

# FTfm Quarterly Industry Review

## ETFs the only bright spot as outflows roll on

### Overview

Europe's industry needs to address structural problems, writes **Pauline Skypala**

Exchange traded fund sales were the only bright spot for the European fund industry in the third quarter as outflows increased again following a slightly less horrible experience in the second quarter.

Overall, but excluding money market funds, a net €101.1bn (£85.4bn, \$127bn) flowed out of funds in the three months to the end of September according to Lipper FMI, making it the fifth negative quarter for fund sales in a row.

This was a big increase on the

€101.1bn

Outflows from European funds in the third quarter, 2008

€33.6bn

Outflows in the second quarter

€33.6bn withdrawn in the second quarter, but less than the record €131.6bn taken out in the first quarter. However, hopes that the second quarter marked a turn-around have now been dashed, with an expectation that October figures will be worse still, and the fourth quarter is unlikely to show any improvement.

The only fund markets to buck the trend were those of Estonia, the Netherlands and Romania. Even the UK, which had recorded positive flows in the previous three quarters, turned negative.

"In September, we saw about €125bn come out of funds [including money market funds], which was almost double the previous

worst month," says Diana Mackay, chief executive of Lipper FMI.

She is expecting the October figure to be worse as that was when governments started handing out bank guarantees. Combined with precipitous stock market falls, "most investors took the view it was better to be safe than sorry", she says.

Even the money market sector, which had been a success story for fund managers earlier in the year, took a hit in the third quarter, largely due to a €66bn outflow in September when the Lehman Brothers failure spooked institutional investors. Again, Ms Mackay expects the effect to be bigger still in the October figures.

Equity fund redemptions were smaller, at nearly €25bn for September, and flows were positive in August, although only to the tune of €1.9bn. The figures were helped by ETF sales, says Ms Mackay, with €13.2bn of net ETF sales for the third quarter and €30.3bn for the year to date.

Ms Mackay suggests equity fund redemptions up to September could be attributed to profit-taking by investors, but from October they were probably selling out at a loss. "Redemptions are to some extent a symptom of past success," she says. European and eurozone equity funds – among the most successful in the mid-2000s – have suffered such big redemptions that assets under management are 10 per cent lower than in 2001.

One of the problems for fund managers in continental Europe is that funds have been traded like securities, says Ms Mackay. She contrasts the experience of Europe with that of the US, where redemptions have been lower – €41bn in September against Europe's €124bn. Equity fund redemptions were similar; the big difference was in bond fund outflows, she says.

"Money has been coming out of bond funds for three years [in Europe], while equities have been more stable," says Ms Mackay.

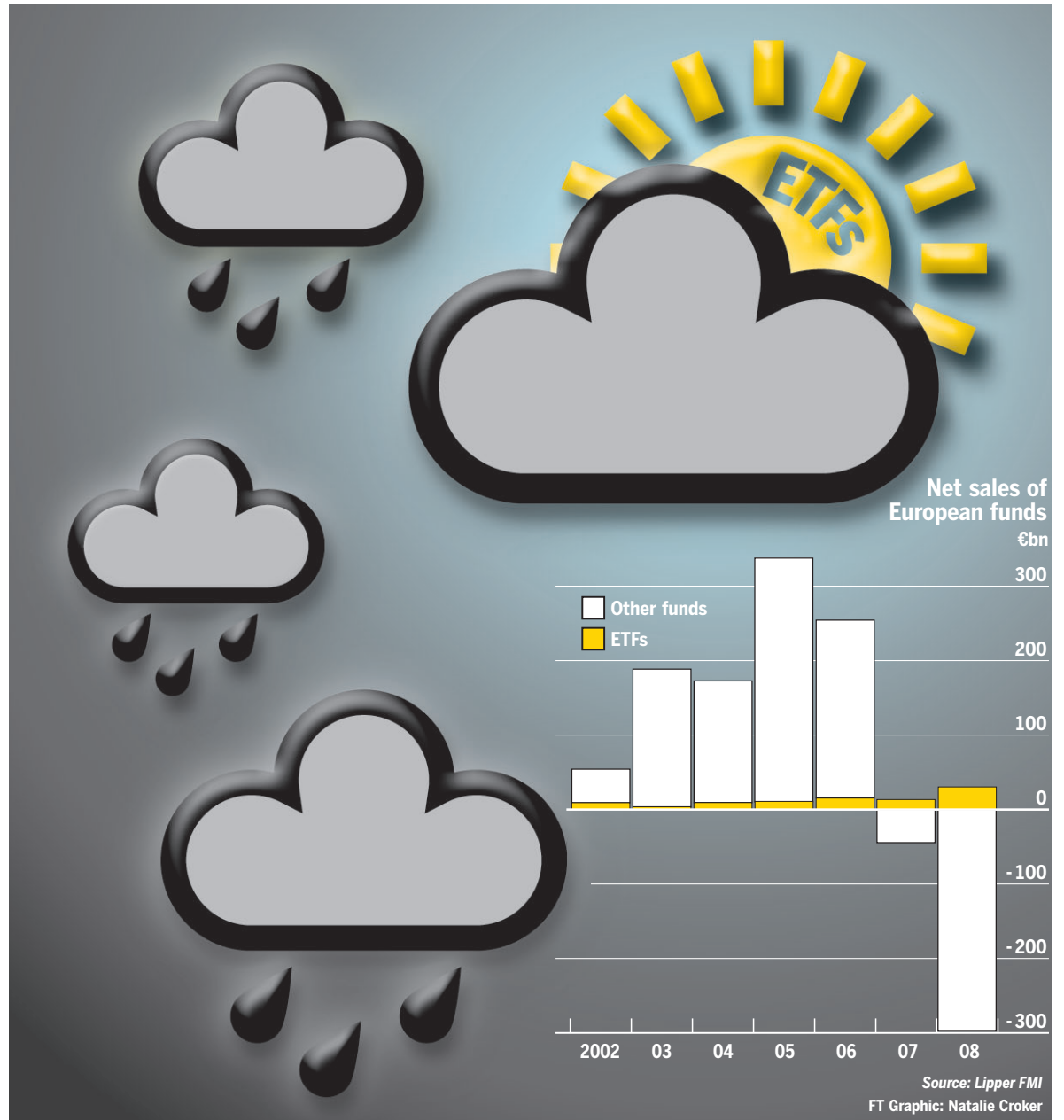
### Top selling new fund launches in Europe

Latest quarter (Jul-Sep 2008)

Rank	Master group	Fund Name	Sector	Fund launch date	Estimated net sales (latest qtr)
1	Deutsche/DWS	DB Privatmandat Comfort Garant	Guaranteed Fund	Sep 15 08	2,305.3
2	Deka	Deka - Optirent 2Y	Asset Allocation	Aug 18 08	1,341.4
3	Deutsche/DWS	DWS FlexPension 2023	Fund of Funds Guaranteed	Jul 1 08	785.1
4	Union	UniGarantPlus: Best of Assets (2014) II	Guaranteed Fund	Sep 24 08	610.5
5	HSBC	HSBC Int'l Select Fund - Multialpha European Equity	Equities Europe	Jul 17 08	376.5
6	KBC	KBC Participation Europe Financial Bond Opportunities	Bonds EUR	Sep 1 08	361.3
7	Towry Law	Towry Law Mixed Portfolio A	Fund of Funds Equities Global	Sep 2 08	343.7
8	Aldermanbury	SFM CAM	Not Sectorized	Jul 2 08	341.8
9	Aberdeen	Aberdeen Global V Fixed Income Alpha 50Year GBP	Bonds GBP	Sep 12 08	313.3
10	Cr Agricole	ENIS Europe Short Term Cap	Bonds EUR Short - Term	Jul 21 08	288.6

Source: Lipper FMI

Data includes retail investment funds only and excludes money market funds because of distortions from institutional liquidity funds



Banks, the main distributors of funds in continental Europe, have been advising investors to sell bond funds in favour of more profitable (for the banks) products such as structured products. More recently, they have directed money into deposits, to help repair balance sheets damaged by the credit crisis.

"Where there is a bank distribution culture there is a clear move from funds into bank accounts," she says, adding that in Italy in particular, "the money coming out of bond funds and going into deposits almost matches".

Italy's fund industry had more than €500bn under management five years ago. That has now fallen

to €284bn due to banks' preference for putting customers into deposits rather than funds.

"Fund managers are part of the banking industry and if banks choose to sell one product over another the fund management industry can't do much about it," says Ms Mackay.

The other contributing factor to the high outflows in Europe, according to Ms Mackay, is that funds are sold as lump sum investments. Investors "dive into the latest investment fashion", ending up with a portfolio of specialist funds, usually with a European equity fund in addition.

In the US, and the UK, by contrast, there is both a strong inde-

pendent advisory sector and a culture of monthly saving, which makes money "stickier".

It is easy to track the value of a lump sum investment, making people more likely to sell to take a profit and creating a more volatile sales environment.

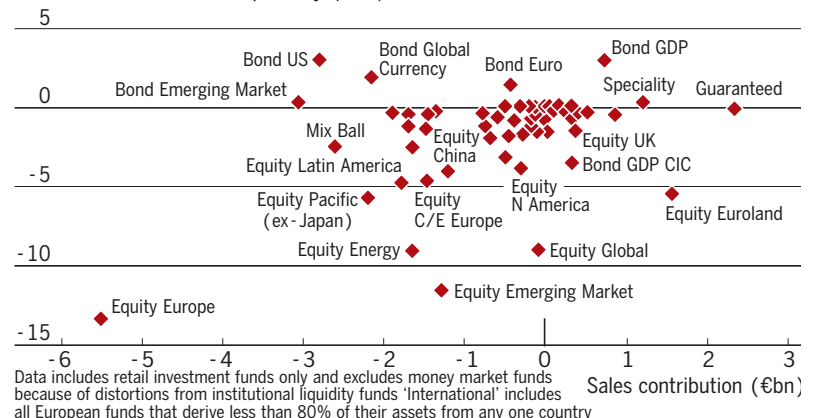
Encouraging a monthly savings culture and reforming the distribution system would do much to help the fund management industry recover, says Ms Mackay.

"Where you have a distribution structure primarily led by commissions and dominated by bank salesforces and lump sum savings, there is a huge conflict of interest. The industry, including regulators, needs to start looking at this."

### Sector positioning for international groups

Latest quarter (Jul-Sep 2008)

Performance contribution, quarterly (€bn)



Data includes retail investment funds only and excludes money market funds because of distortions from institutional liquidity funds 'International' includes all European funds that derive less than 80% of their assets from any one country