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WINDOWS Into Global Asset Management

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In this edition:

January outflows of €60 billion from Europe-based equity and bond funds, following €80 billion lost during 2007, are magnifying concerns about asset retention within the region. Yet Asia flows remain positive, after nearly \$500 billion of gains last year (worldwide, funds absorbed \$1.6 Trillion). China expanded dramatically with \$175 billion of net growth (\$30 billion in Q4), but recent market declines and three-month NAV losses through January exceeding -20% on newly launched QDII products suggest a more challenging period ahead. Despite the gloom in Europe, nine out of the ten highest cash flow products of '07 (exc. money programs) sustained positive flows in the second half, with a few benefiting from rising Asia sourced assets. Performance and ratings will continue to be an important defense against the red: European offshore equity funds rated Morningstar 5-Stars or Lipper Leader together captured billions of euros during '07, while all other lower-rated funds suffered billions in net redemptions. Impressively, four cross-border fund groups have built investment engines and product ranges each featuring over twenty portfolios top-rated by Lipper or Morningstar, many of them registered for sale in Asia and benefiting from the region's continued gains. But the US industry has noticed the strong growth of cross-border international vehicles, and is now discussing the possibility of a US-based but globally distributed alternative to UCITS.

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Perspectives

Contrasting Asia's Boom with Europe's Gloom

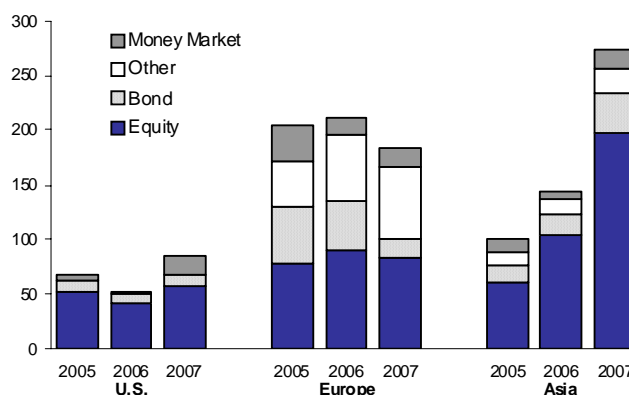
The media in recent weeks has painted a stark picture of the fund management industry in Europe, with for example the Financial Times gloomily suggesting an "exodus" by investors with "no end" to redemptions in sight. The recent sharp declines in stock prices worldwide, and the possibility of further market deterioration, indeed have overshadowed last year's record global expansion, raising the level of apprehension in the industry. And the January numbers in Europe will bring further distress:

- **A rough start to 2008:** Long-term funds in Europe suffered €80 billion in net redemptions in January, offset by €70 billion of inflows to money programs. Investors in the US pulled a net \$35 billion out of equity funds during the month, but this represented just 0.5% of beginning assets. Asia again remained the bright spot, with preliminary data suggesting inflows in the first month of this year.
- **On top of a difficult year:** Equity and bond funds in Europe lost €80 billion to net redemptions during 2007; however, €170 billion of gains among money market and institutional liquidity funds, plus other categories including guaranteed, real estate, and alternative, helped the industry post a €90 billion inflow. Still, this was 70% down from the prior year, and even lower than 2002 levels.
- Given current concerns, it is not surprising that many already have forgotten that **2007 was a record year for mutual funds globally, with \$1.6 trillion in net inflows**. The US market accounted for \$1 trillion of that, as equity funds posted similar gains from the prior year, while bond and money fund flows grew.
- **Asia's fund industry underwent a remarkable boom, marshalling \$0.5 trillion net** to mutual funds last year (this includes **about \$60 billion to cross-border funds** already counted in Europe and other offshore centers).
- **China grew dramatically with \$175 billion of net gains** last year, 35% higher than Japan's industry. Yet flows declined during Q4 to \$30 billion, and the extravagant success of QDII launches have given way to performance losses exceeding -20% over the trailing three months. Thus, while long-term

prospects still appear promising for China, the near-term may prove more challenging.

- **New funds and product development help drive Asia's expansion:** \$270 billion went to funds introduced last year, over 60% of total flows in the region. Importantly, funds introduced during 2006 retained marketing traction, adding another \$50 billion to flows in 2007, on top of the \$140 billion they captured in the year of introduction. Also, **product development remains central to asset gathering in Europe**, with new funds in '07 collecting \$190 billion of flows, just slightly less than what new funds garnered in the prior year.

New Fund Flows by Year of Introduction US\$ Billion



Asia excludes closed-end private placements in Korea; excludes Australia; Sources: Strategic Insight; Lipper, Inc.; Morningstar, Inc.

- **Looking to 2008 and beyond:** In spite of the temporary setbacks and challenges, Asia will remain the center of attention and is expected to experience strong secular growth; meanwhile the long-term retirement focus of US investors will provide a solid foundation for that market; and Europe's industry may eventually emerge stronger from the difficult current period. PWC in its 11th annual CEO survey found that business managers in Europe and the US are cautious, while those in Asia, Latin America and Eastern Europe continue to be optimistic about continued growth in 2008 (especially in China and Latin America).
- In addition to reviewing 2007 themes and current shifts in the investment landscape, this edition analyzes the **importance of performance and high ratings in asset gathering and retention** (pages 8-9), as fund managers try to identify and sustain investment competences in a more difficult sales environment. We also discuss **possible competition for UCITS from a US-based but globally distributed fund structure** (page 10).

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