lakyara vol.172

Investment trust industry starting to look toward expanding customer base

Hisashi Kaneko

12. August. 2013

Nomura Research Institute, Ltd.

Executive Summary

Hisashi Kaneko
Senior Consultant
Financial Technology and Market Research Department

While investment trust sales have recently grown dramatically, redemptions have likewise increased markedly. Net investment trust inflows are consequently barely positive. Few statistics suggest that investment trust customers are increasing or the market is growing, but signs of change have started to appear. Most notably, relatively low-risk funds that have previously not sold well are now starting to gain popularity.

IInflows to the investment trust market have increased substantially in the wake of the equity market rally and yen's depreciation. Investment trust sales have been growing since last December. In February 2013, sales of equity investment trusts excluding ETFs set an all-time monthly record. Investment trust sales subsequently continued to grow every month through May. In the first six months of 2013, non-ETF equity investment trust sales totaled ¥21.4 trillion, over 20% more than the previous semiannual record set in the first half of 2007. Perceptions of the investment trust industry, particularly fund distributors, are changing, with optimism becoming increasingly widespread.

Still no growth in investment trust customers

However, the outlook for the industry differs when investment trust redemptions are also taken into account. Redemptions have likewise recently risen to all-time highs. In April 2013, monthly redemptions exceeded ¥3.5 trillion for the first time ever before increasing further in May. Including other distributions to customers (e.g., dividends, redemptions upon maturity), investment trust outflows totaled ¥21 trillion in the first half of 2013. Consequently, net investment trust inflows (sales minus total redemptions and dividends) in the first half of 2013 were a mere ¥400 billion.

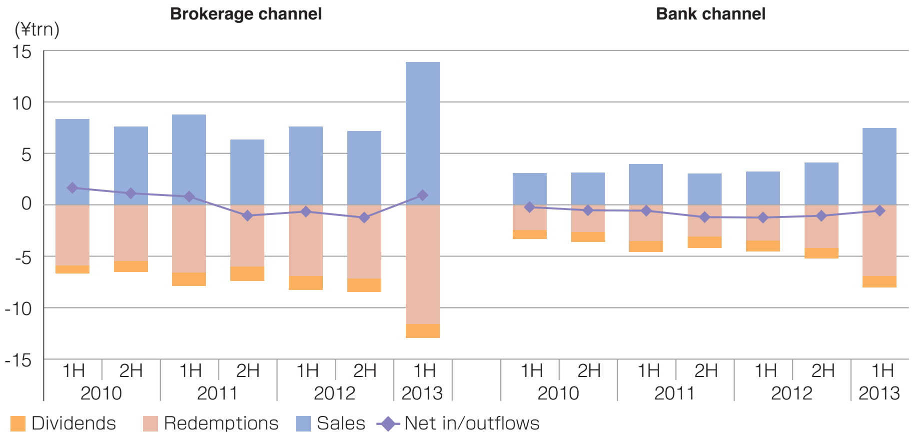
Investment trust sales and redemptions growing or declining simultaneously is not a new phenomenon. Sales and redemptions have tended to rise and fall in unison in recent years. Additionally, this tendency is common to both the brokerage and bank sales channels. Exhibit 1 presents estimated investment trust inflows and outflows via the brokerage and bank channels[1]. In the bank channel in particular, redemptions have a pronounced tendency to increase when sales increase. Outflows consistently

NOTE

1) Based on fund distributor information, we classified the universe of investment trust into two categories: funds sold mainly by brokerages and funds sold mainly by banks. We then estimated sales, redemptions and dividend distributions for each of the two categories. In doing so, we used Investment Trust Association Japan data on investment trust NAVs for reference.

exceeded inflows in the bank channel for 10 consecutive semiannual periods from the second half of fiscal 2008. The brokerage channel exhibits a similar correlation between sales and redemptions, albeit to a lesser extent. For example, in the first half of 2013, investment trust sales and redemptions in the brokerage channel increased 90% and 60%, respectively, relative to the second half 2012. Although sales rose to an all-time record level in the first half, the trend in net investment trust flows remains unchanged from previously.

Exhibit 1. Equity investment trust (ex ETFs) inflows and outflows



Source: NRI estimates based on fund distributors' information on individual funds

A major reason that net investment trust flows have not turned positive like in the past is an absence of growth in first-time purchasers of investment trusts. According to one research institute, the number of investment trust accounts at regional banks has stopped growing since March 2008 and decreased by more than 10% in the past two years[2). The trend in investment trust accounts at megabanks and trust banks is reportedly nearly identical to that of regional banks. Improvement in the investment environment has not yet had any ripple effects in terms of expanding the population of fund investors.

2) According to the Kinzai/Quick Fund Databank, investment trust accounts at regional banks (including Saitama Resona Bank; excluding Chiba Kogyo bank and Kitakyushu Bank) decreased from 3.28 million in March 2011 to 2.88 million as of March 2013.

Nascent signs of change in fund investor preferences

We want to delve a little more deeply into sales trends by fund type. As often noted, high-risk funds have accounted for an outsized share of the top-selling investment trusts in recent years. While this trend persisted in the first half of 2013, signs of change have started to emerge.

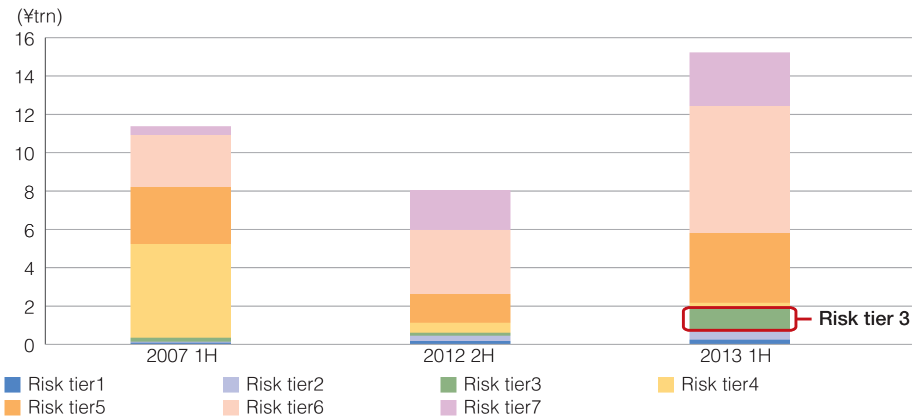
3) We sorted investment trusts into seven tiers risk based on their daily volatility (six-month measurement period). Classifying funds into seven risk categories based on volatility is consistent with UCITS.

Exhibit 2 plots investment trust sales broken down by risk level[3]. In the first half of 2007, when investment trust experienced large net inflows, funds in risk tier 4, which includes many global bond funds, accounted for nearly half of investment trust sales. In the past few years, however, higher-risk funds' share of investment trust sales has been increasing. In the second half 2012, for example, funds in risk tier 6 (developed market equity funds, etc.)and above accounted for nearly 70% of investment trust sales.

High-risk funds generally charge high sales commissions, making them an efficient source of fee revenues from the standpoint of fund distributors. However, the pool of investors with a risk tolerance robust enough to purchase such high-risk funds is limited in size. Fund distributors' single-minded focus on high-risk products of recent years is incompatible with expansion of their customer base, a key driver of medium-term earnings growth, if distributors were to pursue such expansion instead of focusing on efficiently capturing revenues from a short-term standpoint.

The situation started to change in the first half of 2013, when sales of funds in risk tier 3 (funds with annualized volatility of 2–5%) grew to ¥1.1 trillion. Risk tier 3 includes funds that invest in overseas bonds (including high-yield bonds) but hedge their foreign currency exposure and risk-controlled funds. In fact, fund distributors that are achieving steady growth in sales of this fund type report that purchasers tend to invest large sums in these funds per transaction. Sales commissions consequently tend to be nearly equivalent to commissions on high-risk products. Funds in risk tier 3 appear to be contributing to growth in assets under management in addition to generating short-term revenues.

Exhibit 2. Open-end equity investment trust sales by risk tier



N o t e: Excludes ETFs and funds in existence for less than six months.
Source: NRI

Investment trust distributors have started to turn their attention to expanding their customer base in preparation for next year's advent of tax-exempt individual savings accounts in Japan. Going forward, they should seriously pursue market expansion by offering investors a broad array of products with diverse risk profiles.

about NRI

Nomura Research Institute, Ltd. ("NRI", TYO: 4307) is an independent, global IT solutions and consulting services provider with annual sales of 363.9 billion yen as of FY ended March 2013. With front-to-back support for the buy- and sell-side, NRI's tradition of innovation has positioned them as a trusted international market leader. Leveraging NRI's global consulting business, NRI is able to provide innovative financial IT solutions for investment banks, asset managers, banks and insurance providers. For more information, visit www.nri.com.

Inquiries to : Financial Technology and Market Research Department
Nomura Research Institute, Ltd.
Marunouchi Kitaguchi Bldg.
1-6-5 Marunouchi, Chiyoda-ku, Tokyo 100-0005, Japan
E-mail : kyara@nri.co.jp

http://www.nri.co.jp/english/opinion/lakyara