EXPERT INVESTOR

FUND SELECTOR ASSET CLASS REPORT

MAY 2016

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WELCOME



Welcome to the latest edition of this report, which aims to provide a snapshot of the current sentiment for different asset classes from across the investment community.

The year got off to a tough start for investors with ongoing fears of slowing global growth and turmoil in the energy sector leading to increased market volatility. But then, of course, investing is not meant to be easy!

However, as is often cited, it is precisely these periods of uncertainty that can provide long-term investors with opportunities to reposition their portfolio and take advantage of the pricing inefficiencies that markets present.

I hope you find the report both interesting and informative, and at the very least I'm sure the data will generate some interesting debate!



Peter Preisler
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HIGHLIGHTS

Welcome to the latest Asset Class Report. A lot has happened since the last report in October 2015. Firstly, the macroeconomic outlook has taken a sharp downward turn (see page 5 for the country breakdown).

Europe remains at the top of the equity tables, while on the bond side, high yield has risen up to take the popularity crown (see pages 6-7).

Other asset classes and strategies have more or less maintained their position, with the exception of commodities, which has finally come in from the cold (see page 9).

Our two pieces of research look at the popularity of sector funds (page 10) and some sharp moves in correlations between US, European, GEM equities and high yield. The results are probably not what you'd expect. See page 11 for details.

Our in-depth asset class this issue is European equities – see pages 12-13 for a country-by-country breakdown.

As ever, there is a lot in this report so please dig deep – we hope you'll find something of interest inside!





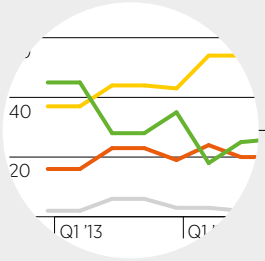
Dylan Emery, editor
dylan.emery@lastwordmedia.com

USER GUIDE & METHODOLOGY

We use three data sources in this report. Firstly, 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 fund selectors across 13 countries. We gather the data in the last month of each quarter: March, June, September and December of every year.

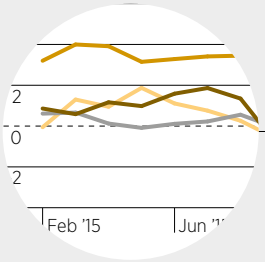
Secondly, we include historical fund flows data across all the most common asset classes for all funds domiciled in continental Europe.

Finally, we have a fund manager sentiment database. This is the 12-month forward return predictions from around 20 global fund groups in a variety of asset classes.



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.



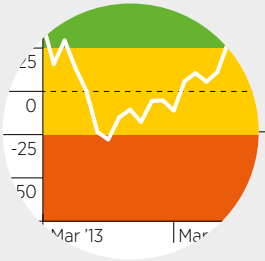
Fund flows graphs

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.



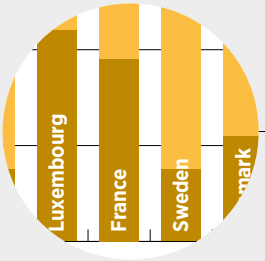
Fund selector sentiment bar chart

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

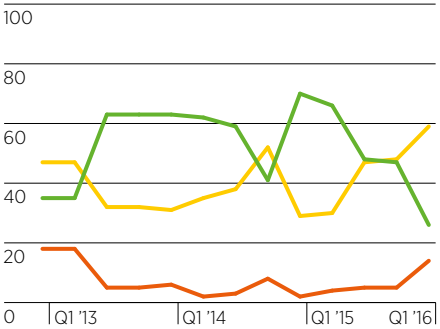
This shows the attitude of fund selectors towards the general macroeconomic outlook.

The general outlook has worsened strikingly this quarter.

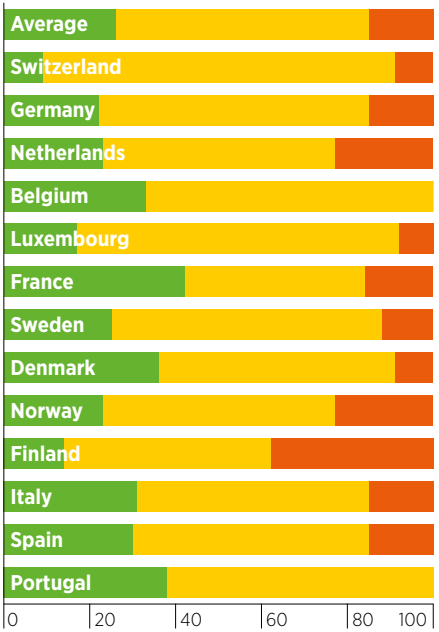
But nonetheless, there are still more optimists than pessimists – it's just that those with a neutral attitude to the macro outlook are dominating.

The big outliers to this are the Finns, who are the most pessimistic in Europe by a large margin; and the French and Portuguese, who are the most optimistic.

Macroeconomic sentiment



Country breakdown



Equities Buying/selling intentions

Increase Hold Decrease Not use

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

Europe: Europe still remains the most popular of equity classes with most respondents expecting to buy more.

US: US equities has the highest number of those looking to sell of all equity classes, although 1 in 5 still expect to buy more.

Japan: Demand for Japan equities has continued its descent. It has now reached a neutral position, with buyers and sellers balanced.

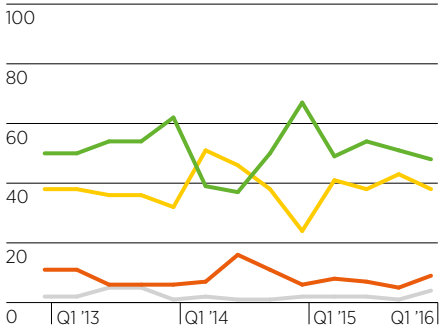
GEM: Last quarter's jump for GEM has sustained for a second quarter with roughly 40% buying and another 40% holding.

Asia ex Japan: Asian equities remains almost as popular as GEM, with a healthy number of buyers.

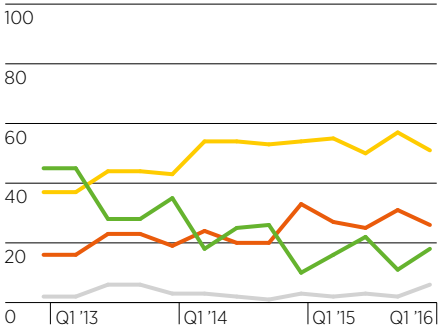
Frontier: Interest in frontier remains muted. Overall use is about 50%, and of those, buyers only fractionally outnumber sellers.

Global equity funds: Demand for global equity funds remains consistently positive. Just under 80% of our respondents use these products and almost a quarter expect to buy more.

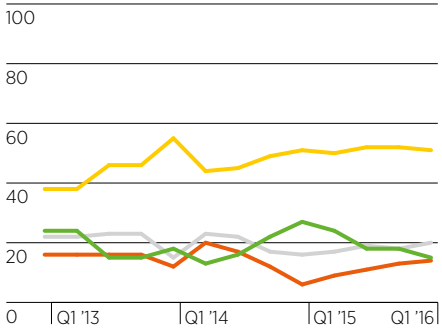
European equities



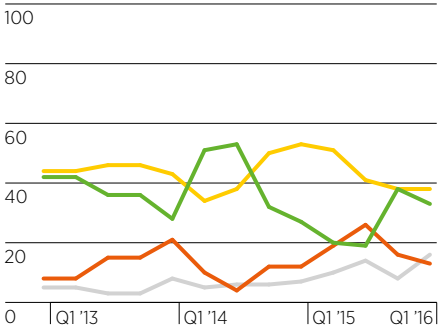
US equities



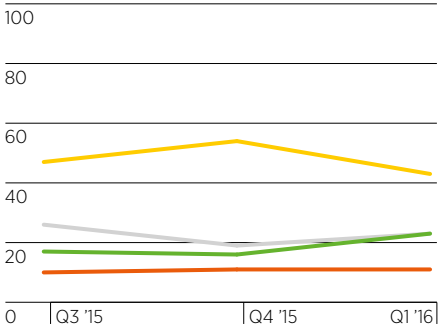
Japanese equities



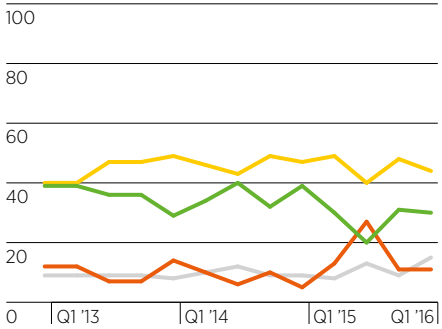
GEM equities



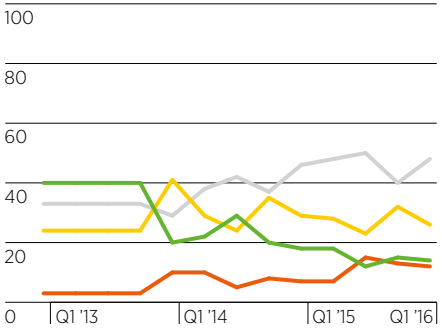
Global equity funds



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 deeply negative, a position they have had for more than three years.

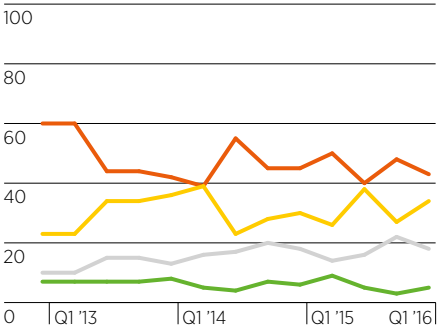
Developed mkt corporate bonds: Even though the attitudes of fund buyers is negative, it has slowly been creeping up towards neutral.

Developed mkt high-yield bonds: High yield has had a big boost this quarter. It's by far the most popular of all the fixed income asset classes.

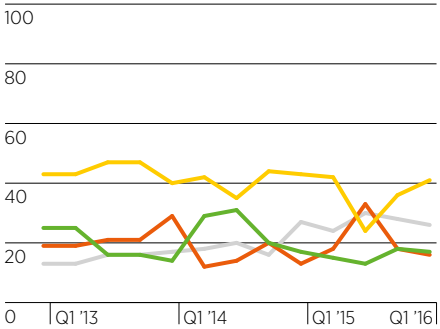
EM government and corporate bonds: Both EM govvies and EM credit are in churn with almost perfectly matched numbers of those looking to buy and those looking to sell.

Unconstrained bond funds: Having been positive for a year, the demand is starting to drop – it's still positive, but only just.

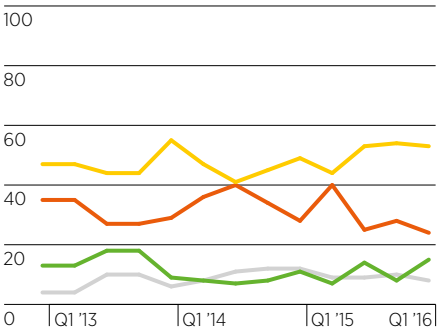
Developed market government bonds



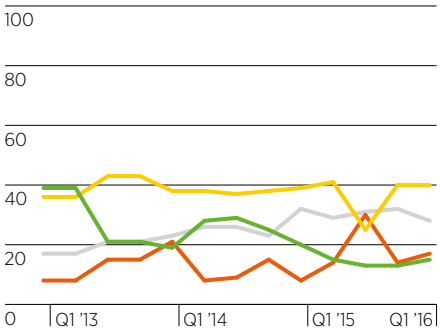
Emerging market government bonds



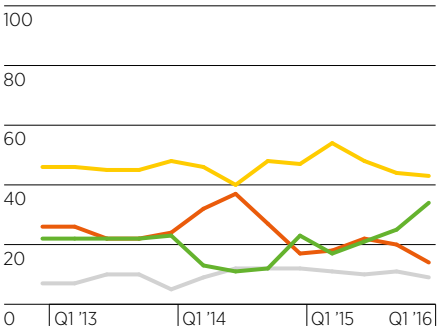
Developed market corporate bonds



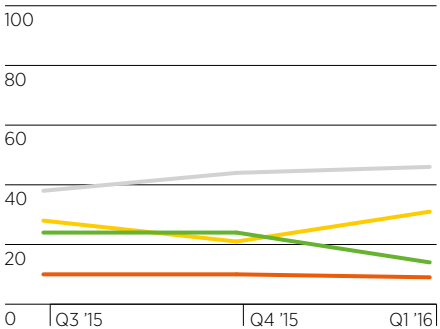
Emerging market corporate bonds



Developed market high-yield bonds



Unconstrained bond funds



Absolute return Buying/selling intentions

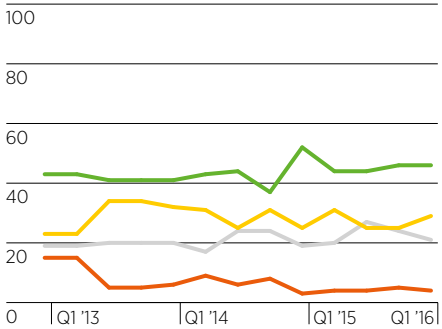
Increase Hold Decrease Not use

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

– Absolute return remains consistently one of the most sought-after investment classes.

– The number of those looking to sell is close to zero, while close to 50% of European fund selectors are looking to buy more.

Absolute return



Hedge strategies Buying/selling intentions

Increase Hold Decrease Not use

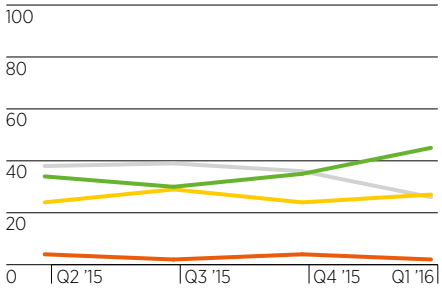
These tables show the forward-looking intentions of European fund selectors and asset allocators towards the four most popular hedge strategies.

– All the hedge strategies are net positive, but the most popular by far is long/short equity, which has been rising in popularity for a year.

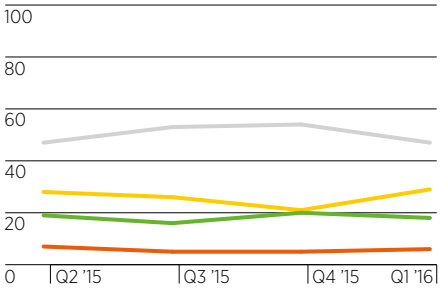
– Multi-strategy hedge is the second-most popular with a strong demand and few sellers.

– Long/short debt and global macro funds are at the bottom of the hedge league – but that's still not bad: they both show around a fifth of all respondents saying they want to buy more.

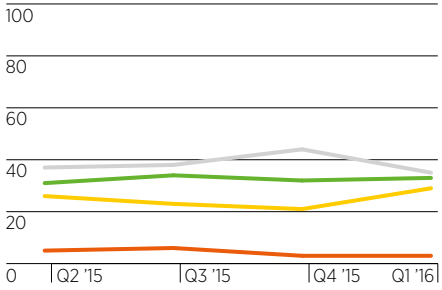
Hedge strategies: Long/short equities



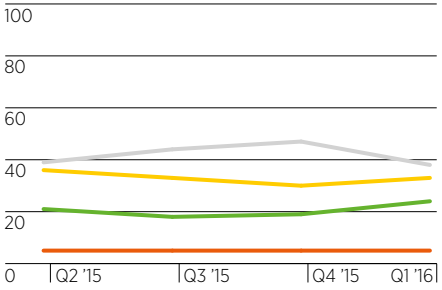
Hedge strategies: Long/short bonds



Hedge strategies: Multi-strategy



Hedge strategies: Global macro



Commodities and index-tracking products Buying/selling intentions

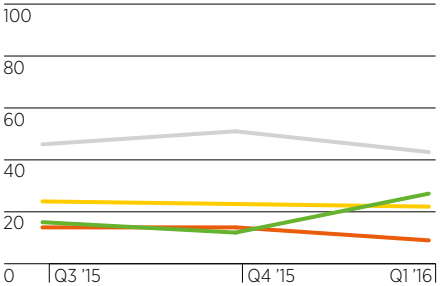
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This table shows the forward-looking intentions of European fund selectors and asset allocators towards commodities and index-tracking products.

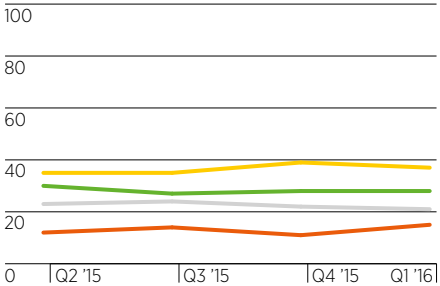
– Spring may have sprung for commodities. After years of sluggish or no demand, this quarter we have seen a big surge in interest in this area.

– Index-tracking products are used by around 80% of respondents and around twice as many expect to use more than expect to sell off, so a relatively positive picture.

Commodities



Index-tracking products



EI research analysis: Sector funds

Increase Hold Decrease Not use

The most popular and biggest sector funds in the world – who wants to invest?

As a one-off, we asked a carefully selected subset of top fund selectors (40 people from 13 countries) to give their forward-looking investment intentions on different types of sector funds.

The bars on the right show the percentage of respondents who expect to buy, hold, sell or not use the various strategies; the number in the column on the right is AUM in all funds of that theme domiciled in Europe ex UK.

We've listed it in order of how much money is in each strategy in Europe, with Healthcare the biggest (€19.4bn in AUM).

Aside from private equity, a high level (65-80%) of respondents use these funds.

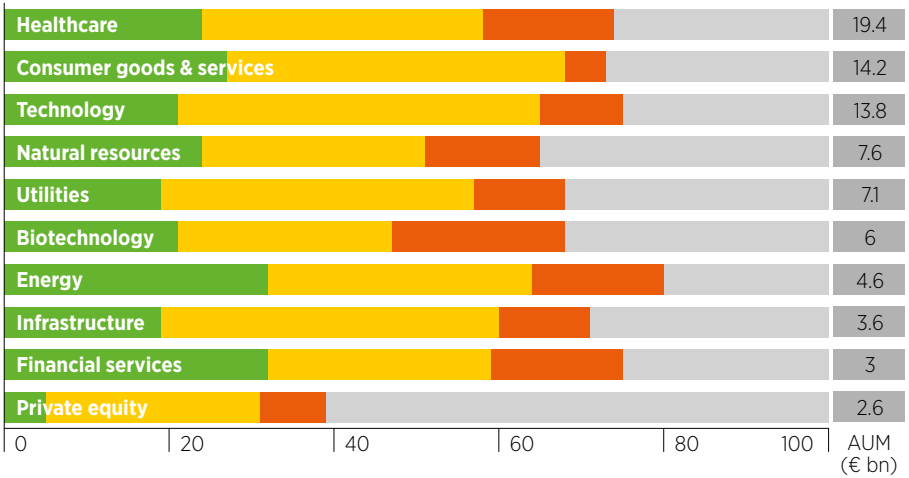
Perhaps surprisingly, the highest numbers of buyers are in energy and financial services funds.

Biotechnology is in a churn with roughly one in five looking to either buy or sell.

Overall, all the largest-themed fund sectors, except for private equity, are enjoying a healthy level of demand.

The AUM numbers are from Morningstar – they are an aggregation of the assets of every sector fund domiciled in Europe.

Sector funds: buying/selling intentions:



Correlations switch-over for European equities, high yield, US and GEM equities

It seems that fund selectors have radically changed their assumptions about asset class behaviour over the past year.

In the year up to mid-2015, the attitudes of fund selectors to GEM and US equities were highly correlated.

European equities and developed market high yield were similarly correlated to each other.

And the two pairs of correlated asset classes mentioned above were inversely correlated to each other until half-way through last year.

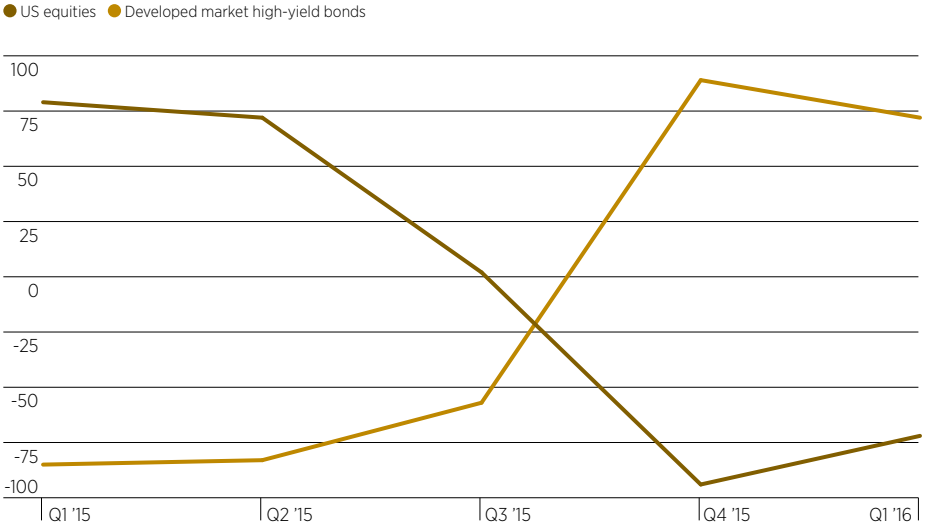
In other words, when fund selectors turned against US/GEM equities, they would become more positive towards Europe equities/high yield and vice versa.

That medium-term relationship started changing sharply around a year ago. Now sentiment towards GEM equities is strongly correlated with high yield and inversely correlated with US and Europe equities – a complete turnaround.

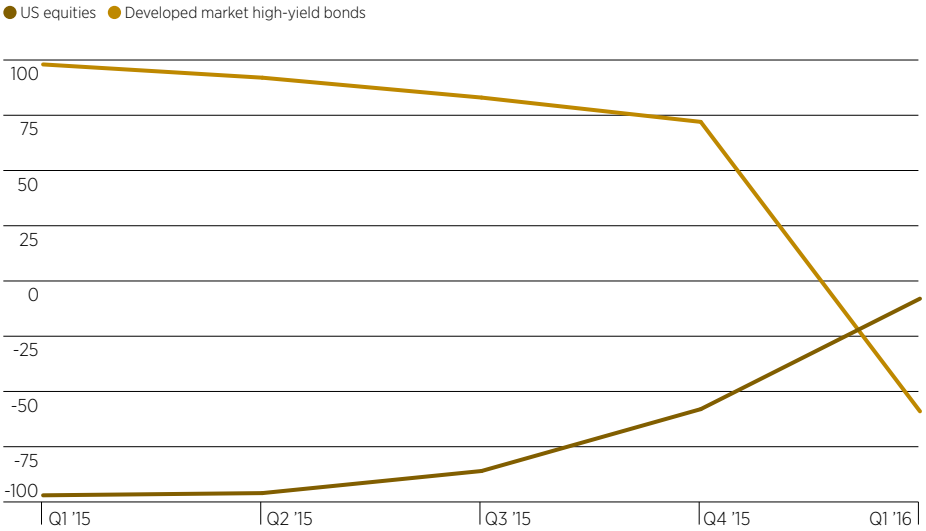
It's clear from this that habits of portfolio construction and assumptions about the behaviour of these asset classes have changed across Europe.

Do you recognise these changes in your attitudes to these asset classes? If you either disagree or agree with these patterns, please email us with your thoughts. Send your messages to dylan.emery@lastwordmedia.com

Rolling four-quarter sentiment correlations vs GEM equities



Rolling four-quarter sentiment correlations vs European equities



In depth: European equities

Increase Hold Decrease Not use

Here we take an in-depth look at just one asset class. In this issue, we are examining European equities, not only showing the aggregated attitudes across the continent but also the country breakdown.

– Studying the three-year trend presented here, European equities has been a consistently popular asset class. In fact in the past three years, there have been more people looking to increase their weighting toward the asset class than the buyers and holders combined in all except for two quarters. Those two quarters were Q2 and Q3 2014, a period during which the Eurozone crisis was gripping the markets.

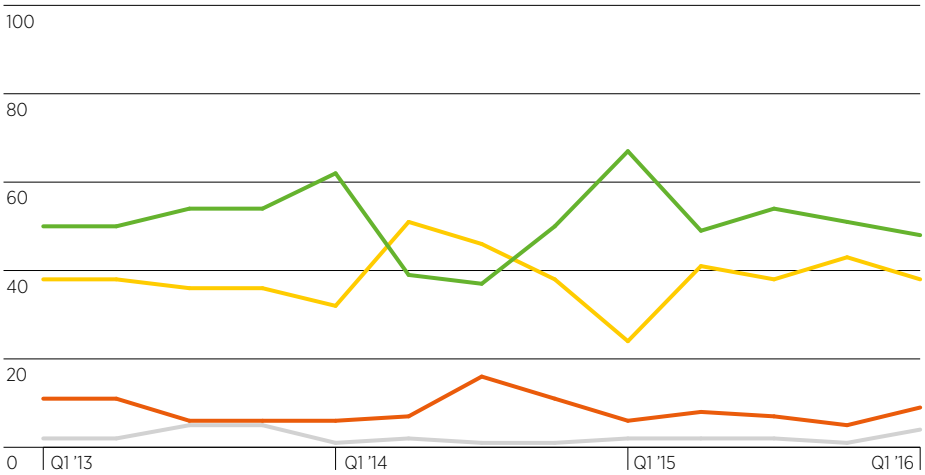
In the following two quarters, the number of buyers leapt up and it has remained more or less the same since.

– The bar chart underneath shows the latest quarter's data with a country breakdown.

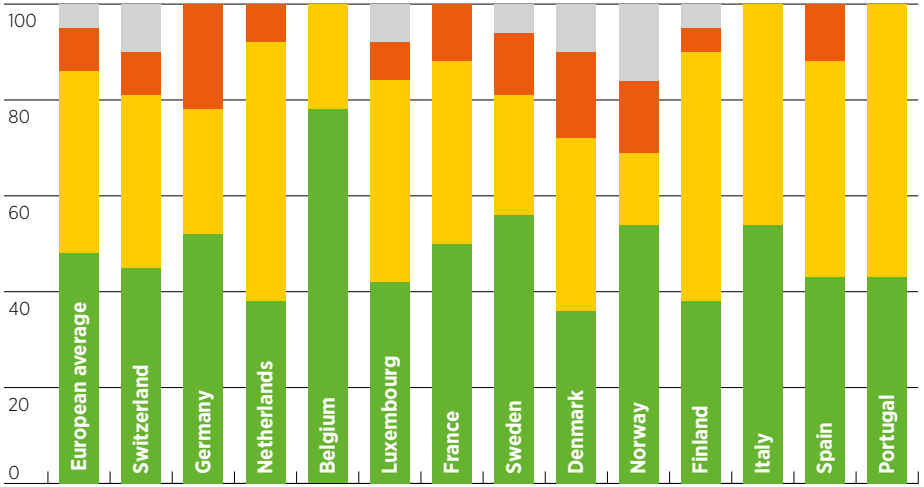
Belgium has a record high of almost 80% of fund selectors wanting to load up followed by Sweden, Norway, Italy, Germany and France, which occupy the rest of the top European spots for buyers.

Denmark, Finland and the Netherlands have the lowest number of buyers but even these show just under 40% of respondents looking to buy more.

European equities: buying/selling intentions %



European equities: buying/selling intentions % Q1 2016



In depth: European equities style preferences

We look at how style preferences differ from country to country by asking fund selectors whether, when it comes to European equities, they favour large-cap or small-cap; and whether they favour growth or value strategies.

– On average and across Europe, large-cap beats small-cap by 45% to 33% while value outnumbers growth by two to one.

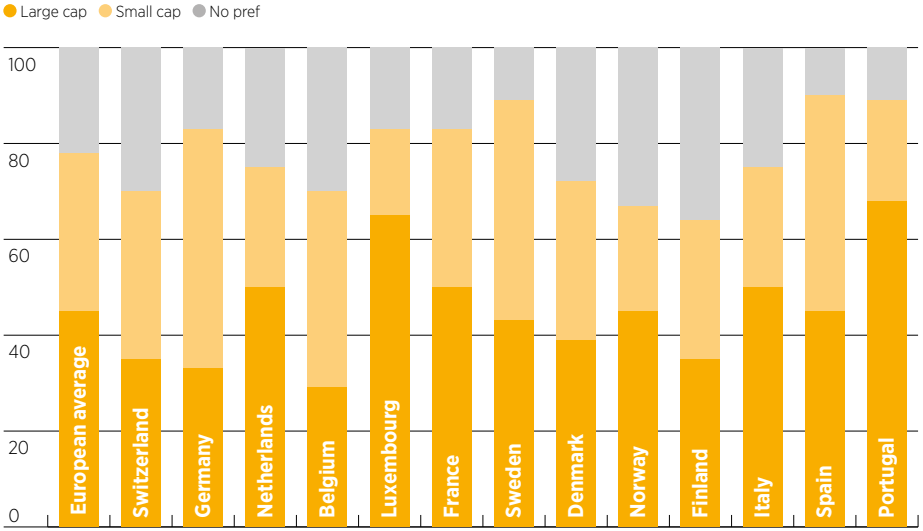
But this masks the diversity of opinion out there. For example, large-cap is overwhelmingly the favourite style in Portugal and Luxembourg whereas small-cap edges ahead in Germany, Belgium and Sweden.

In other countries such as Switzerland and Finland, opinion is split and there is no clear cap preference.

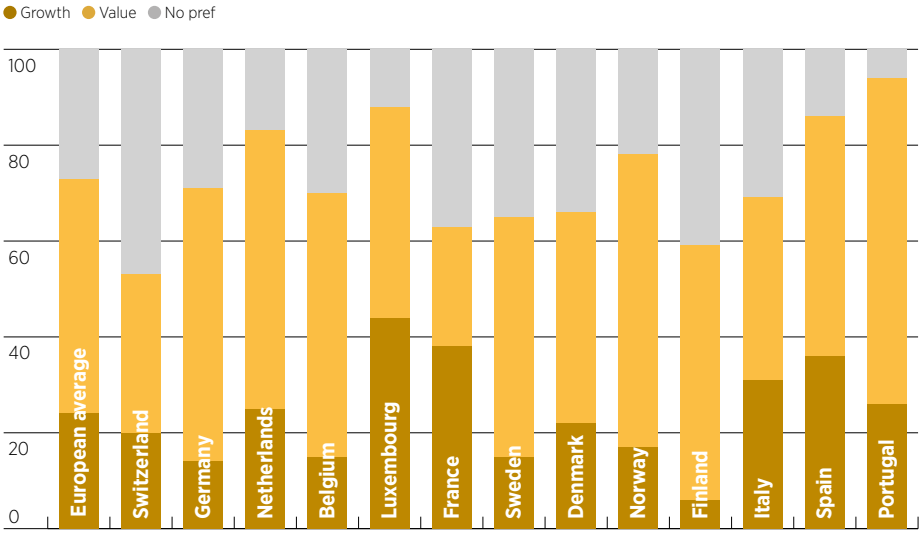
– The growth vs value picture is clearer, with value dominating, especially in Finland, Norway, Germany and Portugal.

Even though it is not as popular, there is still demand for growth strategies, especially in Luxembourg, France and Spain.

Small cap vs large cap



Growth vs value



European Fund Flows Data

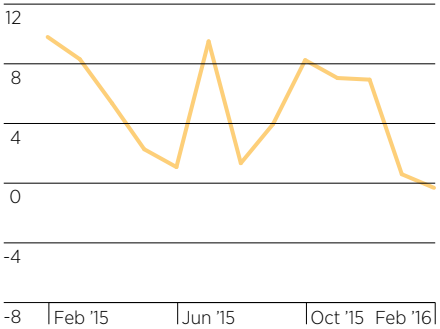
These graphs show the assets flowing into and out of European-domiciled equity funds over the past year.

There has been a lot of volatility in equities over the past year. Europe has jumped from flat to very positive and back several times. It's now in the flat position and has been for two months.

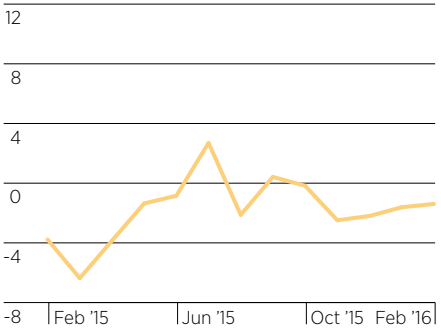
As for US equities, flows remain negative – not hugely, but consistently.

GEM and Asia have very similar patterns. There was a very sharp sell-off in August and things have been neutral or negative ever since.

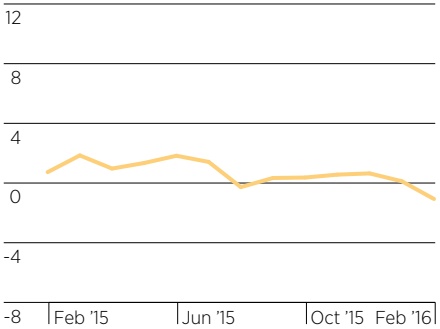
European equities (€bn)



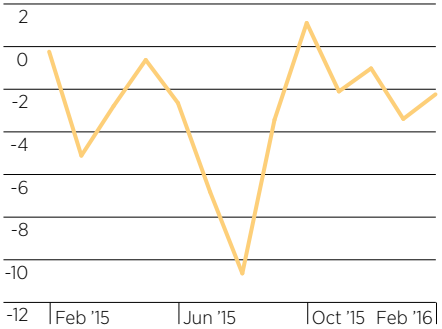
US equities (€bn)



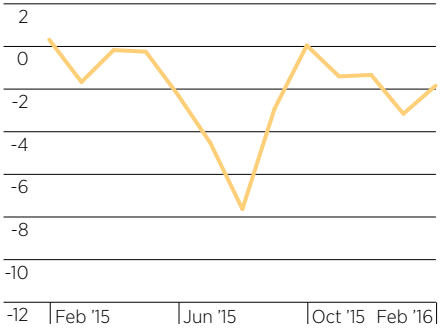
Japanese equities (€bn)



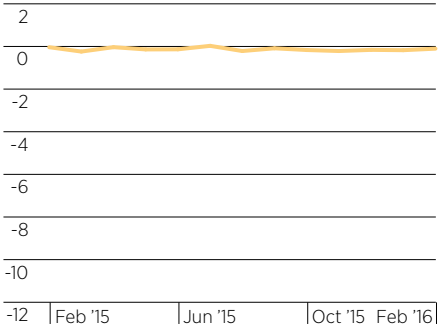
GEM equities (€bn)



Asian equities (€bn)



Frontier market equities (€bn)



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European Fund Flows Data

These graphs show the assets flowing into and out of European-domiciled bond and alternative funds over the past year.

As you will have seen elsewhere in this report, there has been a spike in demand for high yield. This is reflected in the asset flows, which have gone from very negative to neutral.

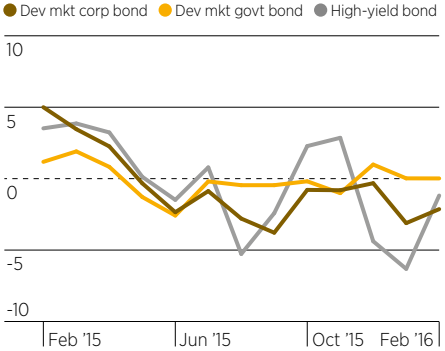
Developed market investment-grade credit and govvies remain flat or negative.

The same goes for EM bonds – nothing much is being bought or sold.

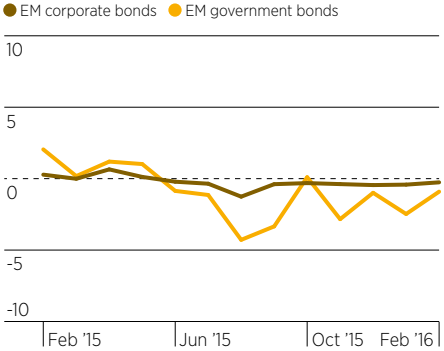
As for alternative funds, the strong flows of cash going especially into multi-strategy and long/short equity funds, has come down sharply. Still positive, but less so than before.

Long/short debt funds have seen significant outflows in the last few months.

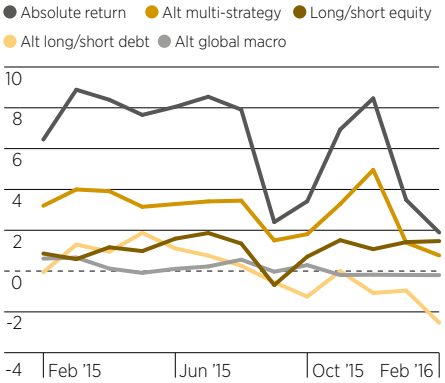
Developed market bonds (€bn)



Emerging market bonds (€bn)



Alternative strategies (€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.

– European equities maintains its 18-month position deep in the green. That means the overwhelming majority of fund houses think that the European stock market will be up 5% or more in a year's time.

However, it is worth noting that in the past month that has come down.

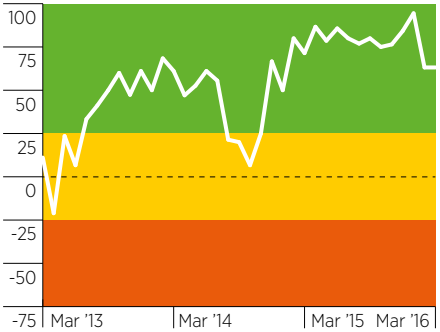
– The other market that inspires optimism is Japan, which has been in the most positive part of the sentiment charts for three years.

– Fund managers are at odds with fund buyers when it comes to the US. Fund buyers had a big December slump in demand, followed by a slight recovery; fund managers have not had that recovery – they are getting more and more pessimistic about US equities.

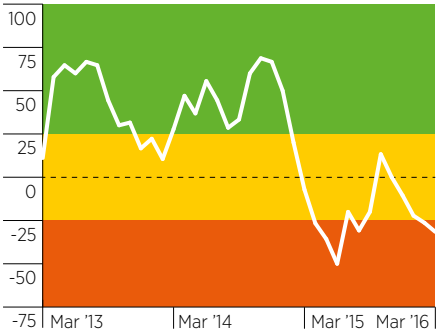
– EM and Asia are both close to neutral, in other words the bulls and bears roughly match in number. This is notably different from fund selectors, who are generally optimistic.

– The attitude of fund managers toward property continues its slow year-long decline. It is still positive, nonetheless.

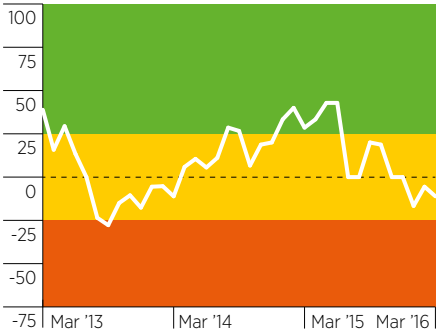
Europe ex UK equities



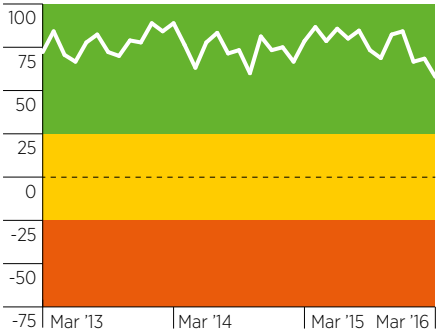
US equities



Asian equities



Japan equities



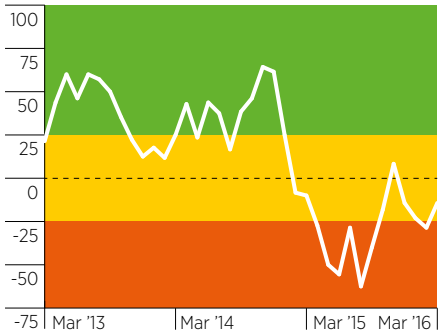
Fund manager predictions data gathered by

OLDMUTUAL INTERNATIONAL

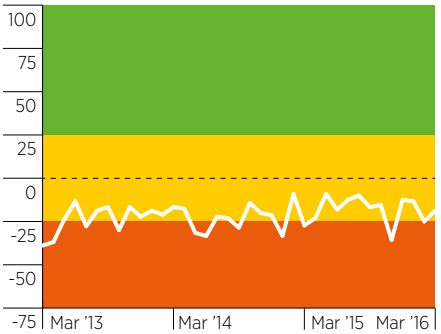
EI fund manager predictions database

Bullish Neutral Bearish

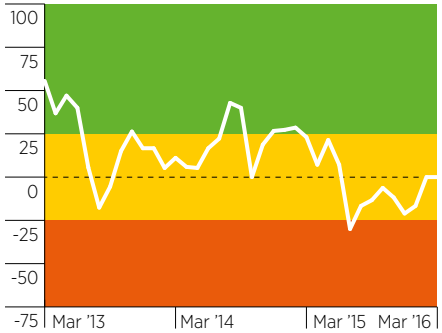
US smaller companies equities



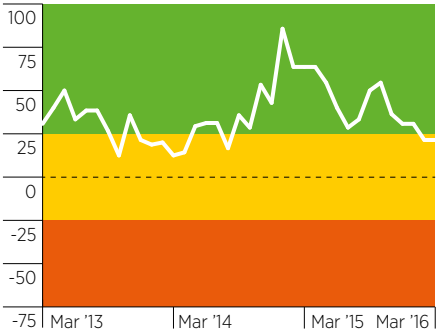
Global government bonds



Emerging market equites



Global 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 31 December 2015. The T. Rowe Price Group of companies includes T. Rowe Price Associates, Inc., T. Rowe Price International Ltd, T. Rowe Price Hong Kong Limited, T. Rowe Price Singapore Private Ltd., T. Rowe Price (Canada), Inc.
[2]As of 31 December 2015.

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