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Record outflows may signal bottom

Overview

There is widespread belief that the worst is over, writes **Steve Johnson**

Outflows from Europe's beleaguered fund industry hit a record high in the fourth quarter of 2008 as resurgent market volatility in the wake of the Lehman Brothers collapse saw investors accelerate their rush for the exits.

However, there are tentative signs that the worst may be over with tumbling deposit account rates leading wealthier investors, in particular, to look afresh at corporate bond and equity income funds.

Across the continent, flows into equity funds turned positive in November and December, while in some markets, such as the UK, flows into bond funds were positive for the fourth quarter in aggregate.

"I was expecting December to be dreadful but there was quite a bit of activity in equities and there have been some clusters on the corporate bond side in some European markets as well," says Diana Mackay, managing director of Lipper FMI, which compiled the data.

"There are some people out there with savings and they are faced with getting zero point nothing on their deposit accounts and that is creating some pressure, particularly at the wealth management end of the spectrum, to look at better options, even at the cost of a little extra risk.

"People are not looking so much at capital growth now, it's a matter of how to replace income."

Ms Mackay believes the modest improvement in sentiment has continued since the turn of the year. "The feedback I get from fund groups is that the markets have stabilised quite considerably and they are saying that flows seem to be coming back in," she says.

Her comments mirror those of Peter de Proft, director general of Efama, who believes the worst is over for the industry, with net outflows in November and December slowing to a trickle and anecdotal evidence pointing to further stabilisation so far this year.

"I'm much more positive than I was a couple of months ago. There are a number of positive signs; equity markets are bottoming out and bond markets are functioning again," he told the FT last week.

Despite the cautious optimism, the fourth quarter, in aggregate, was another horror show for the industry. Stripping out low-margin money market funds, net outflows hit €132.2bn (£117bn, $166bn), marginally ahead of the previous record of €131.5bn witnessed in the first quarter of 2008.

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Net outflows totalled €396bn in 2008 as a whole. Combined with slumping markets, these withdrawals meant industry-wide assets, excluding money market funds, plunged 34.5 per cent to €2,715bn.

Fourth quarter net flows were negative in all but three countries; Slovenia, which had a tiny inflow; the UK, which benefits from the profusion of regular savings products; and Sweden, where pension scheme money is put to work in the final quarter.

At this stage it remains unclear as to whether corporate bond or equity income funds will be the primary beneficiaries of the hunt for income.

Six of the 10 best selling fund launches in the fourth quarter were bond funds, with multi-asset funds also generating some interest. Sterling-denominated investment grade corporate bond funds were popular, attracting new inflows of €1.4bn in the fourth quarter.

However, equity funds also exhibited signs of life in December, attracting net inflows of €10.3bn, the highest monthly figure since February 2007, with eurozone and global funds in demand.

Barclays and Société Générale, Europe's two largest exchange traded fund houses, were by far the most successful groups in terms of fourth quarter in terms of net inflows.

More surprisingly, the top 10 in the "international" sector, defined as those that do not generate four-fifths of their assets from a single country, also featured two hedge fund managers that have expanded into the regulated environment; GLG Partners and Odey Asset Management.

The UK saw a dogfight between two houses for pole position in terms of net inflows; M&G Investment and Invesco Perpetual, with their respective strengths in corporate bonds and equity income. Impressively, Mediolanum, the Italian house, not only dominated flows in its home market but also doubled its assets in Germany, thanks to demand for a Luxembourg-domiciled equity income fund.

However, rather than looking over its shoulder, the industry is likely to be more focused on the extent of any pending pick-up in demand.

There have been a few bright spots so far this year. Regulated mutual funds in Switzerland saw SFr4.3bn (£2.5bn, €2.9bn, $3.7bn) of net inflows in January, according to Lipper, although SFr4bn of this went into money market funds, suggesting confidence in riskier assets still remains in short supply.

Separately, the closely watched ZEW index of German investor confidence leapt from -31.0 in January to -5.8 in February, its fourth straight monthly rise and the highest reading since July 2007, buoyed by interest rate cuts and the German government's latest economic rescue package.

However, Ms Mackay fears progress will be slow. "I think it's going to be quite a long haul. We will get [inflows] coming from the wealth segment first but I would be surprised if we had much evidence of mainstream investors returning this year," she warns.