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Asset Management
Forces reshaping global opportunities

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Competition, regulation, evolving client needs, and technology are changing the opportunity set for asset managers. What strategies can help capture the $50 trillion fund industry potential?

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EastEdge Analytics

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Impactvesting LLC

Impactvesting enables asset managers to access the fastest growing segments of the global investment industry. Combining data-driven analysis with insights to support business expansion, Impactvesting specializes in international fund distribution, sub-advisory opportunities, product innovation, alternative investment strategies, sustainable investments, and ESG integration.

EastEdge Analytics

EastEdge Analytics helps asset managers better understand the asset and wealth management industry in Asia. The company provides data-driven and insight-led business intelligence with a focus on China, Japan, and cross-border fund markets (Hong Kong, Singapore and Taiwan), supporting clients in market entry, product and distribution development, regulatory impact assessment, fintech innovation and implementation, and other critical business issues.

Investors contributed an extraordinary $1.6 trillion to funds around the world during 2017.

Half of these inflows came from Europe and cross-border markets, where active strategies generated 74% of gains.

But opportunities are shifting as intense competition and regulation reshape fund distribution, products and pricing, and investment solution design.

MiFID II in Europe, pension reforms in China, evolving asset allocation needs, and technology are just a few catalysts that will transform the business.

Fund assets will likely reach $50-$60 trillion worldwide by 2022, offering significant potential to firms that innovate and adapt to the changing landscape.

*This white paper offers featured insights from our comprehensive analysis, **Global Fund Management: 2018-2022 Outlook**.*

TWIN PEAKS

Record inflows amidst divergent trends

2017 was an extraordinary year for fund managers, with strong sales and asset growth helping firms strengthen their businesses, adapt to new regulations and market needs, and prepare for future challenges.

Investors contributed $1.6 trillion of net flows to long-term funds worldwide, triple the amount in the previous year and meaningfully higher than the typical $1 trillion annual results reached in the past decade.

Global fund assets under management grew 23% during 2017 to $34 trillion excluding money market vehicles, the most robust expansion since 2012-13.

The industry scaled twin peaks, with a marked expansion of ETFs and index funds in the US, alongside record inflows into actively-managed funds in Europe and Cross-Border International markets.

However, the opportunity set for asset managers is being transformed by regulation, competition, evolving client needs, and technology. How will industry developments unfold in coming years?

Europe still holds the key for active managers

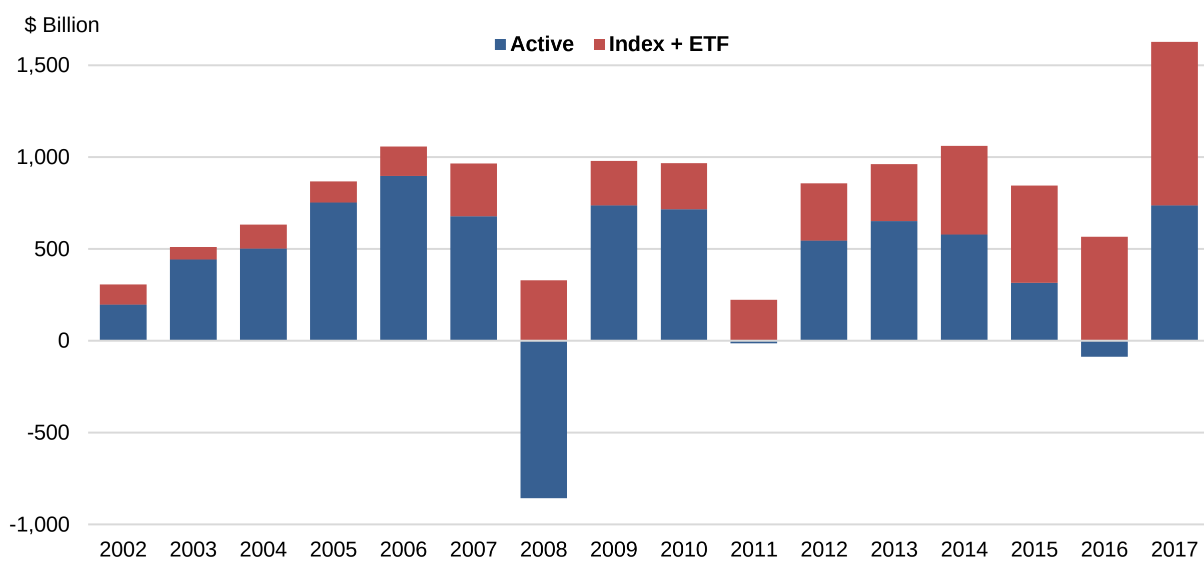
Actively-managed funds in Europe and Cross-Border markets recorded €551 billion ($628 billion) of net inflows last year, almost nine times higher than in 2016 and 48% greater than the previous peak in 2014.

Europe is more important than ever for active fund managers looking to expand. Firms facing constraints in their home market, such as in the US where passive fund growth and intense fee competition create challenges for active managers, will benefit the most from international opportunities.

However, the business in Europe is changing:

- **Competition and regulation** are reshaping the economics of fund distribution, products and pricing, and investment solution design.
- **The need for better client solutions** is pushing the industry towards asset allocation programs, outcome-oriented solutions, fee-based advisory, model portfolios and wraps, target-risk and target-date vehicles, and index funds and ETFs.

Figure 1. Long-Term Fund Net Flows Worldwide, Active and Passive, 2002-2017



Source: Impactvesting LLC based on data from Broadridge Global Market Intelligence. Excludes money market funds.

- **The Markets in Financial Instruments Directive II** (MiFID II) will influence distribution with its bans on inducements and fee retrocessions, requirements for greater cost transparency, product suitability and appropriateness, and for aligning fees with quality of service.

- **Distributors face profit margin pressures** as a result, encouraging them to explore more cost-efficient solutions that comply with the new rules. Sub-advisory, fund-of-funds, and packaged index/ETF solutions are getting more consideration.

- **Vertical integration is another way for distributors to adapt**, with a renewed focus on in-house products, reduction in third-party funds and partners, and expanding use of sub-advisors. This will impact the competitive dynamics for asset managers, with implications for pricing, scale, profitability, and future consolidation.

PERSPECTIVE

Priorities for the future

Last year's record volumes in Europe and Cross-Border International funds may prove difficult to match soon. However, history suggests that **meaningful inflows could persist for some time**, if the correction in Q1'08 does not evolve into a deeper downturn.

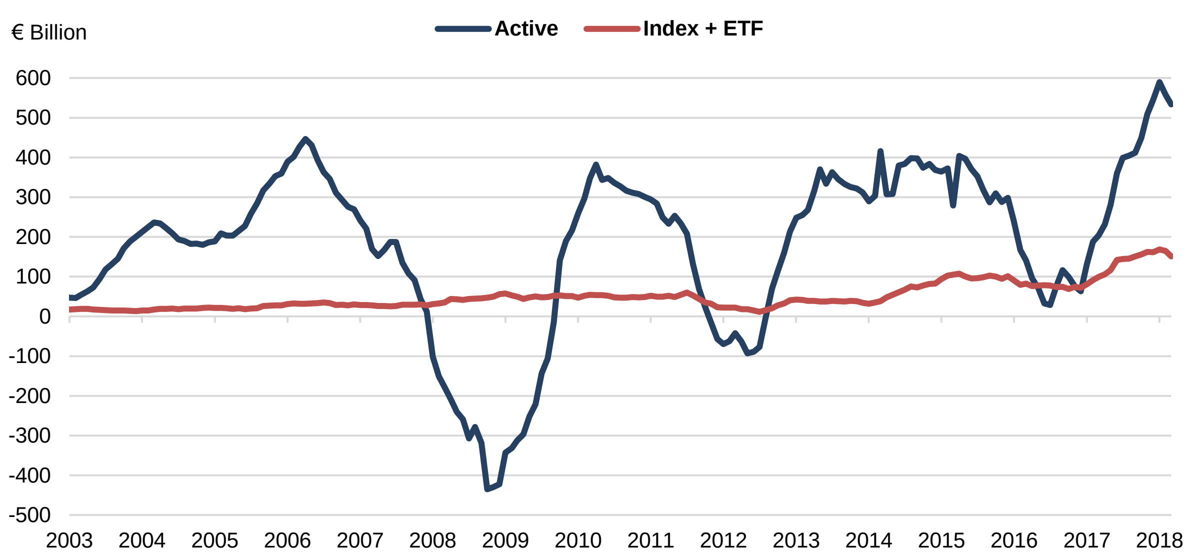
Cumulative 12-month flows of €300-€400 billion to active funds in Europe are typical, sustained for much of the three-year period between 2013-2015.

In addition, index funds and ETFs have reached a €160 billion 12-month inflow run rate. Thus, **combined flows to active and passive strategies in Europe could exceed €500 billion in the coming years.**

Demand for funds and solutions will continue to evolve around a few common themes:

- Multi-asset, risk-based, outcome-oriented solutions
- Income solutions and alternative sources of yield
- Volatility reduction and downside protection
- Global diversification
- Non-traditional alternatives and absolute return
- Lower cost solutions (both active and passive)
- ESG, sustainability, and impact investments

Figure 2. Europe and Cross-Border Flows, Active vs. Passive, Rolling 12-Months 2003-2018



Source: Impactvesting LLC based on data from Broadridge Global Market Intelligence; 2018 through March. Excludes money market funds and internal fund-of-funds.

RETHINKING SCALE

Global reach and capacity

The extraordinary volumes during 2017 benefited a broader range of managers than usual. In the actively-managed fund segment, 24 firms around the world surpassed $10 billion of net inflows each.

The concentration of gains, however, reached unique proportions last year.

PIMCO, last year's net flow leader, outsold all others by a significant margin. Driven by sales of its flagship Income strategy, the firm achieved $104 billion of net inflows during 2017, three times higher than the next top producer.

PIMCO's Income strategy raised large sums through different structures around the world, gaining $49 billion through a Europe-domiciled Cross-Border UCITS, $31 billion through a US mutual fund, and $5 billion via a Canada-domiciled fund.

Together these contributed $85 billion to the company's global active fund flows. PIMCO also runs a sub-advised income strategy for Nomura in Japan that generated $3 billion of additional inflows.

Europe and Cross-Border International markets accounted for 65% of PIMCO's results, underscoring the benefits of a global presence.

In contrast, many US firms remain relatively home-bound, though some are growing faster overseas.

Dimensional, Capital International, and Lord Abbett each derived 15%-27% of inflows outside North America. Yet Morgan Stanley and AQR each sourced more than 70% overseas, while international gains offset net redemptions in the US for BlackRock, Invesco, and Goldman Sachs.

Despite progress, **globalization of the asset management industry is at an early stage.** Five of the top ten highest cash flow firms last year – companies in Europe and Latin America – did not have a presence in North America.

Fragmented markets, regulatory obstacles, local needs and other factors made it difficult for some managers to expand away from home. But some organizations clearly succeeded in diversifying their geographical footprint, strengthening the long-term foundations of their business. Benefits for them were clear in 2017.

Looking forward, the adoption of globally diversified asset allocation programs will drive a wider search for high quality investment firms with the capacity to deliver solutions across multiple markets, at scale, and with competitive fees.

Figure 3. Active Fund Managers: Highest Net Flows Worldwide by Region, 2017

		2017 Net Flows $Billion				% Flows	AUM
	Manager	Cross-Border	Europe Local	North America	Total (inc. other*)	outside US/Canada	2017 $Billion
1	PIMCO	67.4	0.0	34.5	**104.3**	*67%*	564
2	Dimensional	3.4	0.7	26.9	**31.6**	*15%*	444
3	Intesa Sanpaolo	0.0	24.7	0.0	**24.7**	*100%*	233
4	Prudential plc	19.1	-2.7	0.0	**21.8**	*100%*	213
5	GAM	19.8	1.8	0.0	**21.6**	*100%*	113
6	AXA	12.2	2.4	4.8	**20.4**	*76%*	299
7	Itaú	0.4	0.0	0.0	**20.3**	*100%*	190
8	Natixis	9.6	0.9	5.9	**17.5**	*66%*	272
9	Banco Brasil	0.0	0.0	0.0	**16.7**	*100%*	188
10	Capital International	2.4	0.0	11.6	**16.0**	*27%*	1,550

*Total includes other local funds in Asia-Pacific, Latin America, and Middle East and Africa.
**Excludes money market funds. Includes external fund-of-funds; includes internal FOFs in Japan.
Source: Impactvesting LLC based on data from Broadridge Global Market Intelligence.
Above table based on detailed reporting of the 40 highest cash flow managers included in our Global Fund Outlook.

SIGN OF THE TIMES

Dimensional's success

Remarkably, on a five-year timeframe, the world's top active manager is not even a household brand.

Dimensional Fund Advisors captured $130 billion of mutual fund net flows during the five years through 2017, more than any other active manager.

The group attracted more into its actively-managed funds in the past half-decade than JP Morgan, Amundi, Intesa Sanpaolo, or BlackRock – all firms with strong brands globally or in their home markets.

Since its inception in 1981, Dimensional developed funds on systematic, quantitative, and multifactor investment foundations. These strategies were offered with asset allocation guidance to an exclusive segment of financial advisors and institutional investors.

Using alternative weightings to tilt strategies around excess return factors such as market cap, value, and profitability, the firm was a pioneer in implementing concepts later used in "smart beta".

Dimensional's growth reflects several industry trends that include **expanding demand for asset allocation solutions, lower cost investments, fee-based advisory, and model portfolios.** These forces have driven the evolution of the US industry for many years, and now increasingly influence distribution in Europe and other markets.

The firm's success also suggests that other innovative firms could emerge as unexpected winners in coming years.

PASSIVE GAINS

Scale, fees, and return factors

Annual flows into index funds and ETFs tripled during the past half-decade, rising to $0.9 trillion last year. In total, $2.8 trillion migrated to passive funds during the last five years.

However, **two companies – Vanguard and BlackRock – captured 66% of flows in the past five years.** A few others – Fidelity, State Street, Schwab, and Nomura – accounted for much of the rest.

The passive segment remains on a concentrated growth trajectory, with emphasis on scale and intense fee competition, leaving little room for most providers.

Factor-based investments however offer an avenue for innovators. Risk factor investments – including fundamental index strategies and smart/ strategic/ alternative beta – are expanding. Primarily structured as ETFs, they have achieved consistent inflows averaging $50 billion annually in the past five years.

Individual smart beta funds still have a long way to go to match sales of established strategies. The highest cash flow smart beta fund in the world last year, iShares Edge MSCI USA Momentum Factor ETF, captured $2.6 billion.

In addition, factor investing still mostly reflects a US market phenomenon. Only two non-US funds were among the highest 15 cash flow smart beta ETFs in 2017. Nevertheless, factor-based ETFs and index funds outside the US now approach $100 billion in assets, after capturing $11 billion of flows last year.

Figure 4. Active Fund Managers: Highest Net Flows Worldwide, 2013-2017

		Net Flows $ Billion						AUM 12/17
	Manager	2013	2014	2015	2016	2017	5 Years	$ Billion
1	Dimensional	26	31	20	21	32	**130**	444
2	JPMorgan AM	55	48	18	-19	8	**110**	555
3	Intesa Sanpaolo	9	23	24	16	25	**96**	233
4	Amundi	14	36	19	-4	15	**81**	371
5	BlackRock	22	30	23	-28	12	**59**	468

Source: Impactvesting LLC based on data from Broadridge Global Market Intelligence.
Includes external fund-of-funds; includes internal fund-of-funds in Japan; excludes money market funds.
Above table based on detailed reporting of the 20 highest cash flow managers included in our Global Fund Outlook.

CHINA AND ASIA

Renewed potential

Driven mainly by China, the fund industry in Asia will likely double in the next five years, with trillions in assets mobilized by financial industry reforms and the introduction of third pillar private pension systems. Fund assets in the region could potentially rise to $7-$9 trillion by 2022.

Rising wealth among the huge middle class and High Net Worth populations in China and Asia will support demand for increasingly professionalized asset and wealth management. The easing of foreign ownership limits meanwhile will help international firms access the market.

Catalysts include Pension Target Funds for retail investors, the creation of Investment Management (IM) Wholly Foreign Owned Enterprises (WFOEs), and the Mainland-Hong Kong Mutual Recognition of Funds (MRF).

China's enormous potential is exemplified by the rapid rise of the world's largest money fund. Yu'E Bao, launched by Alibaba-owned Tianhong Asset Management in 2013, reached $243 billion. A combination of ecommerce, third-party payments, and the mobile Internet powered the fund's astronomical growth.

China has emerged as a global leader in financial technology (Fintech) innovations, bypassing the credit card payment system and leapfrogging into a cashless society via mobile payments during the last few years. In 2017, Chinese consumers spent approximately $32 trillion through mobile payment platforms, an increase of almost 29% compared to 2016.

Alipay and WeChat Pay, which account for more than 90% of mobile payment transactions, are developing "super-platforms" to offer a wide range of financial services, including fund solutions.

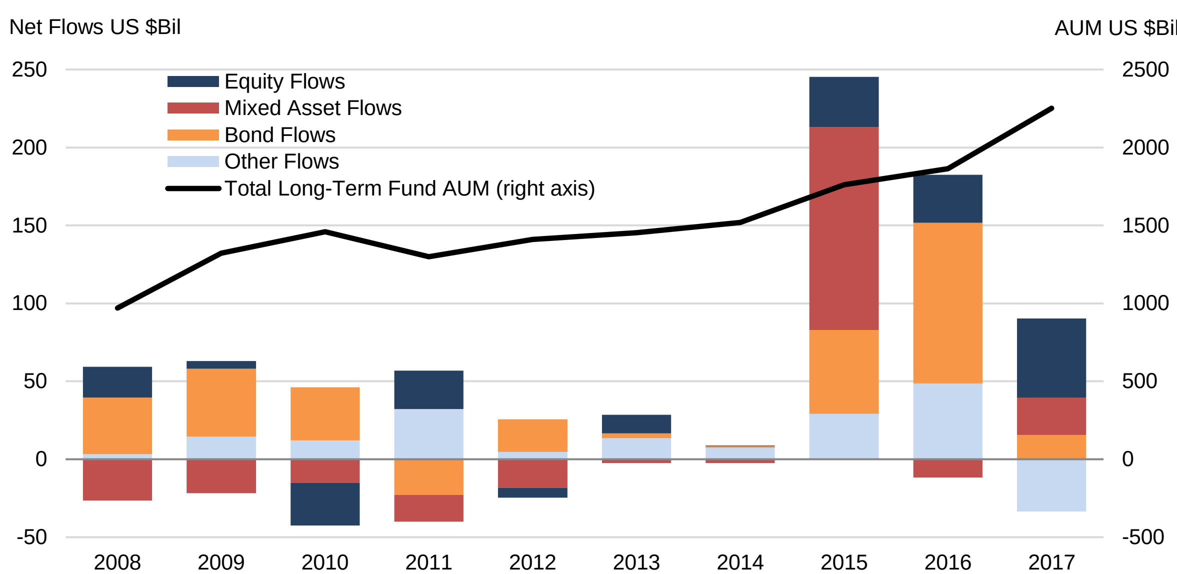
Opportunities in Asia today

China and Asia offer significant potential in the future. Yet aggregate contributions to local funds in the region were modest during 2017, accounting for only 4% of worldwide long-term fund flows.

However, beyond local funds, investors in Asia typically account for 15%-20% of active cross-border UCITS fund flows. **Last year, cross-border funds sourced at least $60 billion from Asia.**

This benefited firms such as PIMCO, which we estimate has sourced assets totaling roughly $200

Figure 5. Asia Long-Term Fund AUM and Net Flows by Asset Class, 2008-2017



Source: Impactvesting LLC and EastEdge Analytics based on data from Broadridge Global Market Intelligence. Excludes Australia and New Zealand. Japan includes internal fund-of-funds. Other long-term funds exclude money markets.

billion from Asia. This includes master-feeder structures in Thailand and sub-advisory and Japan. PIMCO GIS Income, the best-selling active fund worldwide in 2017, generated around $20 billion in net sales during the past year from investors in Asia, particularly in Singapore. Many retail and private banks place the fund on their recommendation list to clients. Examples include HSBC and Hang Seng Bank in Hong Kong, as well as DBS and Standard Chartered in Singapore.

Other firms with notable approaches to Asia include Franklin Templeton, who worked closely with large banks and wealth managers in Taiwan to launch an **innovative share class** that helped attract $2 billion into its emerging bond fund.

Meanwhile in Japan, international firms continue to benefit from sub-advisory relationships with local asset managers. During 2017, **14 out of the 25 highest cash flow active funds were sub-advised** by external managers or co-branded partnerships. Among new sub-advised offerings, AMOne captured $1.3 billion in a fund run by Morgan Stanley, while Daiwa raised $1 billion for a technology-themed fund advised by BNY Mellon/Boston Company.

Figure 6. Japan: Highest Cash Flow Active Long-Term Funds, 2017

Rank	Fund Name	Sub-advisor/ *Co-brand partner	AUM $Bil 2017	Net Flows $Bil 2017
1	Nomura PIMCO Global Income Strategy Fund A	PIMCO/ *Nomura	2.9	**2.7**
2	Rheos Hifumi Plus		4.0	**2.5**
3	Nomura India Equity Investment		5.1	**2.4**
4	**Amundi SMBC Protect & Switch Fund**	***SMBC**	**1.7**	**1.7**
5	Daiwa Robot Technology Related Equity -Robotic-	AXA	3.0	**1.6**

New funds in 2017 in bold; *co-brand domestic partner. Includes external and internal fund-of-funds.
Source: Impactvesting LLC and EastEdge Analytics based on data from Broadridge Global Market Intelligence.
Above table based on more detailed reporting of the 25 highest cash flow funds in Japan, included in our Global Fund Outlook.

ESG AND IMPACT

Sustainable finance for the future

One of the most visible trends in asset management today, sustainable investing comprises a wide range of activities that include screening, the integration of environmental, social and governance (ESG) risk factors, impact investments seeking measurable outcomes, and shareholder engagement.

Climate-related issues rank high among ESG concerns, driving the development of low carbon solutions, green bond investments, and methodologies for carbon footprint analysis of investment portfolios.

Sustainability also sits at the center of efforts to engage younger investors including the millennial generation. In addition, ESG and sustainability align closely with the aim of both corporations and asset managers to shift to a longer-term focus that supports governance, stewardship, and shareholder returns.

ESG integration, screening, and shareholder engagement represent elements of an investment process that are implemented to varying degrees across a vast asset base totaling around $23 trillion.

The universe of registered investment funds with an explicit sustainability mandate exceeds $670 billion in assets around the world. **Net flows into sustainable investment funds surged 70% to $75 billion during 2017**, after growing steadily in the previous five years.

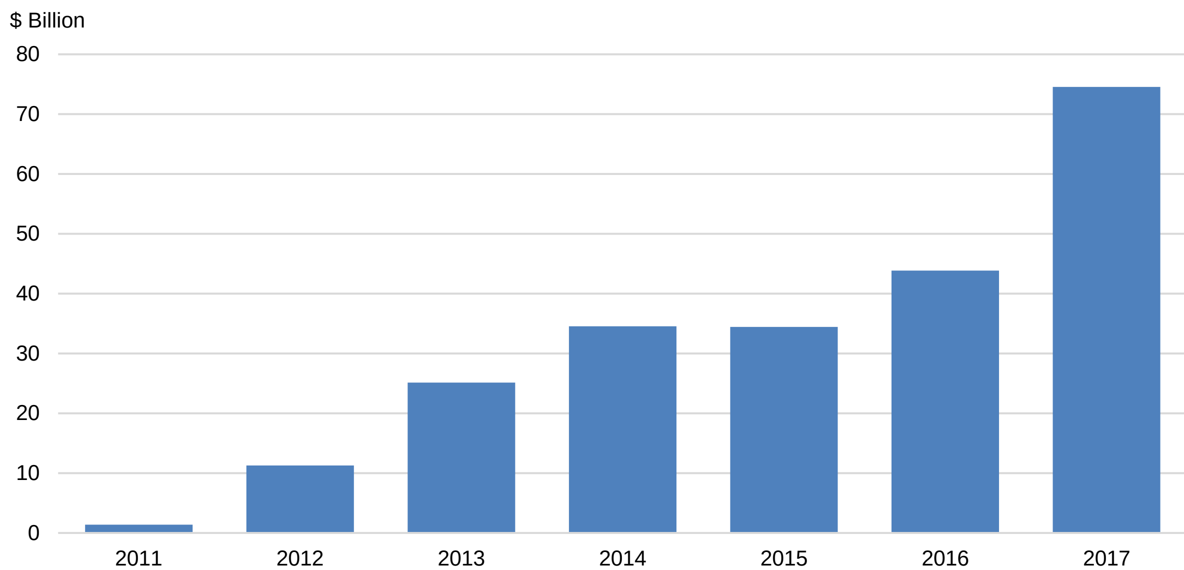
The pace of sustainable product development and innovation is accelerating, with both the number of funds introduced and assets raised during 2017 climbing 35% over the prior year.

Though demand is growing, achieving scale and profitability will be a challenge in this segment for many fund managers. Success will depend on developing alternative distribution channels, targeting advisor relationships, focused marketing, and moving beyond stand-alone products to more holistic asset allocation-based sustainable solutions.

Regulatory actions also will support wider implementation. Europe is looking to get defined contribution plans to increase sustainability disclosure and possibly incorporate ESG into default retirement options. Meanwhile the UK is taking steps to address ESG as a fiduciary requirement.

The EU's Action Plan for Sustainable Finance has already led to proposals which would affect how ESG considerations are embedded into the advice that investment firms and insurance distributors offer to individual clients under MiFID II.

Figure 7. Net Flows into Sustainable Funds Worldwide, 2011-2017



Source: Impactvesting LLC based on data from Morningstar and Broadridge. Includes funds with explicit ESG, responsible investment, sustainable investment, or impact investment objectives. Excludes money market funds.

OUTLOOK

$50 trillion of assets by 2022

Fund assets should reach $50-$60 trillion worldwide by 2022 according to our models, if no major adverse events materialize and economic tailwinds persist.

Global assets expand in each of our projections, even in a market crash scenario modeled on the global financial crisis of 2018. Outcomes though vary by region, as detailed in our comprehensive annual outlook.

The changing landscape of fund management unlocks substantial potential. However, intense concentration of flows and distribution platform rationalization will disproportionately benefit firms. Identifying opportunities across the globe, responding to evolving client needs, adapting to regulation, and planning for unexpected outcomes will help.

Technology will continue to play a vital role in determining competitive outcomes. Innovations in financial technology are being applied across the value chain from investment management to operations and solution delivery, with significant potential to transform product use, marketing and sales, and client experiences. They can reduce costs in the long term but will require significant investment upfront.

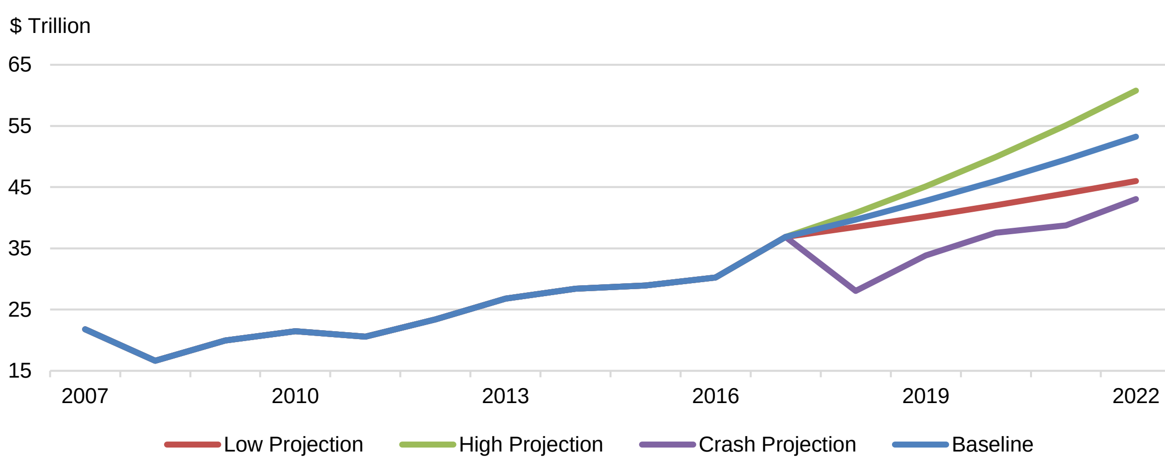
Automated robo-advisory platforms already surpass $200 billion, enabling financial solution delivery at lower costs and reduced account minimums. They also can augment the efforts of human advisors to provide a more robust solution and strengthen customer relationships.

Fintech robo-advisory start-ups have grown quickly, but established firms have taken the lead. Betterment, the largest independent robo-advisor, reached $12 billion in AUM, followed by Wealthfront with $10 billion. In contrast, Vanguard Personal Advisor Services – which integrates a digital platform with a human advisor – has more than $100 billion, while Schwab Intelligent Portfolios has surpassed $27 billion in assets.

China, a world leader in Fintech, may present some compelling opportunities at the intersection of multiple technological developments. For example, Tencent launched the Licaitong online fund platform on the WeChat mobile payments app in 2014. Robo-advisory and digital wealth management represent natural developments in this market.

Looking forward, we expect technology, demographics, and growing needs for savings and wealth management to further support fund demand in the longer term. Difficult economic and financial markets at times may temporarily reduce assets and profitability, but also give investment managers the chance to prove their value to distribution partners and clients.

Figure 8. Global Fund Industry Assets Under Management, 2007-2022 Projected



Source: Impactvesting LLC based on data from Broadridge Global Market Intelligence. Includes Cross-Border International, Local Europe, Asia-Pacific, and US markets. Excludes Canada, Latin America, Austrlia and New Zealand, and Middle East & Africa. Includes money market funds and external fund-of-funds; Japan includes internal fund-of-funds.

This white paper offers featured insights from our comprehensive analysis, **Global Fund Management: 2018-2022 Outlook**.

The Outlook reviews key developments in the asset management industry, offering a forward-looking perspective on opportunities and challenges. It focuses on strategies that support the growth of leading managers around the world, evolving investor demand, product development and innovations, and the forces shaping many areas of the business including active fund management, index funds and ETFs, factor-based investing, sub-advisory, ESG, technology, and robo-advisory.

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