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WINDOWS Into Global Asset Management

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Trends in Perspective and Looking Ahead

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Reviewing the Facts, Assessing Strategies, Taking Action

- The magnitude and pace of change in the fund industry is exceeded only by the challenges, even in segments benefiting from growing demand. Take money market products for example. **Sought after as a liquid safe haven, with \$800 billion of net inflows worldwide in 2008, money funds now face challenges and potential regulatory changes that could radically alter that business** in the US and other markets. Financial reform recommendations by the Group of Thirty would lead money fund providers in the US to give up stable net asset value pricing or reorganize as special purpose banks. This comes as the need for cash managers expands and a few equity houses try to redefine themselves around a wider range of conservative investments, even as providers wrestle with how to balance fees with lowered cash yields.
- More broadly, fund executives internationally are grappling with growing complexities and uncertainties about how the industry will evolve. Reduced sales volumes, assets, revenues, and margins make for an extremely challenging operating environment, but their implications are relatively discernable and understandable. In contrast, the transformations among financial intermediaries, in fund distribution dynamics, regulatory direction, client needs, and risk aversion would leave a more lasting imprint, but are more ambiguous at the moment.
- Amidst the most severe financial market conditions in eighty years, **mutual funds worldwide recorded net inflows of around \$100 billion during 2008, supported primarily by money market funds. Long-term fund flows were down \$1.5 trillion compared to the prior year.** This swing in flows along with 40% to 50% NAV declines among equity funds caused a marked shift within most companies towards a lower fee, lower margin product mix, leading to adjustment in cost structures and scaling back of many efforts.
- The **flight to greater safety drove \$625 billion of net flows into money market funds in the US and \$170 billion into offshore liquidity programs** (Dublin and Luxembourg, with assets sourced from Europe but also Asia and elsewhere). **Local money funds in Asia gained another \$40 billion,** supported by institutional purchases in China in the fourth quarter. The desire for stable income and

capital preservation strategies has risen, but the ability to satisfy these needs are compromised by the environment. Beyond the challenges faced by money funds, bond vehicles are constrained by low yields and the potential long-term inflationary impact of global monetary stimulus and deficit spending to accommodate recovery.

Mutual Fund Net Flows 2005-2008, \$ Billion

	2005	2006	2007	2008
Asia	106	162	408	73
Europe	290	191	-30	-335
Int'l/Offshore	254	274	172	-151
US	369	560	1,038	526
Total above	1,019	1,188	1,588	112
<i>Memo:</i>				
<i>MMF Flows</i>	138	326	801	793

Source: Strategic Insight Simfund.

Mutual Fund Net Flows, excluding Money Market 2005-2008, \$ Billion

	2005	2006	2007	2008
Asia	101	169	403	35
Europe	249	146	-58	-328
Int'l/Offshore	223	217	64	-288
US	308	330	379	-99
Total above	881	862	787	-680

Source: Strategic Insight Simfund.

- Bond funds in the US captured \$50 billion of inflows,** benefiting various active, index, ETF, and specialist vehicles. PIMCO's flagship Total Return fund pulled in \$16 billion (the highest cash flow actively managed fund in the US), bringing assets to \$132 billion. Highlighting differences in product success in the US and demand and marketing limitations in the rest of the world, the offshore version of PIMCO Total Return posted outflows of about 10% of assets, despite positive returns (augmented in Euros by dollar appreciation). **In Asia, bond funds collected \$40 billion of inflows,** 60% of which was in Japan around global and emerging market themes, and 40% into stable income and enhanced yield products in China.
- Bond funds in Europe on the other hand suffered \$220 billion of net redemptions. **Long-term funds overall in Europe lost \$620 billion (€430 billion) to outflows including product liquidations.** Each of the four main

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