REFINITIV LIPPER FUND AWARDS

NAVIGATING THE NEW NORMAL

STRATEGIC 2020 INSIGHTS FOR FUND MANAGERS AND FUND MANAGEMENT COMPANIES

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INTRODUCTION

The ensuing report outlines the key developments that helped shape the global funds market during 2020. It outlines the key lessons that both fund managers and fund management companies can take away from the 12 months, with a view on making their funds more resilient while identifying new opportunities for alpha.

The report also addresses emerging trends, such as heightened interest in ESG investing, and discusses how best to deploy active and passive strategies. Notably, it features the views of Refinitiv Lipper executives from four key markets — the U.S., Europe, the U.K., and Asia, offering a valuable global wrap on a year that market watchers will be discussing for some time to come.

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PART 1:
A YEAR LIKE NO OTHER – THE STORY OF 2020

From market sell-offs to record fund flows, the year was characterized by surprises, as some fund types performed exceptionally well while others were severely challenged. Globally, flows from bond funds to money market funds at the height of the crisis were by and large expected, but the robustness of equity funds was unanticipated.

"The funds market in 2020 was a reflection of the ebb and flow of human emotion to a degree rarely seen," said Robert Jenkins, Global Head of Research at Refinitiv Lipper. "Initial shock and a bit of panic were then followed by equal parts optimism and a bit of gamesmanship."

The big story of the year wasn't the spectacular worldwide crash that took place in March, but rather the extraordinary "risk-on" attitude of investors in its immediate aftermath. Despite the global economic shutdown and potentially damaging impacts to earnings and corporate valuations, equities around the world soon rallied to new records.

"Working from home fostered renewed interest in the markets and investing in stocks, and online discount brokerage operations helped facilitate easy access through low commissions and fractional shares," Jenkins said. "It lent a video game-like aspect to investing that became intoxicating."

The MSCI World Index's rapid recovery epitomizes the swiftness of the global recovery

"An unsurprising aspect of 2020, he noted, was the relatively poor performance of value stocks in industries that were either directly or tangentially impacted by the pandemic and lockdowns. These included energy, retail, hospitality and real estate-related stocks."

It lent a video game-like aspect to investing that became intoxicating.

Robert Jenkins, Global Head of Research at Refinitiv Lipper.

For Dewi John, Head of Research for the U.K. and Ireland at Refinitiv Lipper, U.K. passive equity funds being in positive territory during March's market crash was noteworthy. "Investors needed some equity exposure, and large-cap passive was the easiest way to gain it and stay nimble," he explained. "Over the year, large-cap passive has been the winner, as market sentiment was dominated by the quest for liquidity. This is despite the fact that small caps have largely outperformed their large cap peers."

U.K. passive equity funds were in positive territory in March 2020, with inflows of £611 million ($835 million)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	2020 Total
Passive	3,580	1,479	611	4,084	712	2,049	1,592	1,946	1,366	16,834	1,984	5,190	41,427
Active	1,542	-6,200	-8,639	15,165	16,073	1,846	10,265	-7,106	-5,718	3,451	8,847	8,173	37,699
Sum	5,122	-4,721	-8,028	19,248	16,786	3,894	11,857	-5,160	-4,352	20,285	10,831	13,364	79,126

Reassuringly for investors, these trends demonstrated that even amid a crisis, fund managers typically remain pragmatic — adapting their portfolios while seeking balanced and liquid asset class exposures.

Winners and losers

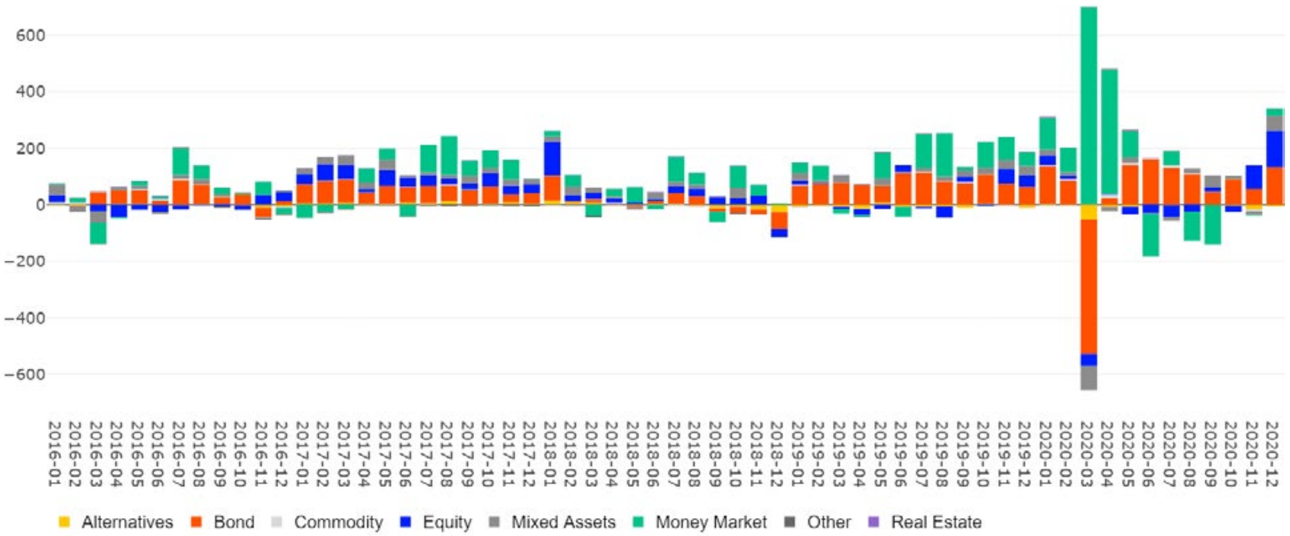
At the height of the crisis in March, investors globally withdrew an unprecedented $265 billion from bond funds. Meanwhile money market funds worldwide witnessed net inflows worth $681.3 billion.

"Bond funds were impacted by a dual issue: a lack of confidence in many municipal and lower-quality credits being able to service their debts, coupled with the general liquidity problems in fixed income," Jenkins explained. "Money markets on the other hand were a logical place for investor flows to go, given the uncertainties of the pandemic's impacts to the global economy."

While there were some initial losses, equity funds across many markets remained largely unchanged. “The lack of selling-out of equities was surprising,” Jenkins added. “Investors tend to jump ship.”

By the end of Q2, bond fund flows worldwide returned and continued through Q3. Accordingly, money market inflows globally began to unwind throughout the rest of the year.

Global fund flows by month and by asset type. March 2020 saw flows from bond funds into money market funds

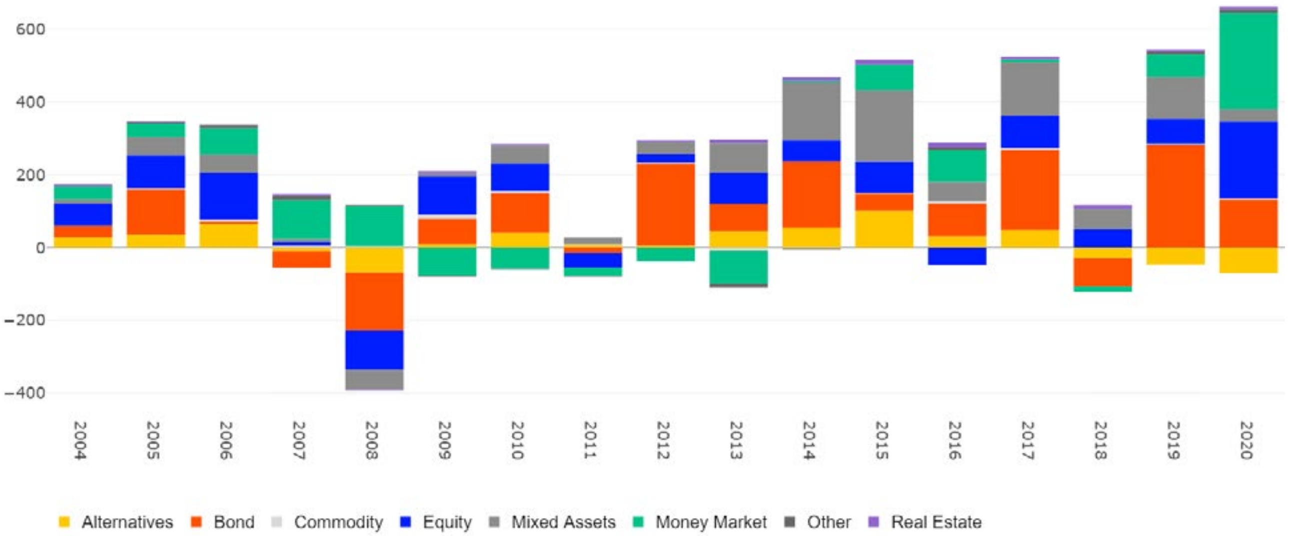


Inflows into European-domiciled funds reached record highs, topping an estimated €574.3 billion ($696.1 billion) for the year — a number far higher than the long-term average positive of €192.7 billion ($233.6 billion) for the full calendar years between 2004 and 2019. The figure also marked the second-highest inflows into mutual funds and exchange-traded funds (ETFs) in the history of the European fund industry. The majority of these flows, about €483.5 billion ($586.1 billion), were invested into mutual funds, while ETFs enjoyed inflows of €90.8 billion ($110.1 billion) throughout the year.

“European investors were somewhat cautious, since the majority of the inflows were invested in money market funds to the tune of about €268.4 billion ($325.3 billion), while long-term investment products enjoyed inflows of €305.8 billion ($370.7 billion),” explained Detlef Glow, Head of EMEA Research at Refinitiv Lipper.

In terms of inflows, Europe’s money market funds outperformed all other asset types. These were followed by equity funds (€212.4 billion [$257.5 billion]), bond funds (€129.6 billion [$157.1 billion]), mixed-assets funds (€26.7 billion [$32.4 billion]), other funds (€7.7 billion [$9.3 billion]), real estate funds (€6.5 billion [$7.9 billion]), and commodities funds (€3.2 billion [$3.9 billion]).

European fund flows during 2020. Money market funds outperformed all other asset types



Alternative UCITS funds were the only European asset type that experienced outflows for the year, shedding €80.2 billion ($79.2 billion); 2020 was the third consecutive year of such outflows. “Investors were seemingly unhappy with their results,” Glow said.

Off guard

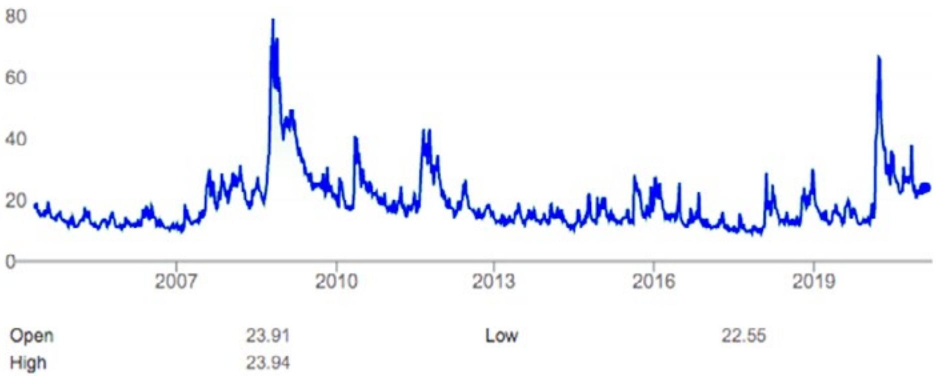
Numerous developments caught fund managers off guard. Jenkins recalled how globally, U.S. municipal bond investing swiftly became a flashpoint of uncertainty as investors considered the revenue impacts many local governments would experience as a result of the shutdown across many tax-generating segments of the economy. In a sector that is typically stable and predictable, this was unusual.

Similarly, investors who panicked and decided to sell while markets were retreating were astonished when the V-shaped recovery in equities swiftly led to new all-time highs across numerous market indices worldwide.

The convergence of unexpected macroeconomic events exacerbated the volatility. "Global markets tumbled like dominoes hit by various headwinds at once, ranging from geopolitical tensions between the U.S. and China, Hong Kong, and Iran, extreme weather conditions, an oil price war, and the novel coronavirus, which forced various forms of lockdowns and social distancing across the globe," said Xav Feng, Head of Research for Asia Pacific at Refinitiv Lipper. "Volatility soared in the markets to decades-high levels in mid-March, causing several circuit breakers and trading halts on some stock exchanges. The stock market bottomed down, and major equity indices dropped into bear-market territory, ending an 11-year bull run in the stock market."

According to the CBOE Volatility Index, or VIX, global market volatility was the second-highest on record during March 2020.

The CBOE Volatility Index. Global market volatility was the second-highest on record in March 2020



Central banks and governments worldwide were also taken by surprise, and rushed to cushion the free-fall in the financial markets and their economies. Economic contraction was unavoidable, however, moving faster than most governments had expected.

Viewed as one of the world's economic powerhouses, Asia saw a sharp recession. At the height of the crisis in early Q2, India's economy had contracted by almost 7.5%, Japan by almost 7.9%, Singapore by about 41%, China by 6.8%, and South Korea by 3.2%.

How much more might these economies contract, fund managers questioned, and which assets will be left standing when the crisis abates?

Paving the way

Within weeks, China, which provided assistance to other countries in the aftermath of the Global Financial Crisis (GFC) of 2008, once again began taking a leading role. After hitting a trough in February 2020, China's economy received a boost from infrastructure and real estate investment, and a surge in exports — mainly of medical and protective equipment, as well as work-from-home-related electronics. This was followed by a gradual recovery in private non-housing investment and consumption. Even proponents of China were surprised by how quickly the nation rallied.

In late December, the CSI 300 index, which tracks the value of the biggest companies on the Shanghai and Shenzhen stock exchanges, closed at 5,368 points — the highest level since January 2008.

"This record stands as the latest dramatic turnaround in global financial markets since the onset of the coronavirus pandemic," Feng asserted. "It comes as China's economy stages a faster recovery than expected at a time when other nations around the world are still grappling with rising infections and severe disruption to business and social life caused by the pandemic." Official figures show that China's economy grew by 2.3% in 2020, with GDP growth for 2021 to reach 7.9%, according to the World Bank.

At the country level, China posted net fund inflows of $1.4 billion, with assets under management topping $2.7 billion. These flows were mostly driven by money markets funds and mixed assets funds, with net inflows of $10.6 billion and $1.1 billion, accordingly. However, fund flows for locally domiciled equities and bonds funds remained in the red for the year, positing outflows of $10.2 billion and $23.4 billion respectively, despite seeing growing inflows into both types of funds during Q4. Interestingly, Equity China funds domiciled in the U.S. and the U.K. were up $1.1 billion and $2.1 billion for the 12 months.

Locally domiciled funds in Korea followed suit. Money market funds experienced net inflows of $22.1 billion, yet equities and bonds funds shed outflows of $13.3 billion and $3.5 billion. Yet in Japan, while locally domiciled bonds too experienced outflows to the tune of $9.2 billion, equities however posted net inflows of $81.6 billion, underscoring the resilience of locally managed equity funds when compared to its Asian peers.

Overall, net inflows for Asia-domiciled funds topped $134.3 billion, with all markets excluding Thailand posting net inflows for the year.

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>
> Xav Feng, Head of Research for Asia Pacific at Refinitiv Lipper

Turning the corner

In the U.K., investors deployed capital tactically, getting back into the market in April as quickly as they got out in the preceding months. However, the largest reallocation to equities was not observed in April, but October. Equity U.S. saw the largest inflows to the tune of £7.24 billion ($9.9 billion), followed by Equity U.K., worth £6.57 billion ($9.7 billion). With both, the bulk of assets flowed into a single index-tracking mutual fund. The same month, Bond GBP Corporates funds experienced record outflows of £3.37 billion ($4.6 billion), followed by Money Market GBP outflows of £2.09 billion ($2.9 billion) and Bond GBP Government outflows of £1.77 billion ($2.43 billion).

October was a pivotal month. Until then, U.K. equities had underperformed for years, and it was one of the worst-performing global indices for the first nine months of 2020. It went on to became one of best performers in Q4. “Was this the ‘Brexit bounce’?” John questioned. “Not likely, in my view.”

Meanwhile in Asia, most markets were already posting robust net inflows for the year. From January to September, Japan posted the region’s highest fund inflows to the tune of $65 billion, driven in part by the Bank of Japan’s (BoJ) asset purchase program. To stabilize markets earlier in the year, BoJ announced unlimited purchases of Japanese Government Bonds (JGBs), and upped its purchasing of ETFs. During 2020, ETF purchases in Japan topped ¥6.214 trillion ($59.9 billion) — exceeding the previous record of ¥6.210 trillion ($59.8 billion) experienced in 2018 — with JGB purchases topping ¥12 trillion ($115.6 billion).

Widening gaps

By the year’s close, many indices globally were in positive territory — further highlighting the detachment of the markets from the global economy as nations continued to struggle financially as well as control the rapidly spreading virus. The Dow Jones Industrial Average was up by more than 7%, while the S&P 500 and Nasdaq Composite Index had rallied by more than 14% and 31%, respectively. In Europe, the DAX was up by almost 4%. In Asia, South Korea was the best-performing market — the KOSPI index had soared by more than 30%. By comparison, Japan’s Nikkei 225 had also rallied by about 14%, respectively.

“Investors appeared to be optimistic about how quickly the global economy could bounce back with the arrival of coronavirus vaccines, as well as the prospect of a Biden presidency,” Feng noted.

However, unlike in the U.S., Japan and Korea, Singapore’s Straits Times Index fell by almost 12% during 2020, becoming the region’s worst-performing stock market. The Philippines’ PSE Composite also slid by about 8%. Similarly, the FTSE 100 lost almost 14% for the year, while the CAC 40 was down more than 6%.

Key observations

“For fund managers worldwide, the sell-off was more emotional than economically driven,” Jenkins asserted. “Thus, reacting to it in a prudent way likely involved controlling emotions, not selling into it, and seeking economic opportunities, using your ‘dry powder’ to scoop up some bargains.”

Globally, U.S. funds were and will remain the overwhelming choice during a market panic, he added. While ESG funds experienced some panic-selling, inflows quickly returned and accelerated greatly into the end of the year — a trend Jenkins believes will continue in the future.

For clients, staying invested proved to be the best investment strategy during 2020 — as it typically is during times of high volatility. “Keeping a portion in stocks and riding out bumps without panic-selling can help avoid timing-related losses,” Jenkins said.

PART 2: DEFINING RESILIENCE – LESSONS LEARNED

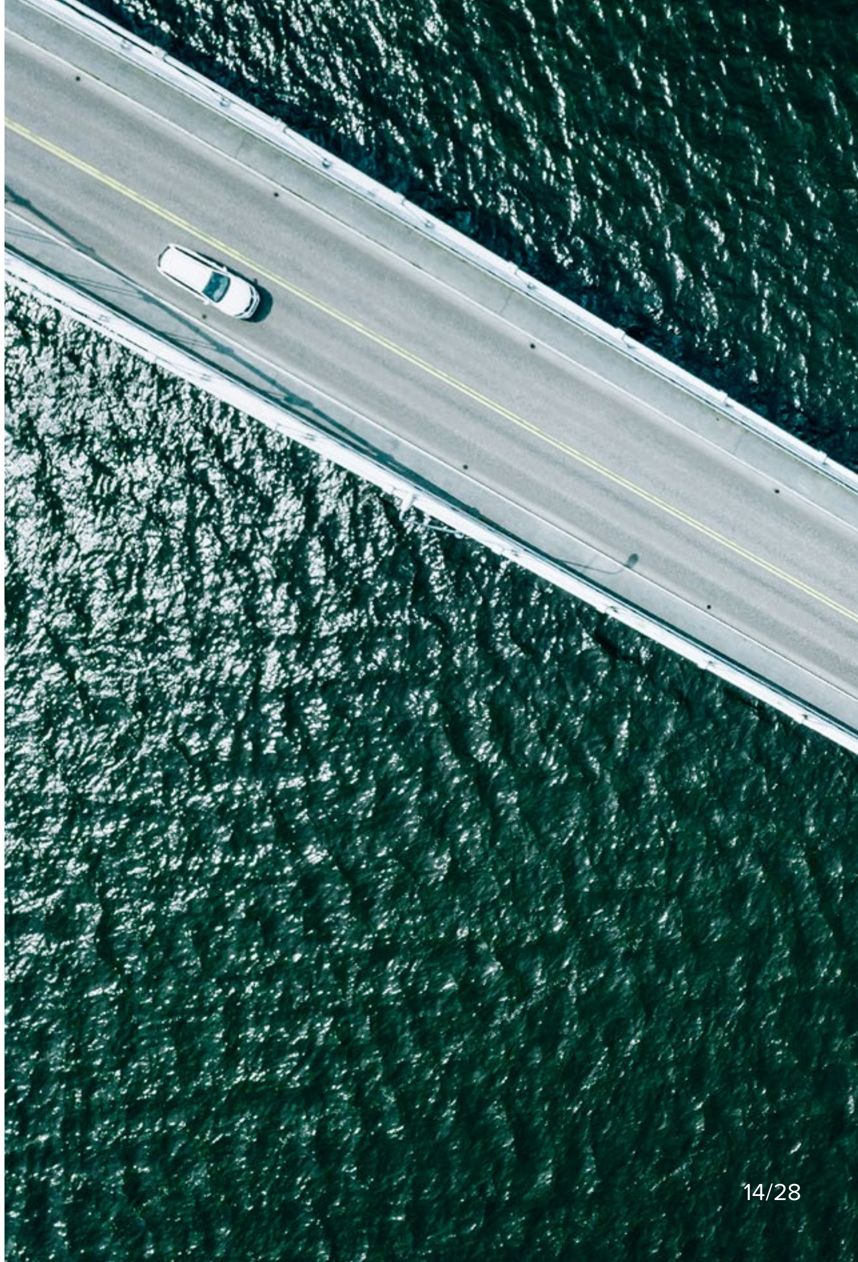
Greater prudence from fund managers globally, combined with increased regulatory oversight in emerging markets, will help mitigate the fallout from another black swan event.

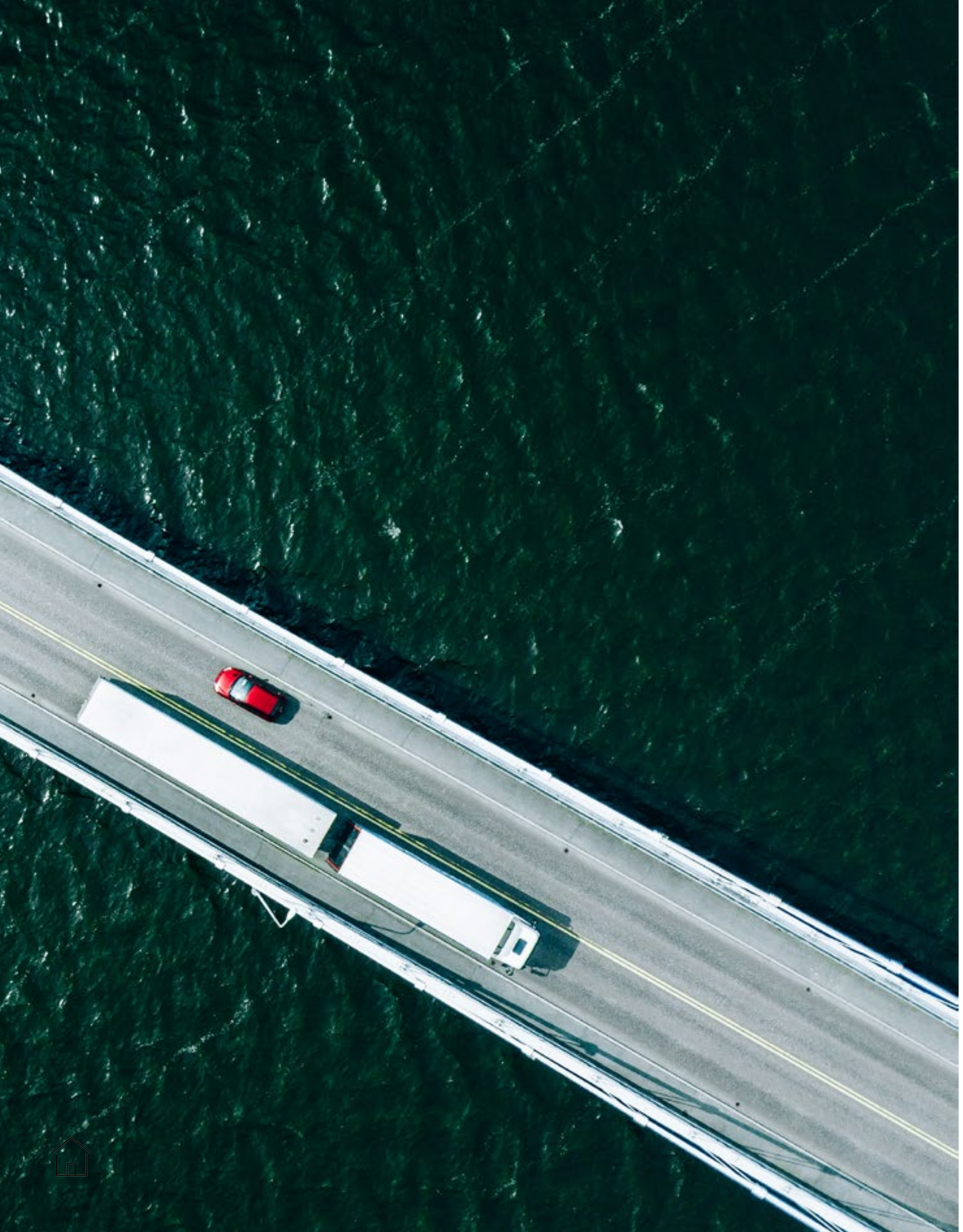
When analyzing the events of 2020, both from a macroeconomic perspective and with regard to the global fund industry, it is clear that there was no precedent for successfully managing a global pandemic on the scale of COVID-19, including its swift and severe impact on both the global economy and financial markets.

“The markets were taken by surprise, and there was no real playbook to work from,” said Robert Jenkins, Global Head of Research at Refinitiv Lipper.

Nonetheless, the industry demonstrated widespread operational resilience. Worldwide, firms were able to adapt to remote working and the many challenges associated with this. They also quickly unearthed which types of funds, products, and strategies are able to thrive under significant stress, as well as those that are less robust.

“Firms around the world have demonstrated a high level of operational resilience despite widespread lockdown measures disrupting demand, forcing people to work remotely, and complicating existing challenges related to technology, cybersecurity, and governance,” said Xav Feng, Head of Research for Asia Pacific at Refinitiv Lipper. “Going forward, they will seek to learn from these experiences to reappraise product lines and market strategies, and contemplate a measure of consolidation, while building a greater degree of flexibility into their business models.”





Greater objectivity required

The rapid market sell-off in March and sharp rally that occurred within days underscores the need for investors to remain objective and pragmatic, and not be swayed by the actions of other market participants. Globally, many investors who sold when markets were tumbling were slow to react when the markets reversed course and rose sharply. Thus these investors ultimately missed out on valuations that were higher than before the crisis.

“An example of the unusual drivers of the recovery were the newly installed legions of stay-at-home day traders scooping up momentum names in a wave that created self-fulfilling positive return results,” Jenkins explained. “This likely attracted more professional traders and investment managers to climb on the bandwagon and play along.”

Irrespective of region, fund managers that weathered the storm were rewarded. Similarly, firms that embedded sustainable investing into their strategies demonstrated how integral robust risk management is during times of high market volatility, rather than simply ‘doing good’ for the environment and society, highlighted Dewi John, Head of Research for the U.K. and Ireland at Refinitiv Lipper.

Market scrutiny

The vulnerability of some fund types might attract greater regulatory scrutiny moving forward. Fixed income is such an area. The low liquidity levels in otherwise quality offerings from established entities is a source of potential problems. Likewise, should panic selling proliferate through the bond exchange-traded fund market, market losses could be as catastrophic as those emanating from mortgage-backed securities during the GFC.

Last year's crisis exposed the fragility of U.S. municipal bonds. "The pandemic spotlighted what is otherwise considered a fairly safe sector in which a lot of retirees put their money for long-term income," Jenkins warned. "Munis are often tied to small regions and can be backed by taxes – which could be impacted by people losing their jobs – or are tied to specific revenue generators like tolls, stadiums, airports, parking lots and so forth. Such revenue sources suddenly became very vulnerable this past spring and they are still in a precarious spot."

Following one of the worst sell-offs in U.S. municipal market history in March 2020, the market rebounded with record levels of issuance. The market issued $474.05 billion during 2020, compared to $426.35 billion in 2019, beating the previous all-time high of $448.61 billion issued in 2017.

"How investors – and not only bond investors – should manage the huge amount of debt is an open question," John said. "To date, they have responded by moving up the risk curve for the required yield. That cannot be sustainable in the long term."

Even before the advent of the market crisis, John was concerned about rising amounts of corporate debt. The market has since ballooned. Since the GFC, fixed income funds worldwide have tended to deliver a given yield by eroding credit quality. "This may be the year that investors will be rewarded for concentrating on credit quality rather than chasing yield," John suggested. "But how long this market is sustainable depends on the amount of continuing government support and loose monetary policy, among other matters."

How investors – and not only bond investors – should manage the huge amount of debt is an open question

Dewi John, Head of Research for the U.K. and Ireland at Refinitiv Lipper

Sustainable growth

Surging investor interest in select stocks could also bring about its own set of challenges. "Trends like remote work and cloud computing are driving unprecedented growth at tech firms. Yet, the concentration of gains in a narrow group of companies concerns many investors who worry that stocks are too dependent on the sector and that a significant pullback in a few names could bring down markets," Feng noted.

Sustainable growth and avoiding the buildup of asset bubbles is key to the development of Asia's fund markets, where the potential is enormous. Indeed, investors throughout the region are a core distribution target for global investment managers.

In China, for example, investable assets are expected to reach $31.8 trillion by 2021, yet only 5% of the country's domestic household savings are currently held in mutual funds. And the Indian middle class, which previously favored traditional assets such as gold or residential property, is shifting its preferences to stock-focused funds.

Accordingly, many Asian countries are bringing in regulations to streamline the fund industry while curbing unwarranted results. Japan's Financial Services Authority recently released finalized principles regarding fiduciary duty, setting out seven overarching principles that will aid the economy in pursuing sustainable economic growth and the stable financial accumulation of Japanese household assets such as personal savings. In India, regulations of mutual fund mergers have been tightened to improve transparency and eliminate product ambiguity for investors. And in China, a new regulatory framework will enhance fund market surveillance and transparency.

Building resilience

"By definition, you can't be truly ready for a black swan event, otherwise it wouldn't be a black swan," John asserted. "What can be done is to guard against the rather greyish swans – risks we are aware of."

To guard against these risks, firms and their fund managers must develop resilience. But what does this involve?

Based on the events of 2020, some might say that growing a fund during a market downturn, mitigating fund losses and offering a well-diversified product range defines resilience at the firm level. "As a fund manager, it is sticking to your process and your buy and sell disciplines, and being careful not to panic and sell on unrelated headlines – while also keeping an opportunistic eye open to bring even more value to your shareholders," Jenkins added.

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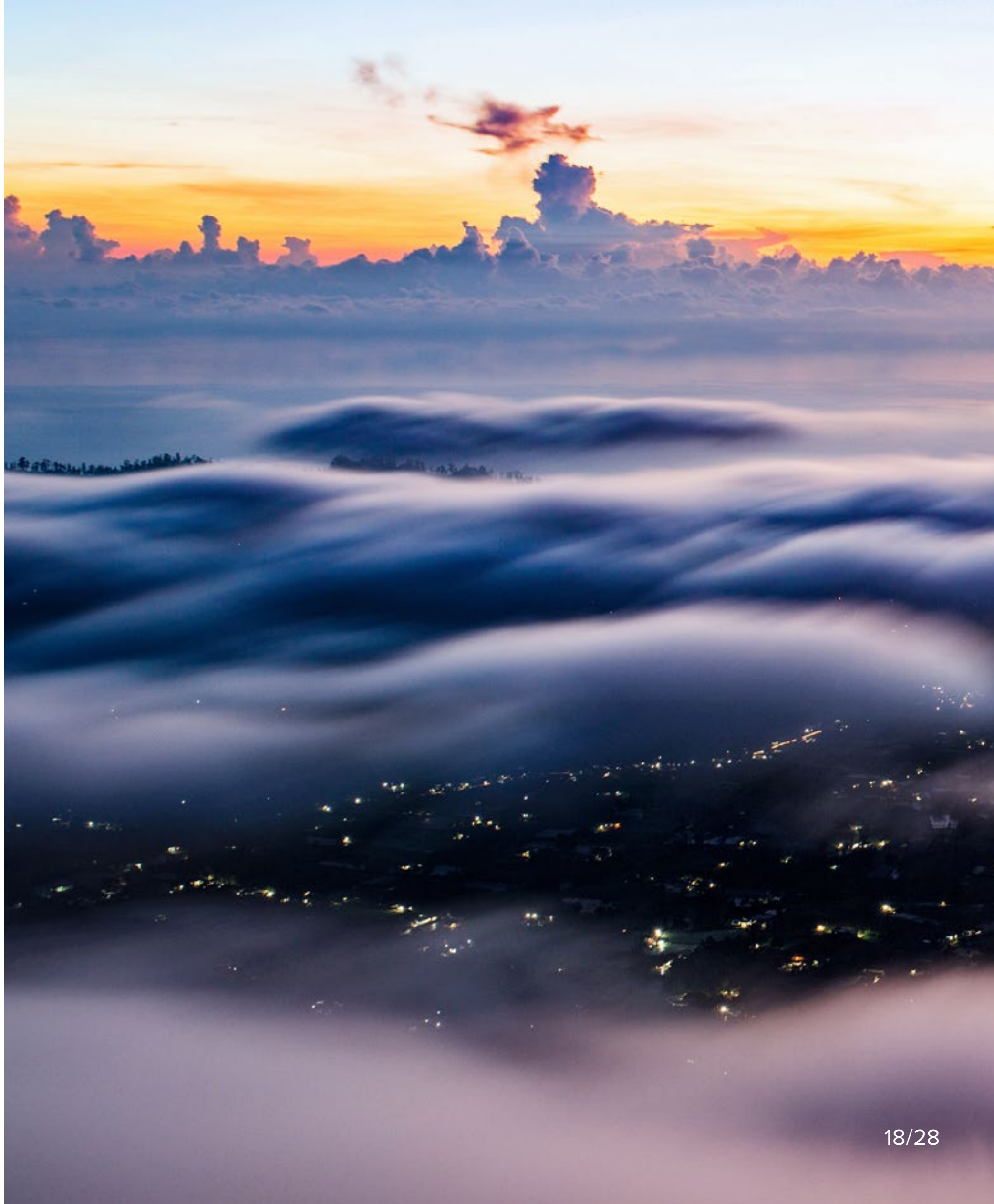
PART 3:
ACTIVE VS PASSIVE

Across most markets, passively managed funds continued to gain market share from actively managed funds, despite the former dominating global assets under management. The year's events underscored how specific fund types and market conditions better suit one style of fund management over the other.

While the events of 2020 created numerous surprises for fund managers, investor preferences for active and passive strategies remained largely unchanged — investors generally favored actively managed strategies for short-term funds and assets bearing noteworthy risks, whereas passively managed strategies were increasingly being applied to longer term funds. Market-specific nuances also had a bearing on which type of fund was preferred over the other.

"Not all fund market regions see the same interplay between active and passive funds, particularly regions in Asia and certain pockets in Europe," explained Robert Jenkins, Global Head of Research at Refinitiv Lipper. "This is often caused by the structure or evolutionary stage of the local fund industry, as well as the preferences of local distribution channels that control the sale of funds. The trend of incorporating passive funds is secular and will eventually impact all major fund regions to some degree."



Core considerations

Dewi John, Head of Research for the U.K. and Ireland at Refinitiv Lipper, points out that for more than a decade, large cap actively managed equity funds globally have experienced a steady loss of share to passive products, albeit that the former still dominates global assets under management (AUM). This trend remained generally intact through last year. “Those investors who sat tight in early 2020, rather than frantically overturning their portfolios, will likely be well-rewarded for their calm in the face of panic.”

An active approach is more appropriate for certain pockets of long-term funds. Bond funds are typically best served by an active approach due to the need for more complex analysis, as well as requiring expert trading desks to navigate typically over-the-counter and illiquid markets. Likewise, emerging market securities in general call for knowledgeable active managers, preferably with people on the ground in these markets. Smaller-cap stocks and junk bonds are also best managed actively, as typically they are void of robust public disclosures and are coupled with high levels of risk.

“Going forward, I suspect ESG investing will be best done via active managers given that the data is so inconsistent and unstandardized,” Jenkins said. “Plus, the vast amount of greenwashing requires active managers to apply even more fervent due diligence in determining corporate ESG footprints and profiles.”

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Steps forward

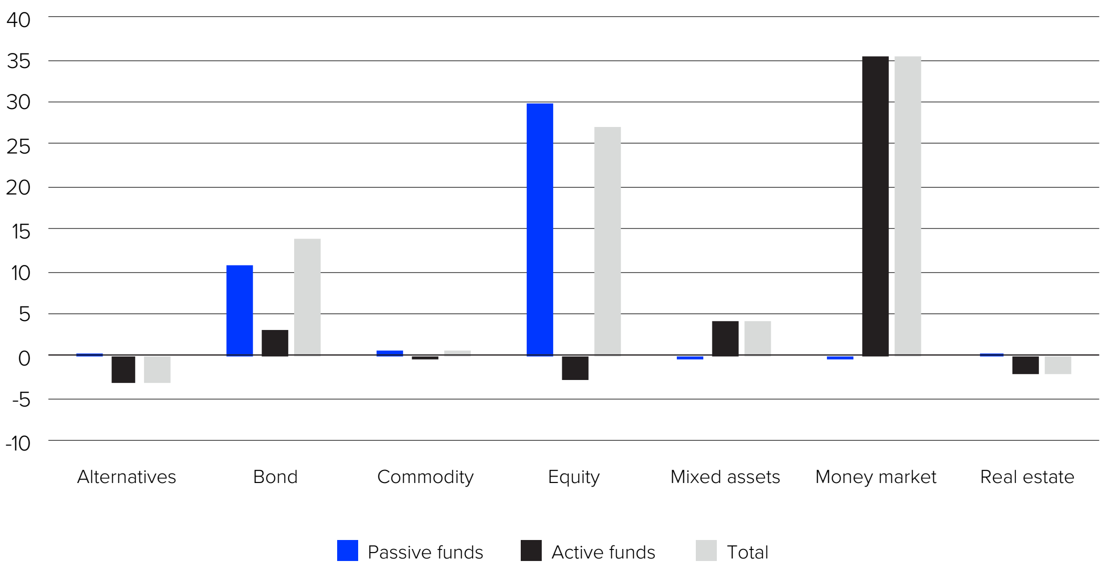
In the U.K., flows into money market funds were exclusively active, accruing £36.1 billion ($49.3 billion) over the year. Flows into mixed-assets funds worth £4.7 billion ($6.4 billion) were also exclusively active.

Conversely, passive equity funds attracted £30.1 billion ($41.1 billion) during the year, although the asset class ended up at £26.7 billion ($36.5 billion) due to outflows worth £2.92 billion ($4 billion) from active equity funds. While bonds were up for the year by £13.9 billion ($19 billion) in total, surprisingly £10.7 billion ($14.6 billion) of this flowed into passive funds — more than triple the amount that went into actively managed bond funds, which stood at £3.1 billion ($4.2 billion).

“Active management is almost the only game in town for Money Market GBP funds, with nearly as great a dominance in Mixed Assets. By that metric it has been a good year for active,” John said. “Looking at equity and bond flows, the story is rather different: active equity funds saw net outflows with passives drawing in more than 10 times that amount, and while actively managed bond funds saw positive flows, bond trackers took in more than three times that.”

The increasing attractiveness of passively managed bond funds, John added, supports the credibility of this strategy for this asset class. About 53.3% of U.K. flows moved into passively managed funds during 2020, versus 46.7% of flows that moved into actively managed funds — the latter being driven by inflows into money market funds.

U.K. asset class flows in 2020, showing active versus passive, mutual funds and ETFs (in £bn)



New trends evolving

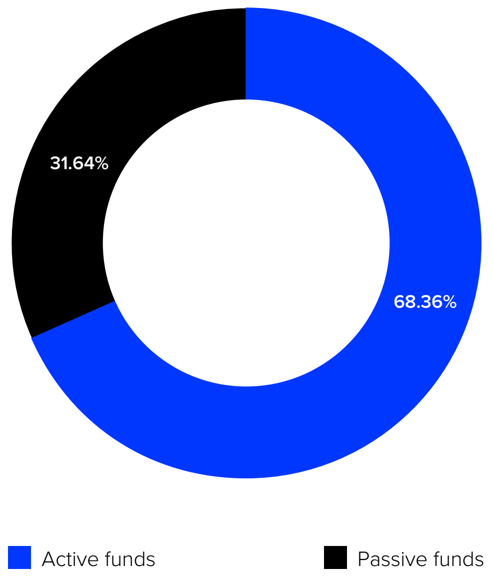
Like the U.K., record flows into Europe's money market funds were noteworthy, as investors sought shorter-term, highly liquid products. Inflows to the region's money market funds topped €268 billion ($324.2 billion) during the 12 months.

Despite the majority of European flows moving into active funds, worth €392.6 billion ($474.9 billion) for the year, inflows into long-term passive funds topped €181.7 billion ($219.8 billion) — outdoing their long-term active peers, which recorded €124.5 billion ($150.6 billion) during the same timeframe.

"This may mark the beginning of a trend; however, as 2020 was an exceptional year, one needs to examine other years in which a crisis occurred. Normally in such years we witness outflows from active long-term funds and inflows into passive products," noted Detlef Glow, Head of EMEA Research at Refinitiv Lipper. "Therefore, one could also say that the flow pattern for 2020 was rather in favor of active mutual funds, but this could have been a result of the sharp rebound of the markets caused by the monetary stimulus from states and central banks."

Increased uptake of passive funds in Europe is a noteworthy trend, Glow added. He foresees the region following the U.S.'s lead, where passive products dominate the fund industry. Currently in Europe this stands at passive funds almost 31.6% and active funds 68.4%.

Market share of the estimated net flows by management approach in Europe, 2020



Growth markets

Investor interest in exchange-traded funds (ETFs) is thriving in Asia, where both active and passive funds are delivering market growth.

Across the region, ETFs are considered low-risk investments, as they are low cost and hold a basket of securities. For many Asian investors, ETFs represent an ideal type of asset with which to build a diversified portfolio. ETFs generally offer lower operating costs than traditional open-end funds, flexible trading, greater transparency, and better tax efficiencies in most markets.

Certain markets prefer passive funds, while in others active products are favored. “In Japan and Hong Kong, passive management is more popular than active management, while in Taiwan and Singapore, the reverse is true,” explained Xav Feng, Head of Research for Asia Pacific at Refinitiv Lipper. “A subtle uptick in AUM was observed in these markets in early 2020, but investor interest in actively managed funds has since declined. It was likely a one-off occurrence — one that appeared in most markets around the world — and passive products continue to gain ground.”

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> Xav Feng, Head of Research for Asia Pacific at Refinitiv Lipper

Hybrid models

Can investors benefit from a hybrid model?

Jenkins believes so. Many active managers globally hold a small number of names for long periods of time, he attests, but make adjustments when needed.

“In terms of hybrids, smart beta strategies give investors the ability to control their exposures in a way that falls between active and passive,” John added. “Another way of interpreting ‘hybrid’ is through a core-satellite strategy, with a core of passive investments across asset classes combined with actively managed satellites.”

PART 4:
ESG RISING

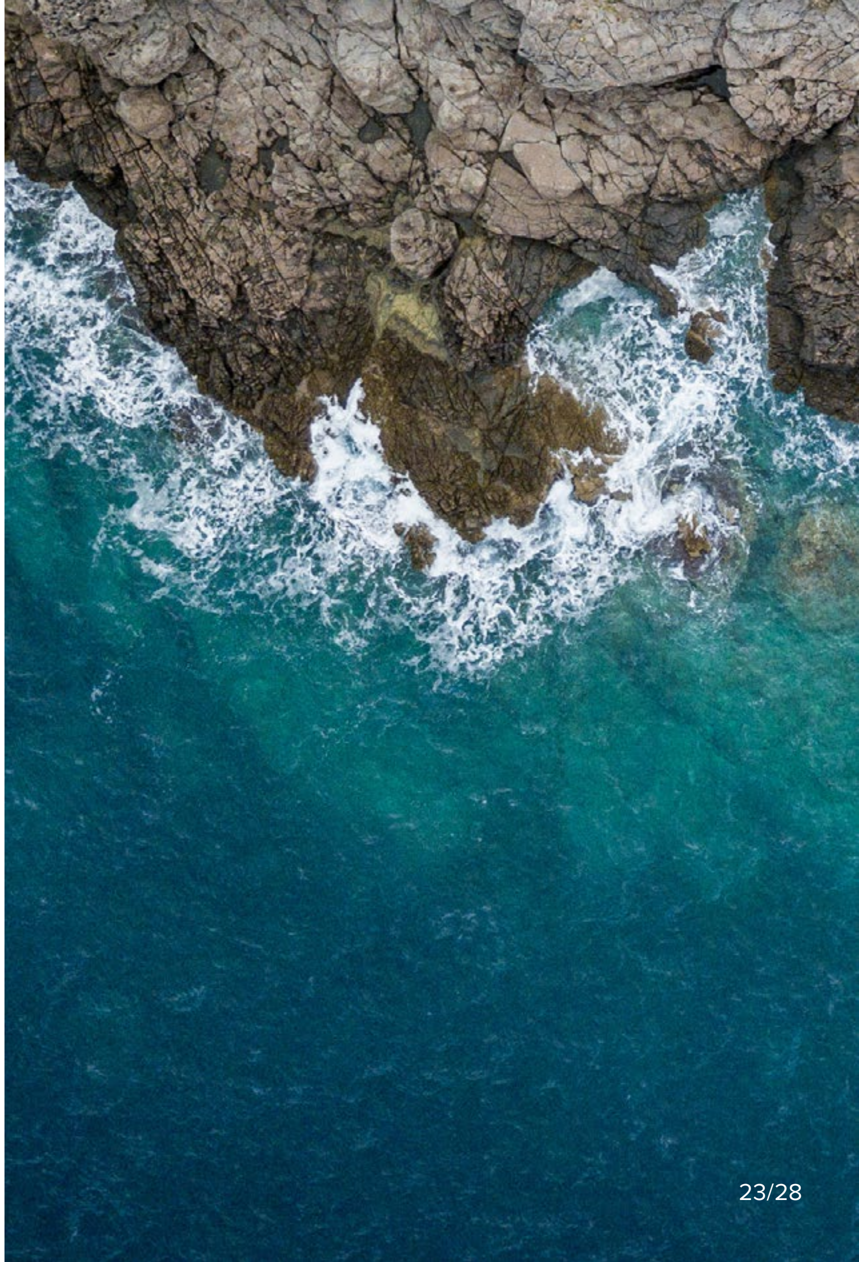
2020 saw investor interest in ESG funds rising to record levels across all markets. The gap in uptake between Europe and other regions narrowed, and overall, new ESG funds added greater variety and market diversification.

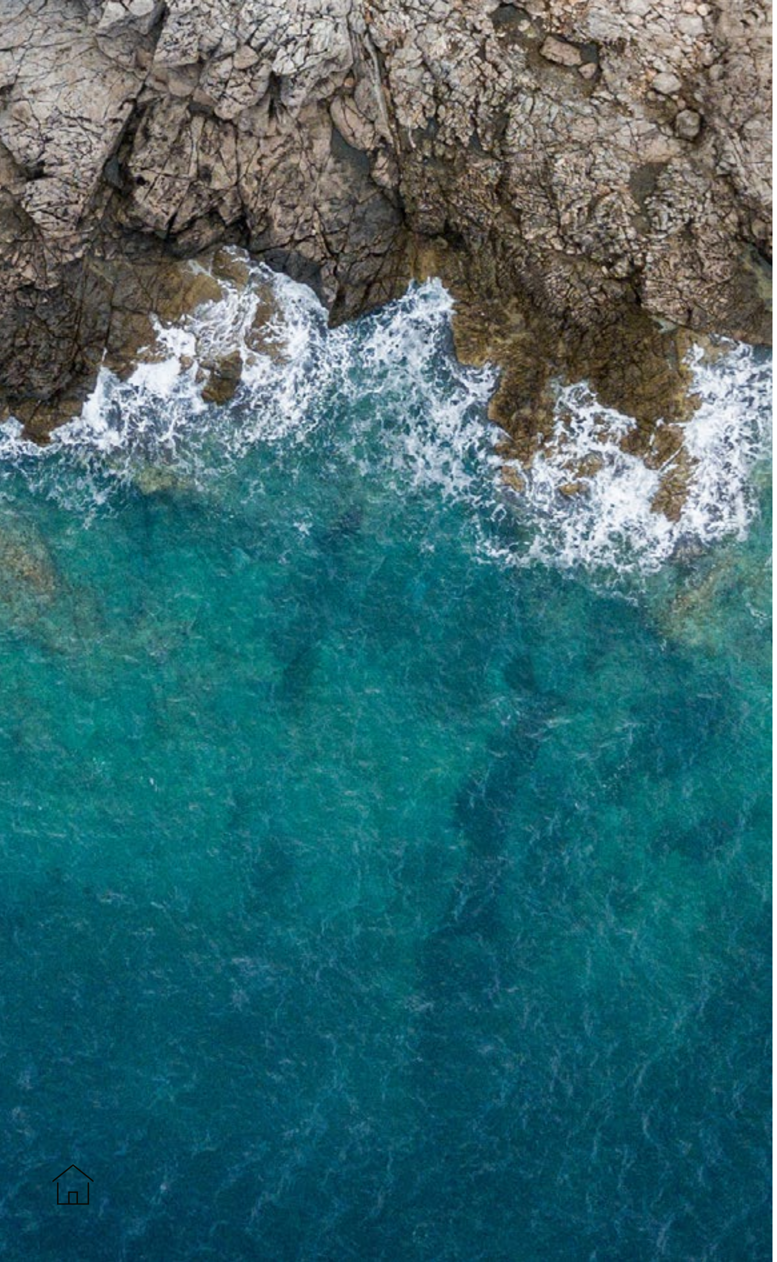
Prior to the advent of COVID-19, ESG investing was both well-known and incorporated into the investment strategies of many fund managers globally. Sustainable investment mandates from clients as well as firms' desire to align with the highest environmental, social, and governance standards drove the agenda in the run up to 2020.

However, the onset of the pandemic and subsequent lockdowns gave firms and their managers time to re-examine their commitments, and explore how their funds could be more impactful from an ESG perspective.

"COVID-19 provided more time to reflect on these important issues and also put people at home in front of their TVs, watching the constant onslaught of wildfires and hurricanes and other global climate calamities," said Robert Jenkins, Global Head of Research at Refinitiv Lipper. "Unrest due to racial inequality certainly heightened humanitarian concerns, and likely will result in increased focus on corporate human capital management practices. There is every possibility that this will over time further propel ESG development and investment."

Within the span of one year, companies around the world ramped up fair hiring and promotional practices, directed more attention towards achieving the United Nations' Sustainable Development Goals, and made changes to their hiring practices to ensure greater inclusivity and diversity — all of which will drive greater ESG performance.





Closing the gap

Even before the crisis, some markets were ahead of others. As an investment style, ESG began in Europe, then moved to the U.S., and is now taking hold across Asia. The gap has since narrowed. Nevertheless, the European Union aims to stay ahead with regard to sustainable finance, as evidenced by the European Commission's action plan on financing sustainable growth, which comes into play in 2021 and drove the trend towards ESG-related investments in the European fund industry.

"ESG used to be considered a 'Western concept' in Asia, but this has now changed — particularly as China put more emphasis on environmental initiatives and became one of the world's largest green bond issuers," noted Xav Feng, Head of Research for Asia Pacific at Refinitiv Lipper. "Asian asset managers are utilizing resources locally to take advantage of the growing market and believe they can make smart investments by analyzing the ESG factors of a company."

Asia ESG fund assets under management (AUM) grew rapidly throughout 2020 — not just in the region, but in other markets as well. Commitments from large institutional investors were echoed by regulatory authorities. Japan and South Korea, for example, announced ambitious carbon-neutrality targets, and Taiwan is in the process of refining its carbon emission infrastructure to further reduce its carbon footprint.

Across Asia, commitments made by governmental pension funds helped move the dial. Japan's Government Pension Investment Fund, Taiwan's Bureau of Labor Funds, Hong Kong's Monetary Authority, Malaysia's Employee Provident Fund, Thailand's Government Pension Fund and many more made announcements at one point or another in 2020 supporting the growth of ESG investing. These actions will encourage more sustainable fund mandates and drive greater inflows into ESG instruments throughout 2021 and beyond.

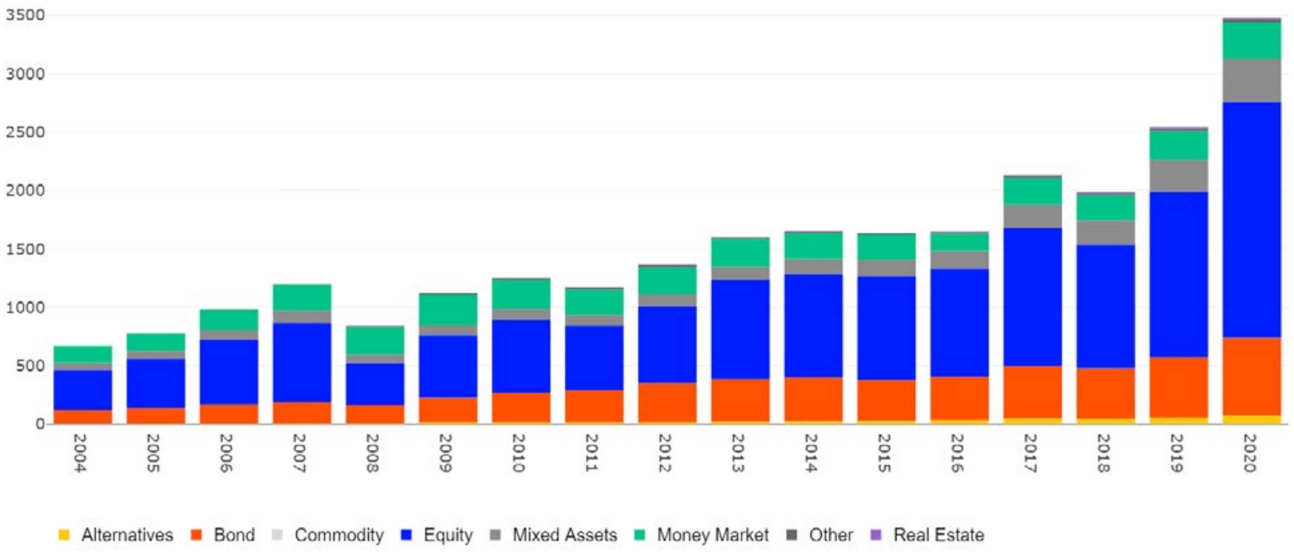
Greater variety

Despite surging interest, AUM for ESG funds significantly lags behind their conventional peers. In Europe, for instance, ESG-related funds amount to €2 trillion ($2.4 trillion), which makes up about 15% of the region's €13.1 trillion ($15.9 trillion) funds market. Of this amount, equity funds account for 55% of all ESG funds, worth €1.1 trillion ($1.3 trillion); followed by bond funds worth €0.4 trillion ($0.5 trillion) and accounting for 20%. Mixed-assets funds (€0.3 trillion [$0.36 trillion]), money market funds (€0.1 trillion [$0.12 trillion]), and other funds (€1.3 trillion [$1.6 trillion]) accounted for 13%, 5%, and 6.5%, accordingly.

The transition from ESG funds being primarily equities-based into other asset classes was notable during 2020.

"Equities still dominate flows, despite the development of such instruments as green, climate, and transition bonds," noted Dewi John, Head of Research for the U.K. and Ireland at Refinitiv Lipper. "Increasingly nuanced and tailored ESG launches, supported by a proliferation of indices in the passive space, are nonetheless allowing investors a greater variety of ways of expressing their ESG strategies." A further benefit, John added, is that ESG fund charges are increasingly cost-competitive when compared to their peers.

AUM of ESG funds globally by asset class



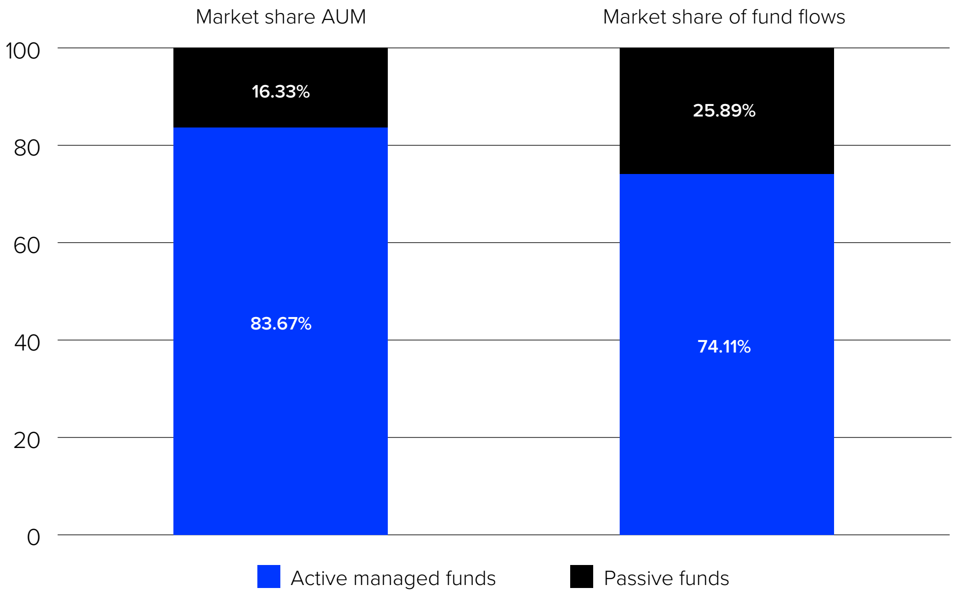
Active management

To date, the majority of ESG funds are actively managed. According to Detlef Glow, Head of EMEA Research at Refinitiv Lipper, there are several reasons why investors prefer this.

"Investors believe that active managers have the chance to outperform their passive peers, as they can react more quickly to bad news that might impact single companies or whole sectors, and they do not have to wait for rebalancing dates to buy or sell constituents of their portfolio," Glow explained. "They also believe that active managers take more action when it comes to the exercising of voting rights or direct engagement with the management of a company."

Another reason for not using passive products could be the lack of strategies. Since the trend towards ESG-related strategies has only just begun to gain momentum, there are very few such strategies — which are required to create an investable ESG-focused index — available at the moment. "This lack of investment options could be a hindrance for a number of investors since ESG-related investments are often driven by beliefs and ethical values, which investors want to realize in their portfolios," Glow said.

ESG market share in AUM and fund flows by management style



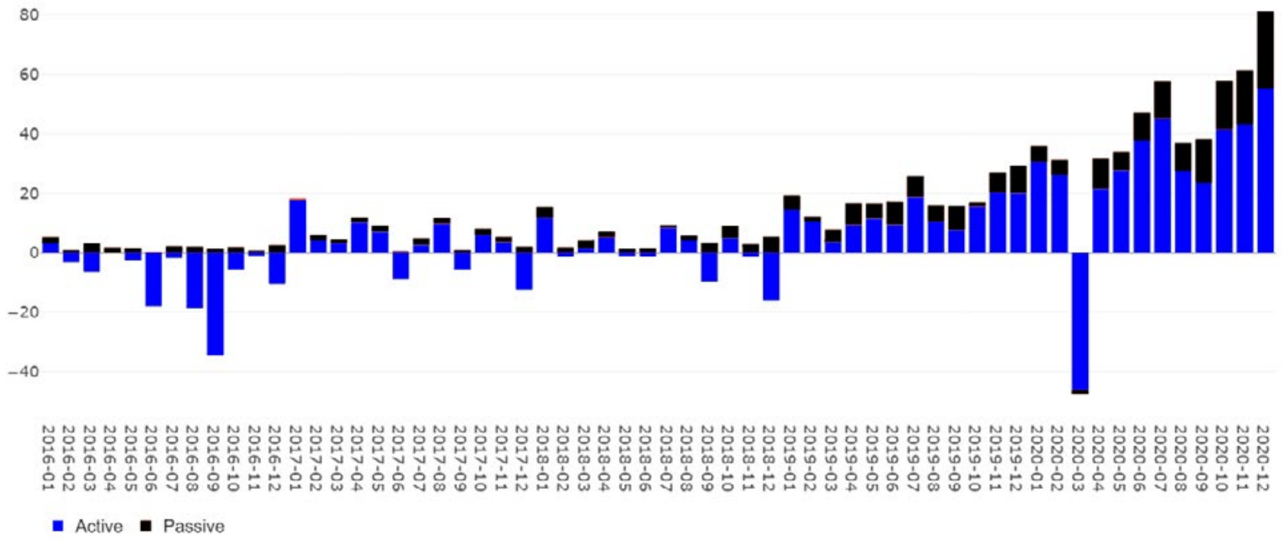
Market anomalies

While on an annual basis AUM globally has been generally rising, 2020 saw some surprising moves.

“A strange reaction to the pandemic sell-off in March was large outflows from ESG money market funds — while conventional money market funds were seeing record inflows,” Jenkins observed. “In fact, all asset classes in ESG seemed to have net redemptions in March 2020 as the knee-jerk reaction of ESG investors led them to flee the space. A core component of ESG investing is long-termism — perhaps even more so than traditional asset class investing — but it appears not all ESG investors have bought into that.”

Despite the sell-off, all asset classes snapped back in April and then marched ever higher in the ensuing months, generating record new inflows. The noteworthy spike in equity funds in the second half of the year was likely due to retail investors getting into ESG investing through equity fund products. “Retail investors powered several trends this past year with more people taking up trading as a work-from-home distraction,” Jenkins noted.

Monthly net flows for ESG funds, active and passive. March’s sell-off of both actively and passively managed ESG funds was followed by irregular yet rapidly growing inflows



Resilience and long-term sustainability

Last year's performance highlighted the resiliency of ESG. In the U.S., equity-based products performed particularly well during 2020, driven by the fact that many are passive or constructed in an equally simple fashion, and have healthy positions in FANMAG — Facebook, Apple, Netflix, Microsoft, Amazon and Google — stocks, which have been leading the markets for several years.

Market commentators claim that the incorporation of ESG factors makes such funds more resilient. The rapid rise in flows globally to ESG funds and the equally rapid proliferation of new products — as well as merged and renamed products — support this.

Across all markets, greater diversity of funds is expected in future. "Themed ESG funds, focusing on say energy innovators, will still exist, but general funds will start to fade. Combining the three pillars into a single fund is a difficult exercise that not only winnows the universe down, but tends to include companies that are good at one pillar — for instance, the 'E' — but terrible at the other two," Jenkins said. "Moving forward, ESG will drive more customized portfolios given that ESG is inherently personal and different for everyone. Eventually, robo-advisors will communicate to investors the finer points of substantive ESG investing."

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