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Executive summary

Fundscape specialises in the research and analysis of the UK fund industry. In our latest research piece, we've put funds of funds under the spotlight in the expectation that they will play a prominent role in the UK's post-RDR scene. In this second 2015 edition of the report, we aimed to understand how UK funds of funds are structured, what the underlying investment trends are and whether any light could be shed on fund selection processes and procedures.

Leading role in the UK fund mix

In the last ten years, UK fund assets have almost trebled to £810bn and the UK is now by far the largest domestic fund market in Europe. The funds of funds sector has grown even faster. Ten years ago, in-house funds of funds dominated, but demand for open architecture led to third-party products rapidly outgrowing their in-house counterparts. In-house assets quadrupled in ten years, but their sexier third-party cousins saw assets rise eightfold to £65bn by 2015. In the last 18 months since our first edition, they have grown by almost £10bn.

In the adverse climate of recent years, funds of funds thrived and even blossomed. In the wake of the global financial crisis, investors sought greater security through diversification, and with the outlook uncertain, the investment decisions were handed over to funds of funds professionals. In 2011 they accounted for 90% of industry flows. In 2012, they pulled in flows of £2bn while the industry was marginally negative. in the first half of 2015 when volatility was once again on the rise, net sales into funds of funds amounted to £2bn— half of the industry's total net sales of £4bn.

Players

In June 2015, there were a total of 78 third-party funds of funds managers in the UK, running 507 funds of funds between them. The largest players are Jupiter and Schroders who together account for 24% of the sector, down from 28% previously. Concentration stalks the sector. The top five funds of funds managers in the UK accounted for just over half of all funds of funds assets, but in terms of net flows, they accounted for a whopping 150% of total net flows between January 2014 and June 2015 so it pays to be in the right funds.

Despite the dominance of established players, the leading players in terms of flows are 7im and Hargreaves Lansdown. Both are examples of the changing distribution landscape. For 7im, its cost-effective solutions are popular with both advisers and consumers, particularly the passive-based funds. For Hargreaves Lansdown, its captive distribution channel and highly effective marketing techniques have captured significant flows.

Funds

There are some large, well-established external funds of funds. The largest is the Schroders Institutional Diversified Growth fund with just under £6bn in assets. This fund is distributed mainly via DC platforms and is a popular choice overall, so it tops the charts for net sales. Next in size is the Jupiter Merlin Income fund with just over £4bn as of June 2015, giving it a market share of 6.4%. However, this fund has faced stiff competition from others, and a result, has seen assets shrink by almost 20%.

Punching above their weight in the net sales charts were the HL Multi-Manager Income and Growth and the 7im AAP Balanced funds. Along with the Schroders fund, these funds accounted for 55.9% of net sales. Overall, the net sales ranking highlights the trend towards cost-effective solutions and the benefits of access to distribution.

Underlying investments

We analysed the holdings of the top 100 funds and aggregated assets for each underlying investment. Our analysis found that were a total of 421 underlying funds by 119 groups. Ironically, for a sector that prides itself on diversification, there is substantial concentration. Five underlying fund managers dominate with 33% of total assets (down from 36% previously). HSBC, BlackRock and M&G topped the rankings of leading underlying fund groups, between them accounting for 23% of assets.

Concentration was less of an issue in terms of individual funds and there were some surprising findings, although it was no surprise to see that the largest and most popular fund was the Woodford Equity Income fund which has gone straight to the top of ranking. Findlay Park American and Artemis Income were second and third. However, in terms of the number of funds of funds that are invested in funds, it was the Majedie UK Equity that topped with 17 funds of funds mandates. It was followed by the Henderson UK Property fund.

Projections

We have three scenarios for the growth of external funds of funds. All three assume that external funds of funds will continue to play a central role in the delivery of investment products to retail investors. Our pessimistic scenario projects assets to £134bn by 2020, the realistic scenario puts assets at £170bn by 2020, while the optimistic scenario puts assets at £213bn by 2020.