

## *Strategic Insight*

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# WINDOWS Into Global Asset Management

August 2007

### **In this issue:**

The global mutual fund industry collected over \$820 billion of inflows in the first half, but financial market declines and related events since late July suggest that the second half may evolve differently. Certain categories in Europe, especially dynamic money market, cash plus, absolute return, and market neutral will be more difficult to promote than before. Yet the Asia fund industry looks set to build on the \$250 billion of record net inflows in the first half. China staged a remarkable show in the second quarter with nearly \$50 billion of inflows to equity and mixed asset funds, second only in volume to U.S. based equity fund programs. Net sales in Japan doubled in the first half, partly as a result of many successful new fund launches (especially around real estate, infrastructure, and diversification), which benefited both international and local money managers; other markets including Korea, India, and Thailand also posted strong gains.

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# Perspectives

## Inflection Points for the Industry in Europe and Asia

The unusually busy and divergent months of July and August, which brought a measure of market turmoil and forced some fund executives back early from their summer vacations, may prove to be an inflection point for segments of the funds industry:

- **Credit market illiquidity severely impacted Europe-domiciled cash plus, dynamic/enhanced money market, and asset backed securities (ABS) funds**, forcing NAV markdowns, investor withdrawals, suspension of net asset value calculations, and product closures. Only a few funds suspended redemption facilities, but the broader effect on investor sentiment may be lasting, since expectations of liquidity are central to the mutual fund proposition, especially for what are commonly sold as cash and money market substitutes. Page 5 of this edition discusses specific responses by different managers to the crisis.
- **Other popular strategies in Europe also have been thrown in a less favorable light, especially absolute return and market neutral.** Up to now, all provided some expectation of ‘cash plus’ outperformance, but sharp price declines may lead investors to review such programs. Five of the top selling absolute return funds lost 2% of their NAVs in the last few weeks, and some market neutral funds have suffered greater declines (in particular the top selling JPM Highbridge offering, where four out of ten euros that were previously committed to the product had exited as of the end of August). Page 6 discusses the ramifications for such products, as well as for quantitative programs and hedge strategies which have struggled in this environment.
- **Of the fifteen top selling sales long-term funds from the first half in Europe (and cross-border internationally), only three suffered outflows in July** (see page 7); but August will prove a better barometer of possible asset rotations to come. Going forward, overall industry flows in Europe will not provide a good gauge of opportunities at the top end of the business; in the first half, the top fifteen selling funds captured €30 billion, more than the top fifteen during 1H’06 when overall long-term flows were much stronger.
- **In contrast to deteriorating net sales in Europe, flows to local mutual funds in Asia reached a new record level**, exceeding \$210 billion in the first half (excluding Australia as well as offshore cross-border funds sold across Asia). Continuing demand for global allocation, real estate, infrastructure, and dividend products in Japan, and an exceptional surge of new product launches and flows in China in the second quarter, were among the main drivers of expansion in the region (see pages 8-10 for more details). Strong progress was also recorded in Korea, India and Thailand.
- **Adding estimates for Australia and Europe-based offshore funds sold in Asia, net new flows in the region exceeded \$250 billion in the first half.** This compares to \$260 billion for all of 2006, and around \$130 billion in 2005.
- **Importantly, during the difficult month of July, funds in Asia achieved \$25 billion in net inflows**, a strong result, even though down from the record \$45 billion achieved during June. In addition, the difference was due to one market – Japan – where net flows declined due to a reversal of gains among a few Nikkei-linked ETFs; excluding the month on month ETF movement, flows in June and July in Japan were similar with around \$12 billion per month.
- **Fund purchases by investors in China accelerated markedly in the second quarter, with \$47 billion of estimated net flows**, in effect all to equity and mixed asset funds. This puts China second only to the U.S. in Q2 net flows to equity and mixed funds, higher than Japan (\$43 billion), and far beyond the next ranking domicile Luxembourg (\$14 billion). A number of foreign/JV fund managers that launched products surpassed the \$1 billion threshold, including UBS, Commonwealth/ First State, Templeton, BNP, Lord Abbett, and SGAM.
- **Strategic Insight is delighted to announce the ASIA FlowWatch**, a new resource to support our clients’ research and business building activities in the Asia region. The **monthly publication** provides over **60 pages of analytics** using our database of more than **20,000 local funds across the Asia region**, with details on top selling funds, new products, management company progress, and investment types purchased by investors in each key market (see page 11 for more details).

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