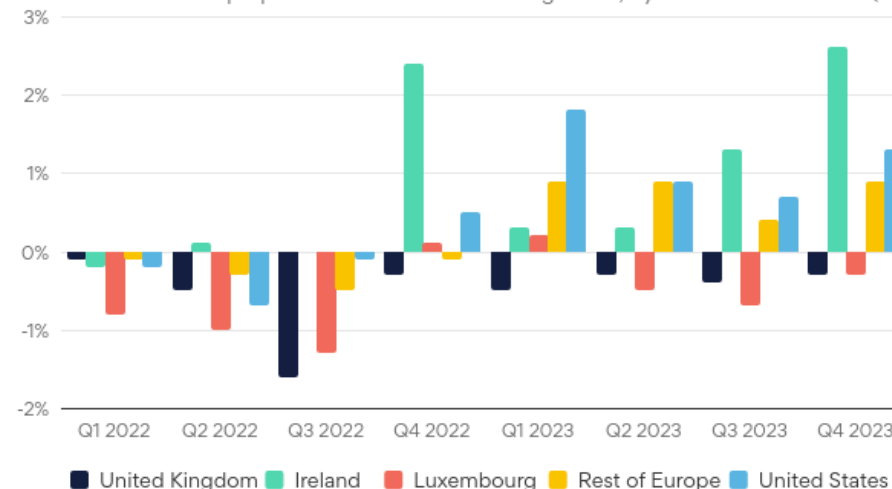
While all domiciles saw outflows in 2022, the UK stands out as having remained in consistent outflow through 2023, with outflows averaging 0.4% of industry size per quarter. Within Europe, Ireland has seen strong inflows boosted by strong money market fund and ETF activity. Inflows through 2023 averaged 1.1% per quarter for Ireland. While active ETFs do exist, ETFs are largely index tracking, and strong ETF sales likely reflect a preference for index tracking funds. The data for this chart includes institutional flows, and ETFs typically see higher use by institutions than retail clients.

Similarly, the bulk of inflows to US funds through 2023 was to money market funds. The collapse of a number of regional banks in the US may have steered some US investors towards money market funds. Inflows to US domiciled funds averaged 1.2% of FUM per quarter in 2023, against an average quarterly 0.1% outflow in 2022.

The below chart is presented on a domicile basis, and as a domicile the UK has limited numbers of smaller money market funds, and no ETFs at all. As a fund domicile, the UK was therefore poorly positioned to respond to shifting market patterns in 2023. Among the mainstream asset classes European investors showed similar preferences to UK investors, favouring bonds and selling out of equity funds.

**Chart nine: UK in a global context**

Total fund flows as a proportion of funds under management, by domicile 2022-2023 (Source: evertiz.com)



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**LOOK AHEAD**



## LOOK AHEAD

The high level of fund outflows seen in 2023 softened in the first quarter of 2024 as markets rallied on the expectation that inflation was coming under control and that Central Banks might cut rates as early as March. Whilst the expectation of Q1 rate cuts proved to be optimistic, markets have not reacted overly negatively.

The macro-economic outlook remains hard to predict as a series of global elections will bring new policy makers into power and with them, new fiscal policies. Whilst the UK has returned to growth in the first quarter of 2024, 0.6% is weak and productivity challenges remain with little headroom for fiscal stimulus whichever party wins the general election.

Persistent inflation in the US, has pushed back expectations for near term interest rate cuts from the Federal Reserve. Expectations for the Federal Reserve cuts in 2024 have gone from 5 or 6 cuts of 0.25% to just one or two, towards the end of the year. Persistent inflation in the US is also a symptom of relatively strong economic growth compared with other developed markets and we have seen inflows to North American equity funds at the start of the year. The US elections will colour investor attitudes, and a new president will bring policy changes.

If the Republicans win, however, it will be hard to repeal the recent fiscal stimulus provided by the Inflation Reduction Act, which has partly been designed to attract jobs to the US and has offered attractive incentives to operate from the US, particularly in sustainable industries.

In the UK, the latest inflation figures for May 2024 are 2.3%, which is close to the Bank of England's 2% target. The Bank may move to cut rates before the Federal Reserve but much of the recent fall in inflation has been driven by falling energy costs, while services inflation remains sticky at 5.9%. Higher services inflation is an indicator of domestic inflationary pressures as salary increases at UK firms contribute to elevated levels, whereas energy and food prices are more impacted by global factors. With the calling of a snap general election in July, the chances of a rate cut at the June meeting have become more remote, making an August rate cut likely.



The prospect of political change, coupled with geo-political tensions in the Middle East, Russia/Ukraine and in China and a sustained period of higher interest rates mean that we think that investors will remain cautious in 2024. Inflows to fixed income funds will continue through the year, a symptom of continued caution and cheap investment grade corporate bonds, where prices will rise on the bank of interest rate cuts that seem certain at some point this year. Equity sales may be more volatile given the macro-economic climate.

Nevertheless, our recent investor polling shows that 77% of investors take a long-term view of investing, irrespective of the rise and fall of markets and 50% of investors cited generating a return better than cash as the most important reason for investing in a stocks and shares ISA. Over five years or more, investments in equities and bonds have traditionally outperformed cash, and with inflation approaching the Bank's target of 2%, we can hope that investor confidence continues to recover improving net flows to funds.

# INDUSTRY DATA EXPERT PAGES

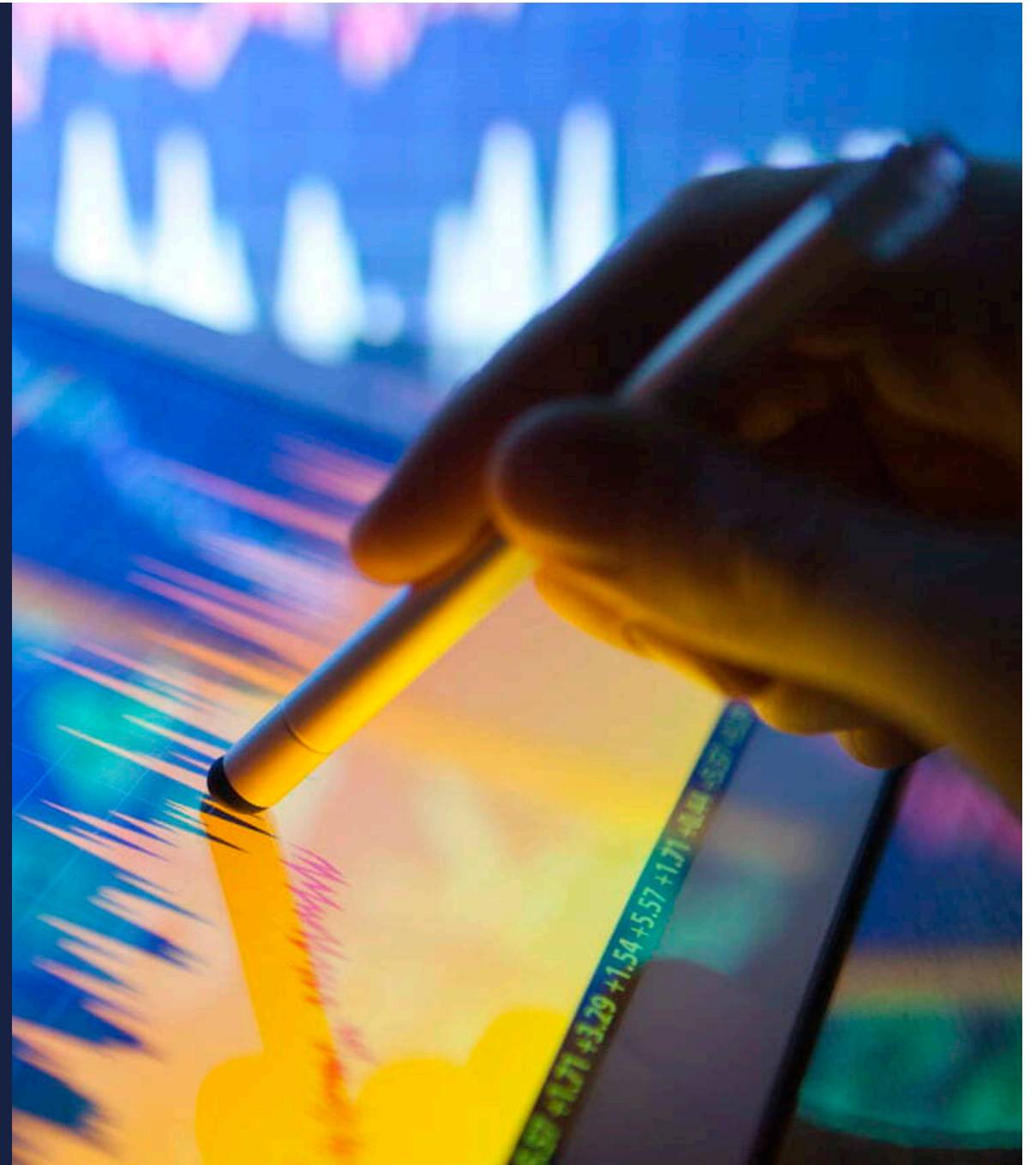
[The IA annual survey](#) provides a snapshot of the UK industry in a European and wider international context. It contains hundreds of data points on trends in how firms invest for their customers and how the industry is evolving.

[Monthly Statistics](#) The sector sales tables below show industry-wide data. They are provided in a downloadable Excel format.

[ECHOweb](#) Available to full members only, enables members to carry out their own detailed analysis of industry trends, including their market share and ranking across the IA sectors and distribution channels.

For more information, send an email:

The IA statistics team.



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