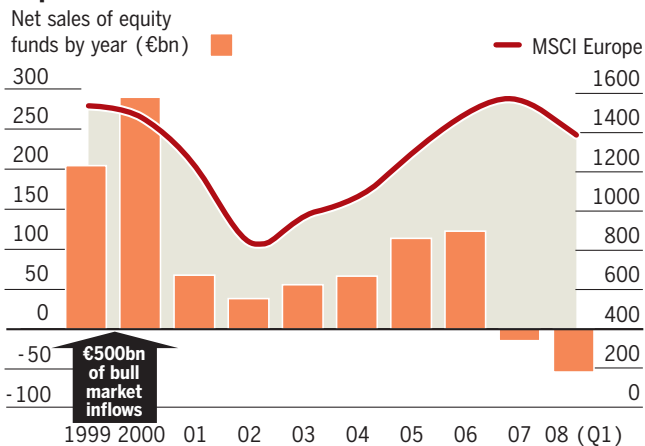
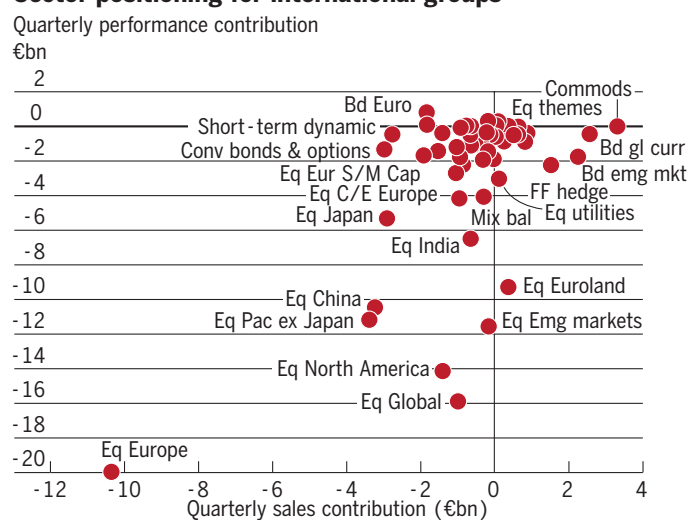


# FTfm Quarterly Industry Review

## Impact of millenium bulls



## Sector positioning for international groups



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

**Money fund losses increase turmoil**

Aug 2007

**Credit crisis drives investor exodus**

Nov 2007

**European outflows may be worst ever**

Nov 2007

**Fortunes polarising across Europe**

May 2007

**No end to outflow from Europe's funds**

Feb 2008

## Core sector performance

Value of €1000 invested in Jan 2003\*

|   | 2003    | 2004        | 2005        | 2006        | 2007        | 2008    |
|---|---------|-------------|-------------|-------------|-------------|---------|
| Bond Euro growth                            | 1,000.0 | 1,035.1     | 1,086.0     | 1,119.3     | 1,117.5     | 1,124.6 |
| Eq Eur/Euroland growth                      | 1,000.0 | 1,162.2     | 1,274.5     | 1,569.4     | 1,853.6     | 1,903.7 |
| Eq global growth                            | 1,000.0 | 1,158.7     | 1,233.6     | 1,500.3     | 1,654.9     | 1,707.9 |
| Eq Japan growth                             | 1,000.0 | 1,210.8     | 1,301.0     | 1,856.7     | 1,770.4     | 1,535.1 |
| Eq North American growth                    | 1,000.0 | 1,188.3     | 1,250.2     | 1,378.4     | 1,476.8     | 1,511.0 |
| <b>Value of €1000 invested in Jan 2005*</b> |         | <b>2005</b> | <b>2006</b> | <b>2007</b> | <b>2008</b> |         |
| Bond Euro growth                            |         | 1,000.0     | 1,030.7     | 1,029.0     | 1,035.5     |         |
| Eq Eur/Euroland growth                      |         | 1,000.0     | 1,231.4     | 1,454.4     | 1,493.6     |         |
| Eq global growth                            |         | 1,000.0     | 1,216.2     | 1,341.5     | 1,384.5     |         |
| Eq Japan growth                             |         | 1,000.0     | 1,427.2     | 1,360.9     | 1,179.9     |         |
| Eq North American growth                    |         | 1,000.0     | 1,102.5     | 1,181.3     | 1,208.7     |         |

\* Figs at start of each year

Source: Lipper Feri

# Outflows surge to record levels

## OVERVIEW

European investors are turning against both bond and equity funds, but the expectation is that they will be back when the time is right, writes **Steve Johnson**

The flood of money being withdrawn from Europe's equity and bond funds turned into a tidal wave in the first quarter of 2008, easily surpassing the level of redemptions seen after the bursting of the dotcom bubble.

Investors withdrew a net €75bn (£60bn, \$116bn) from equity funds in the first three months of the year, extending the net outflow of €7bn witnessed in 2007, according to data from Lipper Feri.

Even during the depths of the post-dotcom depression, flows into equity funds never turned negative on a calendar year basis. Net inflows slowed to €41bn in 2002, which was the nadir.

And, unlike any other period in the past decade, investors are turning against both equity and bond funds simultaneously, withdrawing a net €30.7bn from the latter in the first quarter of 2008.

Stripping out low-margin money market funds, net outflows from

the European fund industry surged to €137bn in the first three months of the year, more than double the €62bn witnessed in the final quarter of 2007, with only the Czech Republic, Hungary and Romania reporting positive flows. Factoring in market movements, the assets of the European industry fell by an eighth, or €530bn, to €3,624bn in just three months.

However, Diana Mackay, managing director of Lipper Feri, says there are rays of hope in the data. Firstly, outflows have slowed since January, when they reached €56bn for equity funds alone.

Early indications suggest April data may show positive flows, although this is largely due to the new-found popularity of money market funds.

German investors are also expected to start buying equity and balanced funds in the second half of the year, with capital gains tax due to be imposed on investment funds from January 2009.

But more importantly, Ms Mackay believes the wave of redemptions is being driven more by profit-taking than by investors fleeing losses, a potentially vital distinction.

"If investors are running from losses we could be talking about a real depression in the investment industry for a generation," she says.

"But on the whole people are taking profits or coming out even, so

there is an expectation that they will come back into the market when the time is right and there is a potential wall of money they have built up."

Ms Mackay bases her upbeat conclusion on two factors. Firstly €500bn, a quarter of the continent's equity fund assets, was put to work in the bull market of 1999 and 2000. Feri data point to this money starting to be redeemed in the summer of 2006, well before the credit

**'If investors are running from losses we could be talking about a real depression in the investment industry for a generation'**

squeeze took hold, when equity markets broadly returned to the previous peaks, allowing investors to break even.

Secondly, the equity sectors now suffering the steepest redemptions are the core global, Europe and North American sectors, the arenas that post-2003 investors were largely steered into by professional fund buyers such as fund of fund managers, Ms Mackay argues. Those who bought in 2003-05 and sold recently will, in the majority of cases, have banked profits.

Bond funds are unlikely to see a return to popularity until the credit squeeze is over, Ms Mackay believes.

The relative attractions of the sector have been dented by bank deposit rates, which have risen to 3.5 to 4 per cent on the continent and 5-6 per cent in the UK as banks have relied more heavily on retail savers as wholesale lending markets have ground to a halt.

In contrast, the average eurozone bond fund returned just 2.7 per cent in 2007 and actually lost 1 per cent in the first quarter of 2008.

"There is no appetite whatsoever for traditional bond funds. Deposits can give a better return," says Ms Mackay, who believes the fate of the sector lies largely with the banks themselves, which are also major distributors of investment products.

"They will decide when their reserves are robust enough that they don't need to be pouring money into deposits," she says.

"I think, generally speaking, banks would prefer their clients to be in more profitable products. A time will come when we will see a move towards long-term investing."

However, while retail investors are increasingly switching from mutual funds to bank deposits, institutional investors appear to be moving in the opposite direction, although triple A rated money market funds appear to be the lim-

its of their ambition. These funds sucked in a net €118bn in the first quarter, an acceleration of the record €138bn attracted in the whole of 2007, with French and German investors leading the way.

European legislation giving institutions greater freedom to invest in money market funds are believed to be partly behind the trend.

The Lipper Feri data also highlight the growing appetite for low-cost exchange traded funds. Although investors have withdrawn €113bn from equity funds since June 2007, they have bought a net €16bn of equity-based ETFs during this period.

Ms Mackay believes Mifid, the European Union's Markets in Financial Instruments Directive, is playing a role here, particularly in Italy where distributors are no longer allowed to take a slice of the management fee from their clients' investments, reducing the incentive to sell more expensive products.

The appetite for ETFs shows up starkly in the list of investment groups that have witnessed the largest net inflows (excluding money market funds) so far this year.

The top three; Société Générale (which owns Lxyor), Barclays and Deutsche/DWS, all have sizeable ETF arms. Vanguard, another passive investment house, also makes a rare appearance in the top 10.