EXPERT INVESTOR

FUND SELECTOR ASSET CLASS REPORT

OCTOBER 2016

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LAST WORD

WELCOME



Welcome to the latest edition of the Asset Class Report. Looking through the latest data has been a fascinating read and some clear trends have been forming.

One of the most consistent themes has been the improving sentiment toward emerging markets, both equities and bonds. It will be interesting to see whether recent flows into the region can be sustained over the rest of the year.

As we move through the final quarter of 2016, many of the uncertainties and challenges that have stalked markets this year remain unresolved. And with the additional matter of the US presidential election taking place next month, asset allocation and stock selection decisions will be as important as ever.



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HIGHLIGHTS

Hello and welcome to this quarter's Fund Selector Asset Class Report. For those who don't know, it uses data gathered from Last Word's Research department to track the forward-looking investment sentiments of fund selectors in 13 countries across continental Europe.

If you are interested in how other fund selectors are planning on changing their asset allocation over the next 12 months, this is the place to look. We cover everything from macro sentiment (page 5) through to equities (page 6), bonds (page 7) and alternatives (pages 8-9).

We've also provided three special reports. The first is on fund selector attitudes to property (page 10). The next looks at the changing correlation between attitude to European equities and attitude towards GEM and Asia – fascinating. And finally, we have an in-depth look at one of our regular asset classes. We selected global emerging market equities, breaking down the country by country demand.

As ever, if you have any feedback, please email me at dylan.emery@lastwordmedia.com

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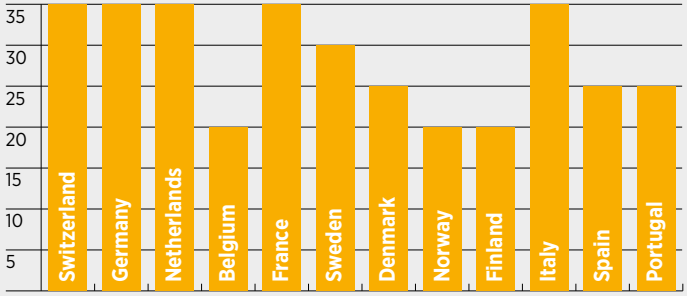
USER GUIDE & METHODOLOGY

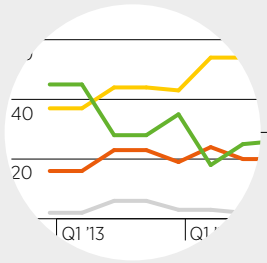
We use three data sources in this report. The fund selector sentiment database is a quarterly-gathered summary of the forward-looking buying and selling intentions of fund selectors and asset allocators across Europe. The minimum sample size we aim for every quarter is 350, divided by country (see graph to the right).

We gather the data in the last month of each quarter, so, for example, Q1 2014 data is gathered in March 2014.

Second, we have historical fund flows data across all the most common asset classes for all funds domiciled in continental Europe. Finally, we have a fund manager sentiment database that comprises the 12-month forward return predictions on a set of asset classes from 15 global fund groups.

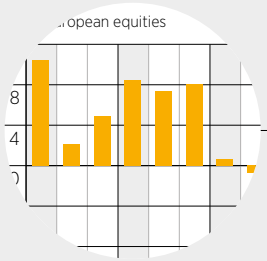
Estimated respondent numbers (total sample size 350+)





Fund selector sentiment line chart

This shows the forward-looking attitude to various asset classes: what percent of fund selectors intend to buy more, keep the same, reduce or have no exposure at all over the next year.



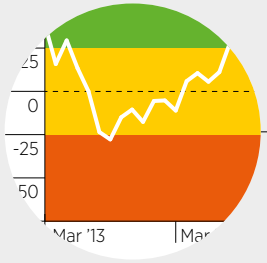
Fund flows graphs

This shows the flows into and out of all European-domiciled funds in the past 12 months. It's only a part of the whole universe of investment assets but it does give very valuable insights into the general behaviour of fund buyers.



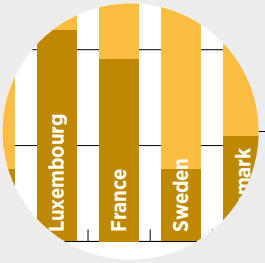
Fund selector sentiment bar chart

These bar charts show the same data as the line graphs next to them – but just take one time slice – generally the latest quarter.



Fund manager sentiment graphs

+100 means that every fund group in the survey thinks the relevant asset class will go up 5% or more in 12 months; -100 means they all think it will drop 5% or more; 0 means the bulls and bears are of equal number. We've divided it into green, yellow and red for ease of use.



Investment styles

This shows the attitudes of different countries to various types of investing: value vs growth and small cap vs large cap.

Macroeconomic sentiment

Positive Neutral Negative

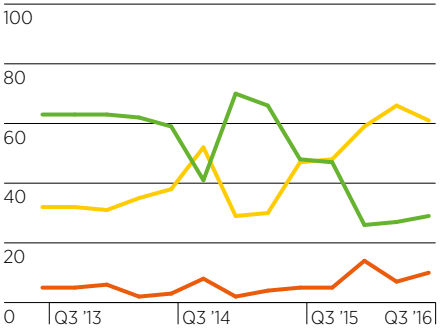
This shows the attitude of fund selectors towards the macro outlook.

– The graph on the left shows that the general attitude of fund selectors and asset allocators in Europe continues to be one of uncertainty. There is a slight increase in the number who think that we should be pessimistic but most are undecided.

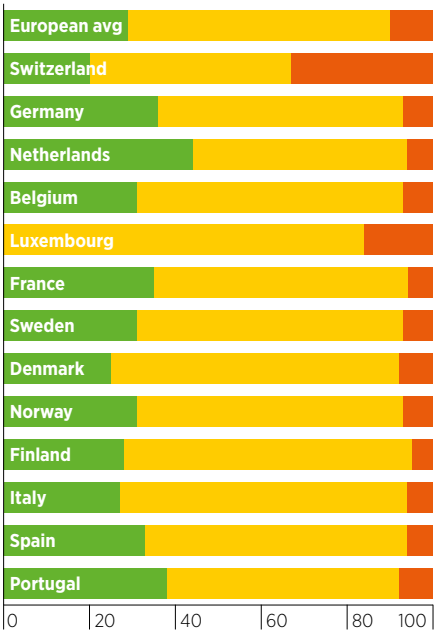
– There is a strong consensus among all the individual countries. For almost all areas, around a quarter of respondents are positive, roughly 5% are negative and the rest are uncertain.

– The only exceptions are Luxembourg and Switzerland. Luxembourg has no optimists and a few more pessimists. Switzerland is much more negative than the rest with around one-third of all respondents saying they have a negative outlook.

Macroeconomic sentiment



Country breakdown



Equities Buying/selling intentions

Increase Hold Decrease Not use

These tables show the forward-looking intentions of European fund selectors and asset allocators towards various equity strategies.

Europe: Attitudes to European equities took a dive last quarter and have stayed at the same level this quarter. They are still net positive, but are the lowest they have been for at least three years.

US: This remains a deeply unloved asset class. As you can see from the graph, this is a long-term pattern and is reflected in the fund flows – see page 14.

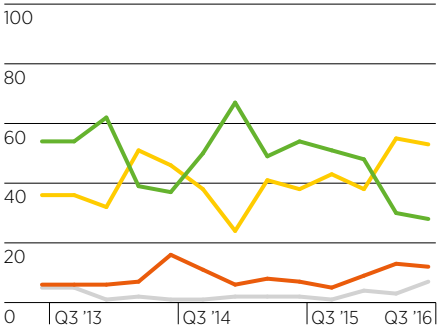
Japan: Having had a year-long boost in popularity from the end of 2014 to the end of 2015, Japan continues its 2016 negative trend.

GEM & Asia ex Japan: Both these asset classes continue their strong positive trends, with buyers outstripping both the neutrals and negatives.

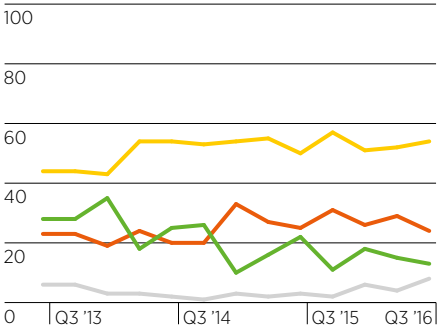
Frontier: The number who have exposure to the asset class is slowly going down, but among the 50% or so who do use it, there has been a strong surge in demand.

Global equity funds: Life is pretty positive for global equity managers with around one-fifth of investors looking to buy more.

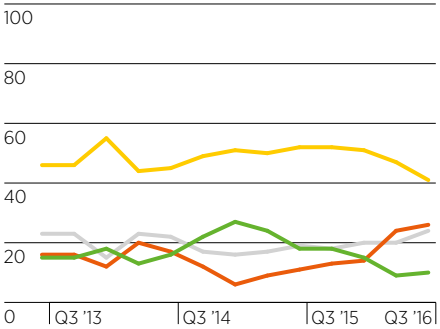
European equities



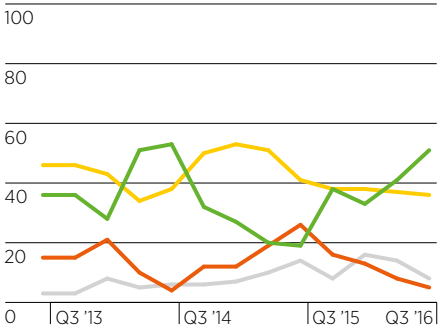
US equities



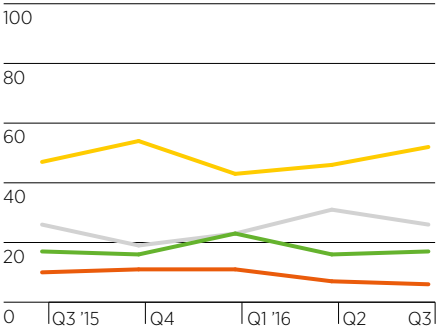
Japanese equities



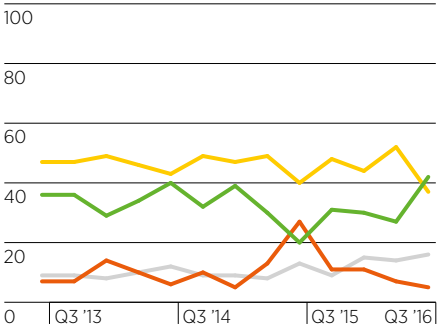
GEM equities



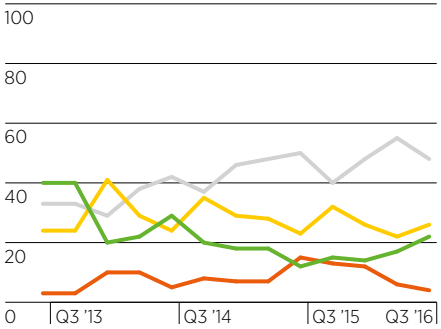
Global equity funds



Asia ex Japan equities



Frontier market equities



Bonds Buying/selling intentions

Increase Hold Decrease Not use

These tables show the forward-looking allocation intentions of European fund selectors and asset allocators towards various bond strategies.

Developed mkt gov bonds: These remain as unloved as they ever have, with around 50% looking to reduce their weighting.

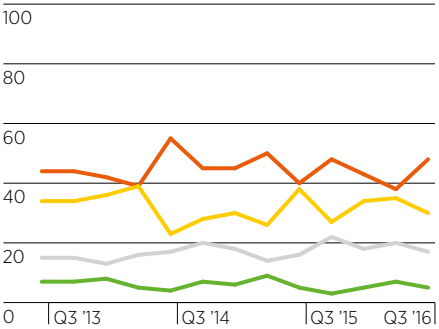
Developed mkt corporate bonds: These are still negative, although not as bad as developed govvies.

Developed mkt high-yield bonds: After a few positive quarters, demand for high yield has come back down to neutral.

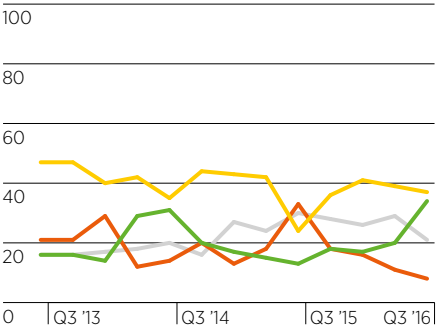
EM government and corporate bonds: These have taken a strong turn for the better, following the same trend in emerging market equities. Investors are very keen to load up exposure anywhere emerging, it seems.

Unconstrained bond funds: There has been consistent positive demand for unconstrained bond funds for the last year and that demand has become gradually stronger this year. The total number of those who use these products remains consistent at just over 50%.

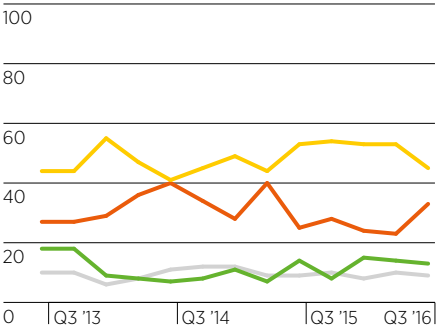
Developed market government bonds



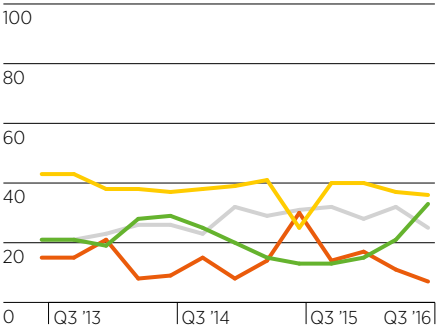
Emerging market government bonds



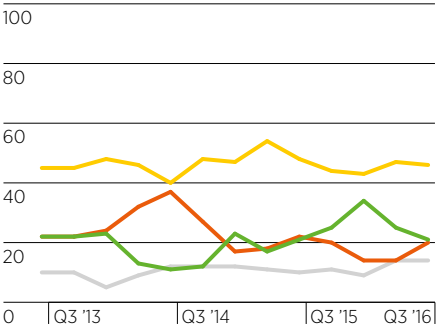
Developed market corporate bonds



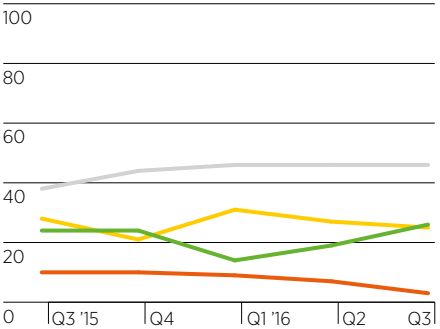
Emerging market corporate bonds



Developed market high-yield bonds



Unconstrained bond funds



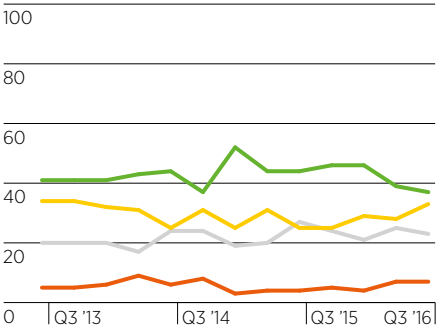
Absolute return Buying/selling intentions

Increase Hold Decrease Not use

This table shows the forward-looking intentions of European fund selectors and asset allocators towards absolute return strategies.

– Absolute return funds have never seen anything less than strong demand since we started gathering the data. This quarter, the number of buyers has come down a little, close to the point where buyers and holders meet but not quite. Nonetheless that is a very positive picture.

Absolute return



Hedge strategies Buying/selling intentions

Increase Hold Decrease Not use

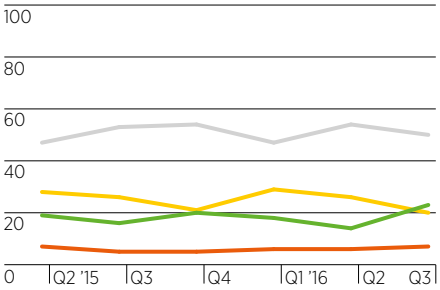
These tables show the forward-looking intentions of European fund selectors and asset allocators towards the four most popular hedge strategies.

– Demand for long/short equity remains better than any other hedge strategy but it has come down a little.

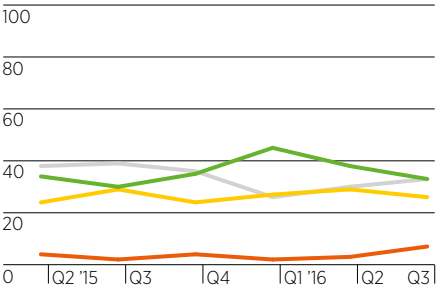
– Hedge multi-strat is second after long/short equity, with a healthy net-buying number, and global macro is just below that.

– Long/short debt has seen a noticeable spike in demand this quarter, bringing it to just above the level of demand enjoyed by global macro.

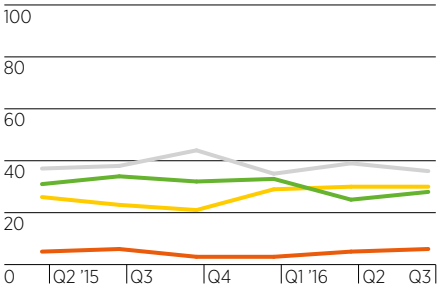
Hedge strategies: Long/short bonds



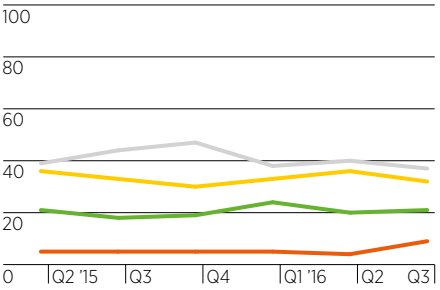
Hedge strategies: Long/short equities



Hedge strategies: Multi-strategy



Hedge strategies: Global macro



Commodities and Index-tracking products Buying/selling intentions

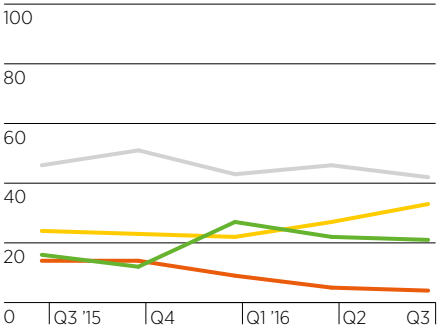
Increase Hold Decrease Not use

This table shows the forward-looking intentions of European fund selectors and asset allocators towards commodities and index-tracking products.

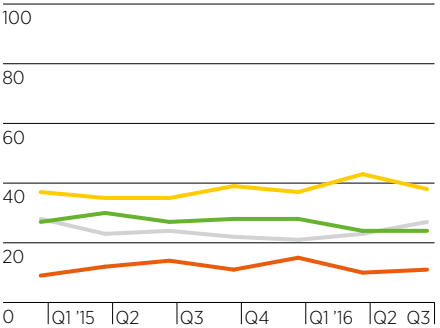
– We spotted the demand for commodities jump at the end of 2015 and it has remained high ever since. Investors are clearly waiting for the right opportunity.

– Index tracking products maintain a consistent course for growth.

Commodities



Index-tracking products



EI research analysis: Property

Increase Hold Decrease Not use

In this issue we thought we would look at fund selectors' attitudes towards property. It's not an asset class that all of our readers have direct access to but it remains one of the biggest in the world and worthy of analysis.

– The overall average throughout Europe is positive. Almost half of those who have any exposure at all to property are looking to buy more.

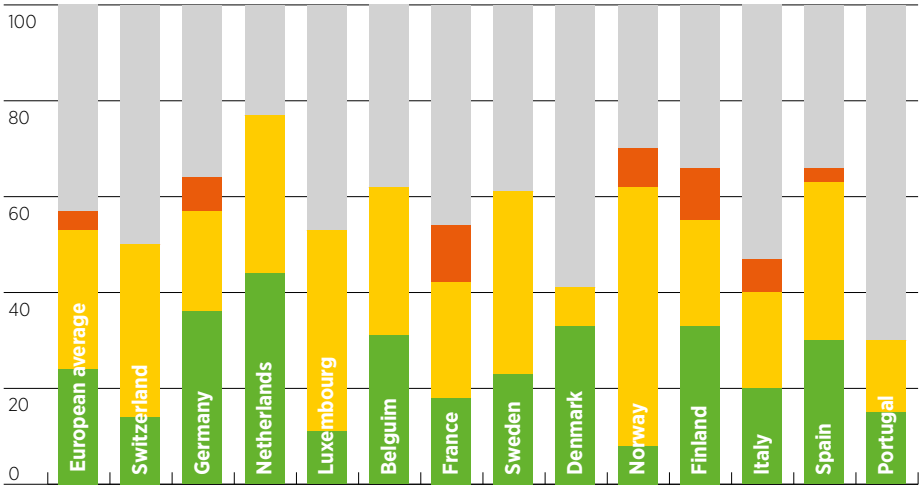
– However, this hides a great deal of variability. The standout countries in terms of demand are The Netherlands, Germany, Denmark, Finland, Spain and Belgium. The countries with significantly low levels of demand are Luxembourg and Norway.

– The only countries with a significant number of people looking to reduce their property weighting are France and Finland, but both those countries also have a reasonable number of fund selectors looking to buy more.

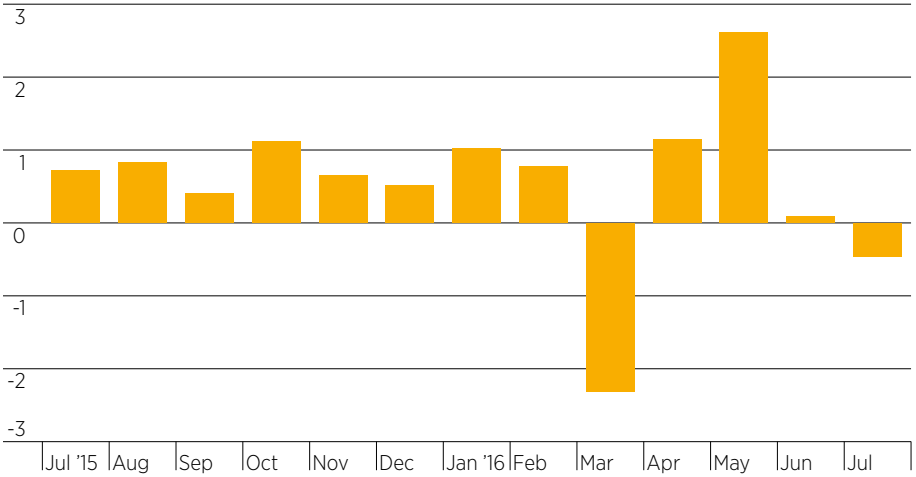
– The fund flows graph underneath shows the total assets going into European-domiciled funds. The aggregate over the past year is positive. You can see there was a big sell-off in March 2016 but the flows back in both April and May more than made up for it.

– If you just took UK-domiciled funds, there were further strong outflows in June and July post-Brexit when investors panicked. But as these numbers show the aggregate of all European-domiciled funds, it is less extreme.

Property: buying/selling intentions % Q3 '16



Net asset flows: European-domiciled property funds €bn



EI research analysis: GEM equities vs European equities

We have in the past looked at the correlation between people's attitude to GEM equities and European equities. It was so interesting last time that we thought it was time to do an update.

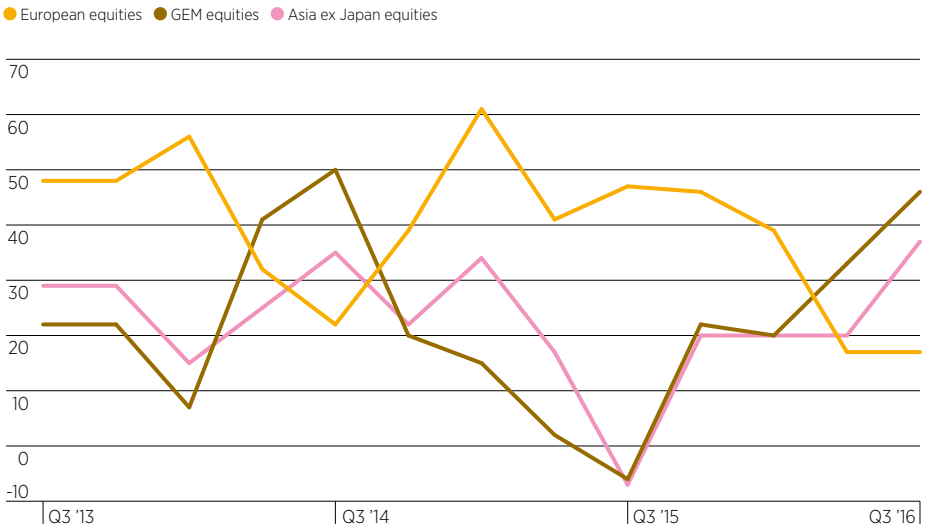
– The top graph shows net sentiment numbers: zero means that the number of those wanting to buy is exactly matched by the number of sellers; a positive number means that there are more buyers; negative means more sellers.

– It compares the net sentiment of European fund selectors to Europe, GEM and Asia ex Japan equities. As you can probably see, for quite a lot of the time, when demand for Europe goes up, demand for GEM and Asia goes down and vice versa. There has been a fairly consistent negative correlation.

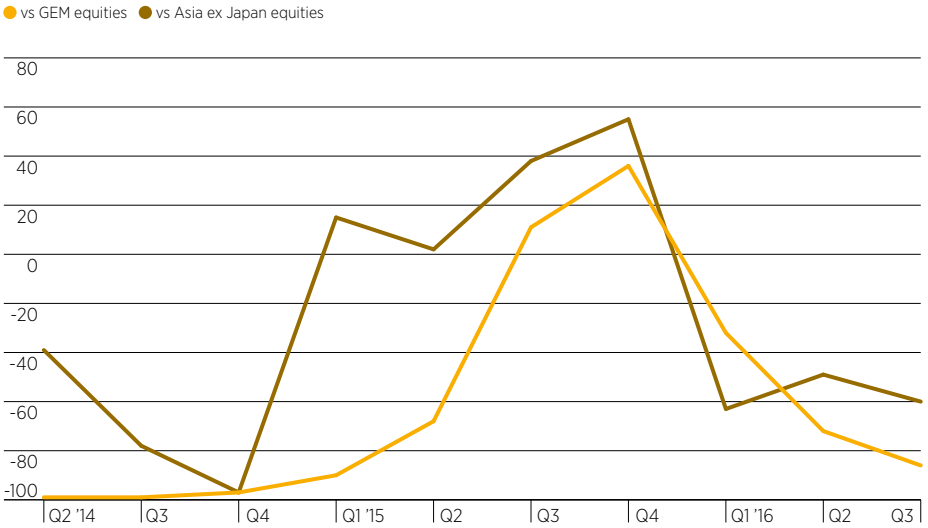
– We use the term 'fairly consistent' carefully, however, because it does change over time. The graph underneath shows the correlation between GEM and Asia to European equities: 100 means perfect correlation, -100 perfectly negative and zero means no discernable pattern at all.

– As you can see in 2015, EM and Europe reversed their negative correlations and became a little bit correlated – never more than 60% but nonetheless it was positive. Since the start of 2016, however, it has all reverted and now attitudes towards Europe and emerging equities are once more utterly divergent.

Net sentiment: net buyers %



European equities net sentiment: rolling four-quarter correlation %



In depth: GEM equities

Increase Hold Decrease Not use

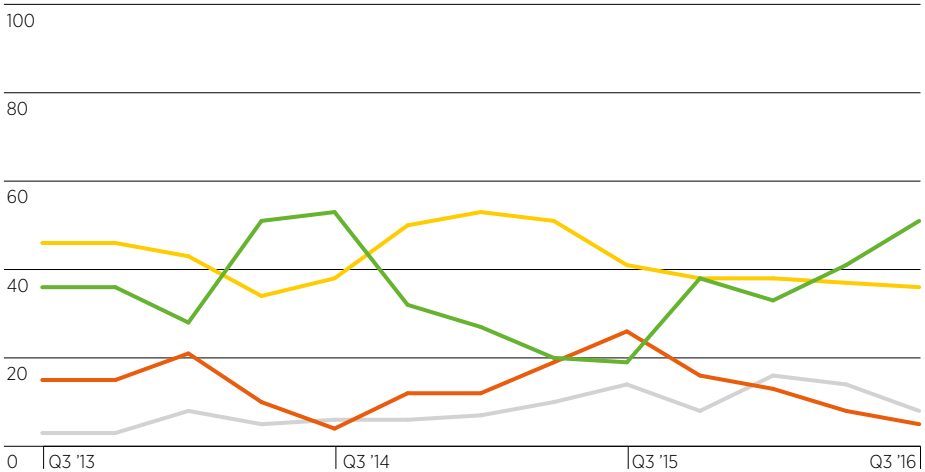
Here is a detailed look at fund selectors' attitudes to emerging market equities. The overall picture is very positive

– 2016 has been the year of GEM. Sentiment towards GEM equities picked up strongly at the start of the year and has maintained that trajectory ever since, with the number of those looking to reduce their weighting in the asset class dropping to almost nothing.

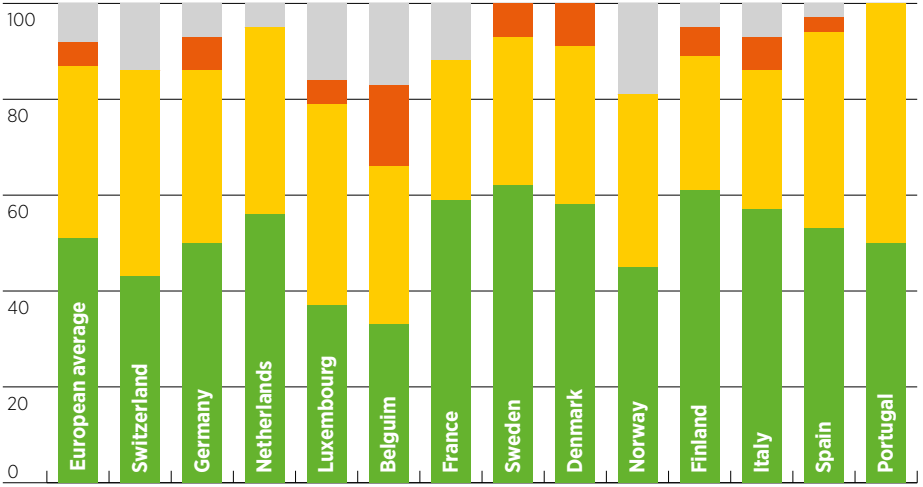
– There has been some variability between countries, but the overall picture is the same everywhere. The only place with a significant number of doubters is Belgium and even there they are overwhelmed by those wanting to buy more.

– If you look at the flows (page 14) for GEM equity funds, you can see that this positive attitude did not convert into fund sales on average until July this year, when suddenly there was a strong flood of money into the asset class.

GEM equities: buying/selling intentions %



GEM equities: buying/selling intentions % Q3 '16



We also gather style data, asking fund selectors whether they have a strong preference between large/small cap or value/growth.

It is important to remember that around a third of all respondents have no preference – so there is potential demand for all styles.

– When it comes to GEM, large cap dominates. That doesn't mean to say that no one buys small-cap funds, but of the two-thirds of people who have a preference, the vast majority want large cap.

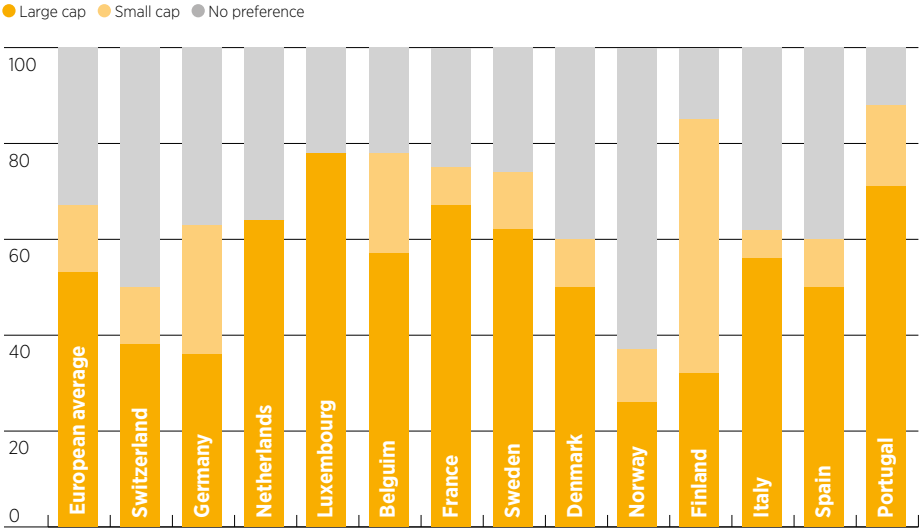
– The only exception to this is Finland which has a trend-busting love of small cap GEM stocks.

– On the growth/value debate, fund selectors fall on the side of growth.

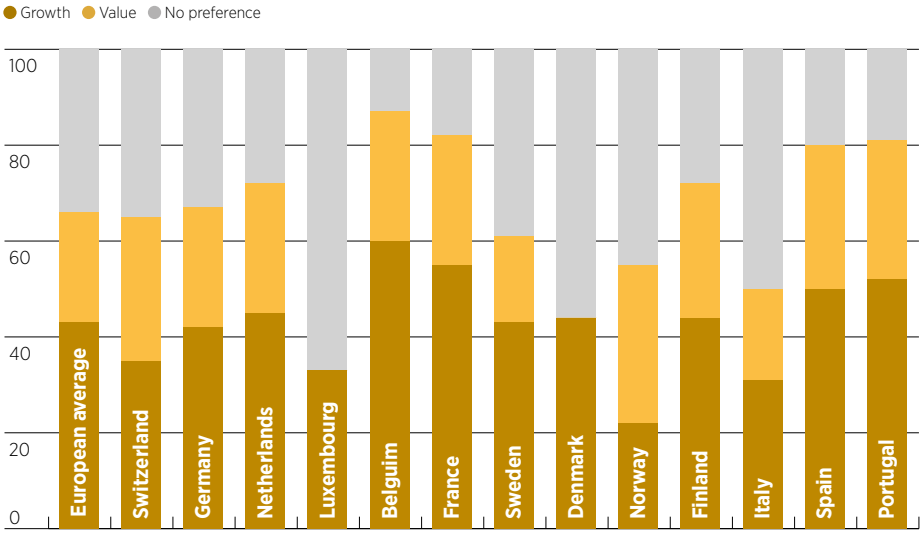
– The outliers are Luxembourg and Denmark where only a small number of people had a preference. Among those that did, 100% went for growth.

– On the other side, the only country that has more fans of value than growth in GEM investing is Norway, and even then the preference is only slight.

Small cap vs large cap



Growth vs value



European Fund Flows Data

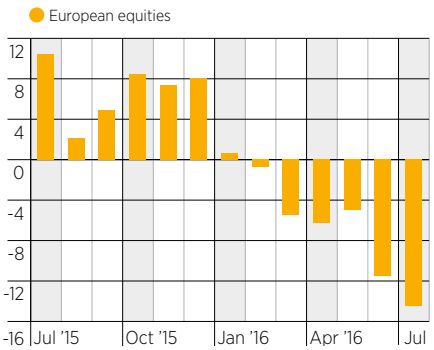
These graphs show the assets flowing into and out of European-domiciled active equity funds over the past year (data is provided by Morningstar).

– European equities have had a volatile year. For the past six months, we have seen a total net outflow of €41.9bn from European equity funds. In the seven months prior to that, we saw €43.4bn flow into those funds!

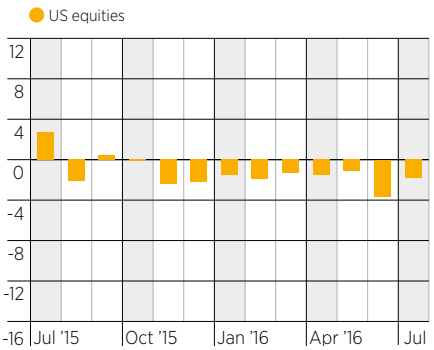
– US equities remains in a slow decline. Every month since November 2015, we've seen around €2-3bn flow out of US equity funds. If you add to that the fact that fund selectors have been bearish for at least the past year (see page 6) and that fund manager sentiment has been negative for almost as long (see page 16/17), you would be right to wonder when things might turn around for US equity fund managers.

– GEM has had a bad time of it over the past year until July when finally money started coming back in. Asia has yet to benefit from any increase in appetite for EM and frontier markets funds remain very small. However, as future demand among fund selectors for Asia, GEM and frontier is so strong, we would expect a positive outcome for all three asset classes.

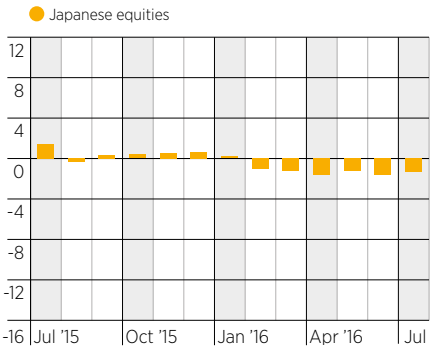
European equities (€bn)



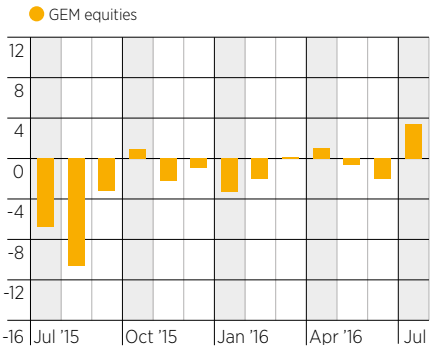
US equities (€bn)



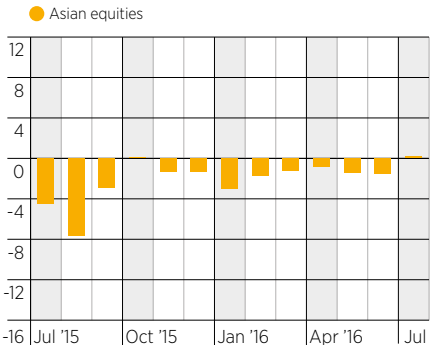
Japanese equities (€bn)



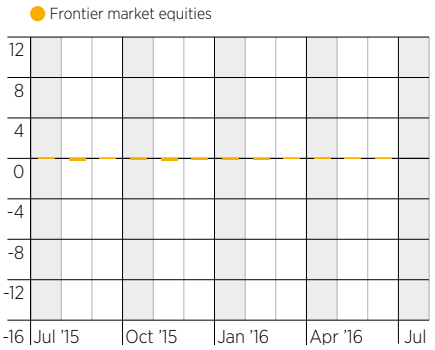
GEM equities (€bn)



Asian equities (€bn)



Frontier market equities (€bn)



In association with

MORNINGSTAR

European Fund Flows Data

These graphs show the assets flowing into and out of European-domiciled bond funds and absolute return/hedge strategies over the past year (data provided by Morningstar).

– The biggest winner continues to be absolute return. Despite a slowing down in the past four months, money continues coming in.

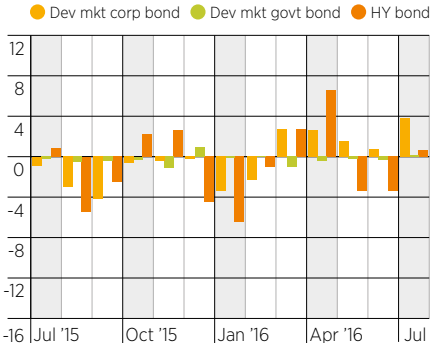
– Of all the hedge strategies, there is only one that really has any weight behind it and that is multi-strategy hedge. The other hedge strategies have seen very little movement.

– Looking at developed market bonds (top left chart), there is almost no movement in govvies. In both investment grade and high yield, however, the story is much more volatile, with billions flowing either in or out every month.

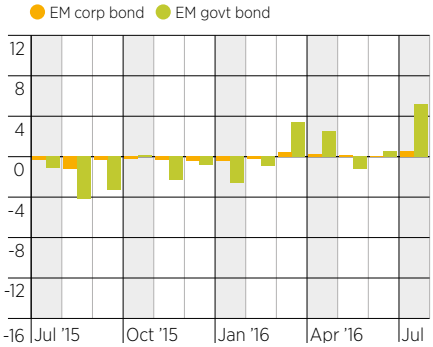
– After a terrible six months, emerging market govvies are back! In July, they came back really strongly with more than €5bn flooding into EMD funds.

– Property had a hectic time of it with strong outflows in March and inflows in April and June – see page 10 for a more in-depth look at property.

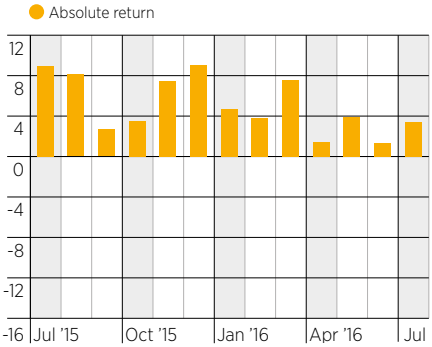
Developed market bonds (€bn)



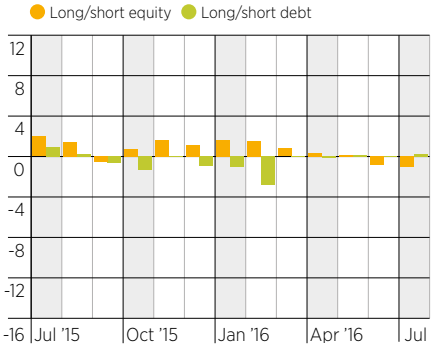
Emerging market bonds (€bn)



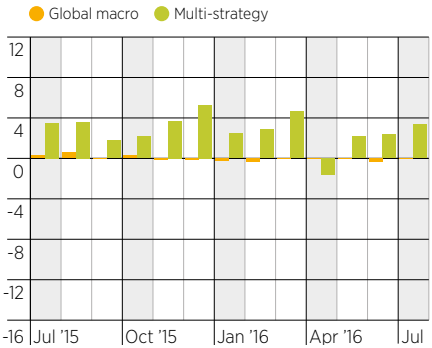
Absolute return (€bn)



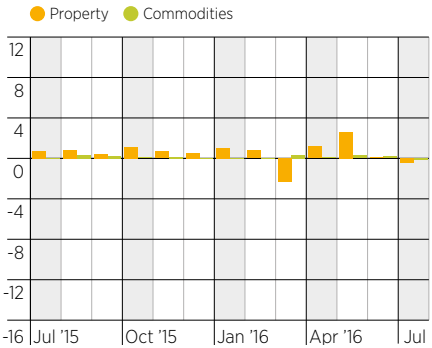
Long/short equity & long/short debt (€bn)



Global macro & multi-strategy (€bn)



Property (€bn)



EI fund manager predictions database

Bullish Neutral Bearish

This shows the 12-month forward-looking investment estimates for a variety of asset classes from a group of international fund management houses. See the description on the far right for more detail.

The enthusiasm among fund managers for European equities continues its slow descent. Bear in mind, however, that there are quite a few more groups that think European equities will be up in a year's time than those who think they will be down.

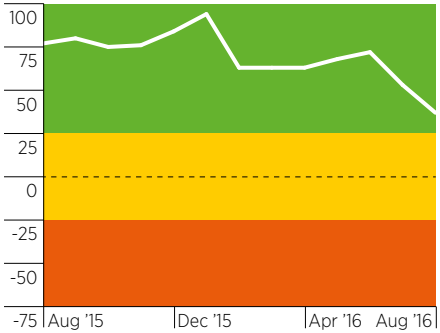
Japan is in a similar situation to Europe, having been the darling of the fund management world for several years; opinion, while still positive, is drifting down towards neutral.

Attitudes to US equities are still very negative (although not so much in small caps) despite the S&P 500 performing well over the past six months. This mirrors the long-term bearish view of fund selectors and also reflects the fact there have been US equity outflows every month since November 2015.

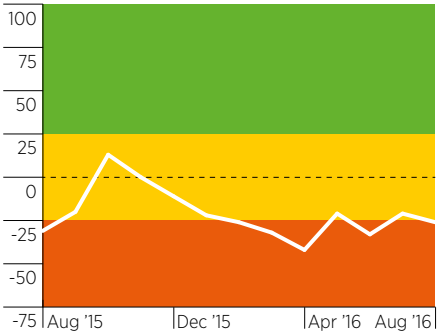
Fund managers are starting to get more positive on EM equities, finally catching up with fund selectors. This has also been reflected in very positive fund flows in July – almost €4bn net.

Interestingly, the attitude to global government bonds has noticeably dipped, perhaps a indicator that international govvies might finally underperfom?

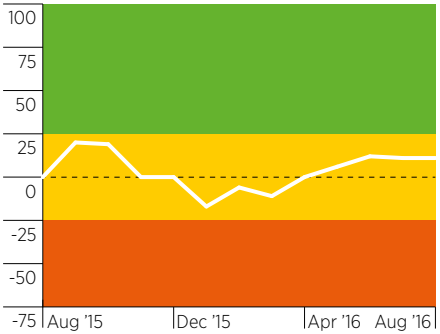
Europe ex UK equities



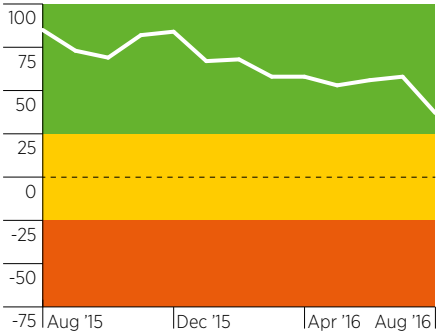
US equities



Asian equities



Japan equities



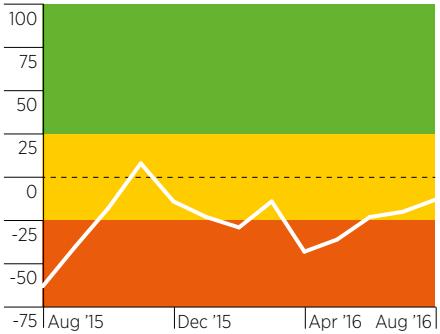
Fund manager predictions data gathered by

OLDMUTUAL WEALTH

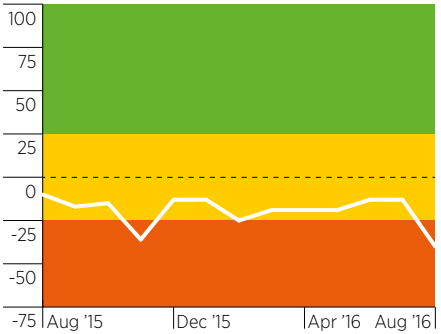
EI fund manager predictions database

Bullish Neutral Bearish

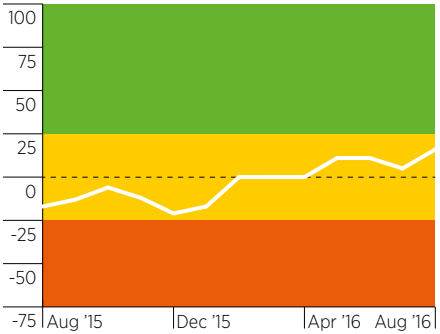
US smaller companies equities



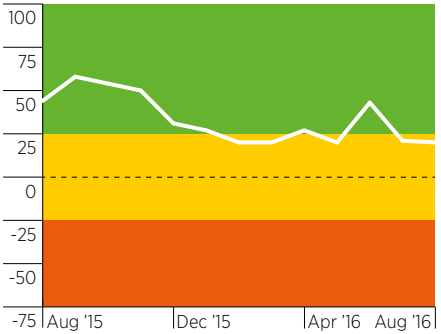
Global government bonds



Emerging market equities



Property



This is how the fund manager predictions database numbers are calculated:

The data for these graphs are collected on a monthly basis from around 20 global fund groups. We've been gathering the data for more than 10 years, although we only show three years of data here.

Every respondent gives the house view on a series of indices, answering the question: do you think that in 12 months' time this index will have gone up 5% or more; gone down 5% or more; or will be between -5% and +5% from where it is now.

We have taken that data and turned it into a sentiment number: -100 means every respondent is bearish; +100 means everyone is bullish; 0 means the bulls and the bears are evenly matched.

Anything from 25 or more we have designated bullish (green) on the graphs; anything from -25 or below bearish (red).

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[1]The combined asset under management of the T. Rowe Price Group of companies in EUR as of 30 June 2016.
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[2]As of 30 June 2016.

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