

## Morningstar Direct<sup>SM</sup> Asset Flows Commentary: Europe

### **In 2014, Active Equity Funds Falter, Allocation Funds Hit New Highs and Bond Funds See Strong Demand**

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The books are closed for 2014 and summing up the flows into open-end funds reveals that investors sent a record EUR 401.11 billion into funds domiciled in Europe last year. This represents the highest level of inflows in any calendar year since Morningstar started to collect asset flow data on an industry level in 2007. The level of inflows in 2014 easily surpassed the demand for open-end funds in 2013, which had already hit a record high of EUR 258.76 billion. The lion's share of inflows -- EUR 364.36 billion -- went into long-term funds. Assets in long-term funds also hit a record high at EUR 5.68 trillion.

Save commodity funds, all broad categories enjoyed positive inflows in 2014, which will arguably be remembered as the year of the allocation fund. Mixed-asset products were showered with net EUR 136.19 billion, thus taking in more than any other broad category group and displaying the strongest net sales in any calendar year. Bond funds also saw strong demand, posting net inflows of EUR 123.52 billion and thereby nearly doubling 2013 inflows. The growth story also continued for alternative funds. These mostly UCITS-regulated products, which employ hedge fund-like management techniques, also enjoyed record inflows of EUR 43.49 billion. In spite of heavy outflows in December, money market funds profited from their status as a safe haven and welcomed net EUR 36.76 billion in 2014, in spite of nonexistent nominal and negative real return perspectives.

Demand for equity funds, however, stood at a relatively meagre EUR 44.77 billion, less than half of the inflows seen in 2013. This arguably reflects investors' distaste for equity market volatility, which repeatedly brought about sharp drawdowns in the past years. Drilling deeper into our data reveals another important story: While inflows into actively managed equity funds dropped significantly to EUR 23.49 billion, demand for index funds (excluding ETFs) gained traction as inflows increased to EUR 21.28 billion up from EUR 15.76 billion in 2013.

This growth disparity is revealed by the organic growth rate, which focuses only on inflows as the source of asset growth. While index equity funds grew at a rate of 10.45% in 2014, actively managed equity funds displayed a nearly negligible 1.28% growth rate.

This trend can also be observed in the fixed-income area of the market. Open-end fixed-income index funds took in EUR 11.58 billion in 2014, which amounts to a growth rate of 22.7%. However, the organic growth displayed by actively managed bond funds stood at a relatively comforting 7.2% when compared with the anemic growth of actively managed equity funds.

Overall, index funds took in net EUR 34.46 billion versus inflows of EUR 329.92 billion into actively managed funds. This translates into an organic growth rate of 13.2% for open-end index funds versus 7.3% for actively managed funds.

However, the growth of the index funds comes selectively. The highest demand for index funds was seen in the United Kingdom and Switzerland, two countries in which retrocession-based advice is in retreat.

## Flows by Global Broad Category Group 2014

Name	Net Assets	Market	Estimated Net Flow			Org Growth
	(€Bil)	Share %	(€Mil)			Rate %
	12-2014	12-2014	1-Mo	QTD	2014	2014
Allocation	850	12.82	10,449	29,551	136,190	20.49
Alternative	239	3.61	2,472	4,780	43,494	23.94
Commodities	15	0.23	(191)	(862)	(1,547)	(8.68)
Convertibles	66	1.00	(350)	(732)	3,682	6.43
Equity	2,341	35.30	(2,221)	(4,586)	44,773	2.19
Fixed Income	1,900	28.66	(2,639)	15,474	123,521	7.66
Property	124	1.86	1,483	3,041	10,614	9.80
Miscellaneous	134	2.02	(461)	(786)	1,885	1.46
Unclassified	6	0.10	581	504	1,747	26.76
<b>All Long Term</b>	<b>5,676</b>	<b>85.61</b>	<b>9,123</b>	<b>46,384</b>	<b>364,359</b>	<b>7.56</b>
Money Market	954	14.39	(20,969)	(147)	36,755	4.27
<b>Total</b>	<b>6,631</b>	<b>100</b>	<b>(11,846)</b>	<b>46,237</b>	<b>401,114</b>	<b>7.07</b>

Looking at 2014 flows by Morningstar fund-level categories shows that the “other allocation” category saw the highest inflows 2014. This category contains a mixed bunch of fixed-term funds, structured funds and share classes hedged to currencies not supported in the more specific allocation categories. EUR cautious allocation funds geared toward euro-denominated assets took in net EUR 22.14 billion. The main beneficiaries were Santander, Invesco, and DNCA, while ETHENEA, Union Investment and KBC saw the strongest inflows in the more broadly diversified category EUR cautious allocation–global, which saw net new money of EUR 12.77 billion. This highlights that European investors tend to prefer a conservative approach when mixing stocks and bonds. (Funds in the cautious allocation bucket tend to limit their equity exposure to 35% of their assets).

Demand for EUR-diversified bond funds remained strong for most of the year, while EUR corporate bond funds arguably benefited from the sell-off of high-yield USD bond funds in the last half of 2014.

Drilling deeper into the multistrategy funds (the only alternative fund group among the top-selling categories) shows a concentrated picture, as more than half of the 2014 inflows poured into the three strategies offered by Standard Life Investments (GARS), GMO (GMO Global Real Return) and DeAWM (DWS Concept Kaldemorgen).

## Fund Level Categories: Highest Inflows 2014

Name	Net (€Mil)	Estimated Net Flow			Org Growth
	Assets (€Bil)	1-Mo	QTD	2014	Rate %
	12-2014	1-Mo	QTD	2014	YTD
Other Allocation	83	920	3,075	22,838	37.22
EUR Cautious Allocation	74	922	3,027	22,136	45.09
EUR Diversified Bond	147	2,210	5,929	19,989	17.63
EUR Corporate Bond	124	2,163	7,116	19,369	20.24
EUR Flexible Bond	43	629	2,859	15,272	64.49
Alt - Multistrategy	85	2,255	5,485	15,162	24.25
EUR Moderate Allocation - Global	102	2,630	6,323	13,167	16.20
EUR Government Bond	80	1,471	4,570	12,934	21.95
EUR Cautious Allocation - Global	78	1,632	4,988	12,772	21.55
Global Emerging Markets Bond	87	(116)	2,403	12,241	18.30

Turning to the laggard categories reveals first and foremost the huge sell-off in the U.S. high-yield market since the summer of last year. USD high-yield bond funds lost EUR 9.45 billion, with most of the redemptions hitting these funds in July and December. (The same holds true for the global high-yield category, which is dominated by U.S. issuances).

The story behind the outflows from USD diversified bond funds remains the same as in 2013, as the outflows from the PIMCO flagship fund, PIMCO GIS Total Return, were again the sole driver of the redemptions out of these funds. Steady outflows turned into a stampede after PIMCO founder Bill Gross exited the Allianz subsidiary in September—in all, investors pulled EUR 8.19 billion out of PIMCO's flagship fund.

Unsurprisingly, outflows from guaranteed funds continued in 2014, as did redemptions out of EUR ultrashort-term bond funds. Both categories continue to suffer under unattractive return prospects as interest rates in the eurozone dropped to subzero as part of the European Central Bank's efforts to combat deflation.

### Fund Level Categories: Largest Outflows 2014

Name	Net	Estimated Net Flow (€Mil)			Org Growth
	Assets (€Bil)	1-Mo	QTD	2014	Rate %
USD High Yield Bond	78	(3,371)	(3,235)	(9,446)	(11.67)
USD Diversified Bond	29	650	(579)	(5,027)	(16.99)
EUR Ultra Short-Term Bond	68	(620)	(302)	(5,018)	(7.20)
Guaranteed Funds	73	(498)	(1,472)	(4,397)	(5.75)
UK Flex-Cap Equity	41	(319)	(1,250)	(3,909)	(9.25)
Sector Equity Consumer Goods & Services	16	(165)	(629)	(3,740)	(21.02)
Global High Yield Bond	76	(2,883)	(2,309)	(3,398)	(4.78)
Global Large-Cap Growth Equity	52	(651)	(765)	(2,988)	(6.39)
US Large-Cap Growth Equity	46	(278)	106	(2,673)	(6.67)
Europe Flex-Cap Equity	29	(431)	(2,663)	(2,571)	(8.56)

In terms of inflows by provider, BlackRock topped the rankings for the second year running, although inflows of EUR 18.47 billion were significantly below 2013 levels. The success came on the back of high inflows into its bond and allocation fund ranges, with most net new money going to funds belonging to the categories USD flexible bond, USD moderate allocation, and EUR diversified bond. Notably, index funds (not including iShares ETFs) contributed substantially, accounting for up to a third of BlackRock's 2014 inflows.

In contrast, the success of JPMorgan Asset Management centered exclusively on actively managed open-end funds, and inflows were spread fairly evenly among fixed-income, allocation, and equity funds, with most new net money being sent into the categories EUR moderate allocation—global, Europe large-cap blend equity and U.S. large-cap blend equity.

Swiss UBS was a main beneficiary of the surge of Swiss money into index funds, with EUR 2.77 billion going into funds distributed in Switzerland. By category, UBS EUR high-yield bond funds took in the highest inflows, followed by USD corporate bond and U.S. large-cap blend funds.

### Fund Providers: Highest Inflows 2014 (excluding money market funds)

Name	Net	Estimated Net Flow (€Mil)			Org Growth
	Assets (€Bil)	1-Mo	QTD	2014	Rate %
	<b>12-2014</b>				<b>2014</b>
BlackRock	219	(509)	3,704	18,465	10.61
JPMorgan	130	902	2,849	18,117	18.54
UBS	172	(238)	1,394	16,980	12.35
Pioneer Investments	102	516	3,295	12,914	16.03
Allianz Global Investors	84	598	2,544	11,451	16.41
Nordea	71	1,079	3,528	11,171	20.38
Deutsche Asset & Wealth Management	133	1,364	3,163	10,692	9.65
Eurizon Capital	115	412	1,126	10,485	16.12
Union Investment	115	1,102	2,850	9,185	9.03
Credit Suisse	94	(290)	502	8,241	10.50

The laggards were led by PIMCO, which suffered outflows for most of the year; these substantially increased in the last four months of 2014 after the departure of founder Bill Gross. Even four months after Gross' departure and the introduction of a new management setup, PIMCO flows display high volatility. After peaking at EUR 8.65 billion in October, outflows receded to EUR 1.86 billion in November only to jump back to EUR 2.15 billion in December. While outflows hit PIMCO GIS Total Return Bond and PIMCO GIS Unconstrained Bond immediately after Gross' departure, December outflows concentrated on PIMCO GIS Global Investment Grade Bond and PIMCO GIS Emerging Local Bond Fund.

Aberdeen and SKAGEN reeled under outflows from their emerging-markets equity funds, with redemptions gaining pace in the course of the fourth quarter.

Carmignac saw outflows petering out in the last quarter. This goes back to net positive inflows into its flagship allocation fund Carmignac Patrimoine which were, however, offset by continuing outflows out of its flagship equity fund Carmignac Investissement.

### Fund Providers: Largest Outflows 2014 (excluding money market funds)

Name	Net	Estimated Net Flow (€Mil)			Org Growth
	Assets (€Bil)	1-Mo	QTD	2014	Rate %
	<b>12-2014</b>				<b>2014</b>
PIMCO	80	(2,151)	(12,659)	(21,521)	(23.03)
Aberdeen	66	(1,028)	(2,568)	(8,000)	(12.25)
Carmignac	47	(193)	(32)	(5,626)	(11.46)
Ignis	20	(703)	(4,709)	(4,404)	(19.46)
Franklin Templeton	137	(972)	(775)	(4,327)	(3.36)
Baring	9	(446)	(889)	(2,581)	(23.40)
SKAGEN	11	(832)	(2,004)	(2,005)	(13.66)
Threadneedle	45	(375)	(812)	(1,845)	(4.58)
HBOS	13	(48)	(319)	(1,786)	(7.62)
Muzinich	13	(590)	(618)	(1,746)	(12.40)

Turning to the largest European open-end funds, the amazing success story of M&G Optimal Income Fund continued in 2014. The cautious allocation fund comfortably outpaced its success in 2013, raking in net EUR 8.92 billion. This story has become a monoculture of sorts, as illustrated by the fact that M&G's European open-end funds were net-flow negative, excluding the Optimal Income Fund. (Total M&G net inflows in open-end funds amounted to EUR 6.75 last year.)

Boasting assets of EUR 31.43 billion, the M&G Optimal Income Fund highlights investors' unwavering confidence in behemoth funds with good track records. While long-term performance remains convincing (this fund carries a Morningstar Analyst Rating of Silver), the retail share classes hedged to the euro underperformed their peer group for the first time in any calendar year. By now, two thirds of the fund's assets – EUR 21.4 billion -- are invested in EUR hedged share classes, and close to EUR 7 billion of last year's inflows were invested by investors from Continental Europe.

Silver-rated Templeton Global Bond Fund, relegated to the second place by AUM behind the M&G Optimal Income Fund in November 2014, climbed back into positive terrain in terms of flows in the second half of the year, after suffering heavy outflows for 12 consecutive months. These outflows occurred in the wake of the sell-off which hit emerging market bonds in 2013. The fourth-quarter comeback of Bronze-rated Templeton Global Total Return was even more pronounced. On balance, however, flows for both funds were deep in the red for the whole of last year.

Silver-rated moderate EUR allocation fund Carmignac Patrimoine enjoyed inflows for the third consecutive month, on the back of a solid outperformance of 200 basis points in 2014.

AllianceBernstein's AB Global High Yield Portfolio suffered heavy redemptions in 2014, which have been observed across the board in global and U.S. high-yield fund categories. However, December outflows of EUR 670 million were the highest seen in any one-month period since June 2013.

The difficult spell for Invesco Perpetual High Income continued for the 16<sup>th</sup> consecutive month. After longtime fund manager Neil Woodford left Invesco and started his own fund house, his former IP funds have witnessed steady outflows. Some of this outflowing money might have found its way to the CF Woodford Income Fund, which was launched in June 2014 and now boasts assets of EUR 5.52 billion.

### 10 Largest Long-Term Funds by Net Assets

Name	Net	Estimated Net Flow (€Mil)			Org Growth
	Assets (€Bil)	1-Mo	QTD	2014	Rate %
M&G Optimal Income Fund	31.426	355	1,598	8,917	43.32
Templeton Global Bond Fund	30.761	1	153	(3,541)	(11.15)
SLI Global Abs Ret Strat	29.882	378	977	2,817	11.85
Templeton Global Total Return	28.450	65	836	(1,887)	(6.62)
Carmignac Patrimoine	23.979	77	221	(4,776)	(17.81)
BGF Global Allocation Fund	18.898	(109)	76	3,016	22.79
AB Global High Yield Portfolio	18.078	(673)	(504)	(588)	(3.56)
IP High Income	16.046	(120)	(378)	(2,979)	(18.29)
Deka-ImmobilienEuropa	12.785	17	67	109	0.88
Newton Real Return Fund	12.301	110	309	753	7.28

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#### Data Notes

The figures in this report were compiled on 28 January 2015. Over 25,000 of 30,000 funds that Morningstar tracks from over 1,200 fund companies across 29 domiciles are included. Swedish funds are not included because some report assets on a quarterly basis only. Organic growth rate represents flows as a percentage of beginning assets.