June 2012
Data thru May 31

Morningstar Direct^{SM} Asset Flows Commentary: Europe

Europe Open-End Funds

Risk Aversion Hits European Funds

by Dan Lefkovitz, European Research Team

With the eurozone crisis roiling markets, investors shifted toward safer assets in May. Long-term funds in Morningstar's European database saw net outflows of nearly €9 billion during the month. Equity funds were the big losers, shedding €12.5 billion in investor assets, according to Morningstar data. Alternatives-focused funds saw €1 billion in outflows, while commodities and convertibles were also in net redemptions.

Much of this money was likely reallocated to money market funds, with short-term funds attracting €15 billion of inflows in May. USD money market – short term was the most popular of Morningstar's money market categories in May with €11 billion in inflows. But funds in the euro money market category took in €7 billion. And funds in the GBP short-term money market category saw outflows of €4 billion. This trend stands in contrast to the second half of 2011, when investors shifted into USD- and GBP-denominated liquid funds, fleeing the perceived risk of the European single currency.

Bond funds also benefitted from May's risk aversion, with nearly €5 billion in inflows. But May was also the weakest month for the asset class in 2012.

Allocation funds, whose multi-asset nature gives them appeal in uncertain times, enjoyed another strong month in May, bringing their net inflows for 2012 to nearly €9 billion. This again marks a departure from the August through December 2011 period, when market turmoil prompted redemptions of more than €7 billion from allocation funds.

Estimated Net Flows €Mil	May 2012	YTD 2012	2011	**Net Assets** €Bil
Allocation	855	8,877	5,379	487
Alternative	(1,096)	6	(2,154)	259
Commodities	(202)	83	(452)	23
Convertibles	(484)	57	(4,953)	37
Equity	(12,560)	(11,345)	(69,816)	1,518
Fixed Income	4,933	48,338	(43,742)	1,316
Property	(341)	671	(2,841)	102
All Long Term	**(8,895)**	**46,687**	**(118,580)**	**3,742**
Money Market	15,353	37,888	(5,708)	963

Source: Morningstar Direct Asset Flows

To learn more about Morningstar Direct Asset Flows, visit us at this link.

Data Notes: The figures in this report were compiled on June 20, 2012. Over 23,000 of 30,000 funds that Morningstar tracks from 1,100 fund companies across 29 domiciles are included. Funds domiciled in Sweden are not included because they report assets on a quarterly basis only. Between €1 bn and €6 bn of AUM from these groups are not included because assets for some funds were not reported by the publishing date: Polaris, Royal London, Allianz, Aviva, GLG, Credit Mutuel, Barclays, CACEIS, Amundi, and RREEF. BlueBay is not represented due to their disclosure policy. They report assets more than one month in arrears.

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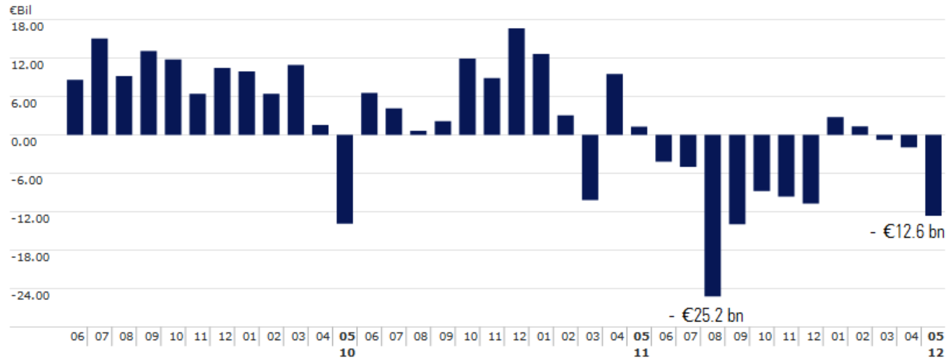
A Flight, but Not a Stampede, from Equities

Equity fund outflows were widespread in May, with 92 of the 117 equity categories in Morningstar's Europe/Asia/Africa category system experiencing investor redemptions. May's outflow was not as severe as that of August 2011, when European investors pulled €25 billion from the broad asset class, or September 2011, when €13 billion was redeemed. But May's outflows erased what had been mildly positive flows to equity funds during the first four months of the year.

Equity Investors Took Flight in May



A Buying Opportunity for Europe?

Eurozone large-cap equity was a big loser in May, with nearly €1 billion in redemptions. This brings the category's outflows for the first five months of the year to nearly €3 billion and earns it the title of Europe's least popular category for 2012. For obvious reasons, most Europe-focused equity categories have been badly out of favor this year (see chart below). Meanwhile, many value-oriented portfolio managers tracked by Morningstar point out that European companies are often global operators and are being unreasonably punished for their countries of domicile.

Categories Ranked by YTD Outflows €Mil

	Estimated Net Flow €Mil		
	1-Mo	QTD	YTD
Eurozone Large-Cap Equity	(982)	(1,861)	(2,849)
Europe Large-Cap Value Equity	(515)	(1,091)	(2,496)
France Large-Cap Equity	(140)	(706)	(2,017)
Europe ex-UK Large-Cap Equity	(407)	(306)	(1,388)
Europe Large-Cap Blend Equity	(688)	(822)	(1,198)
Germany Large-Cap Equity	(284)	(430)	(1,184)
UK Large-Cap Blend Equity	115	219	(1,113)

Source: Morningstar Direct Asset Flows

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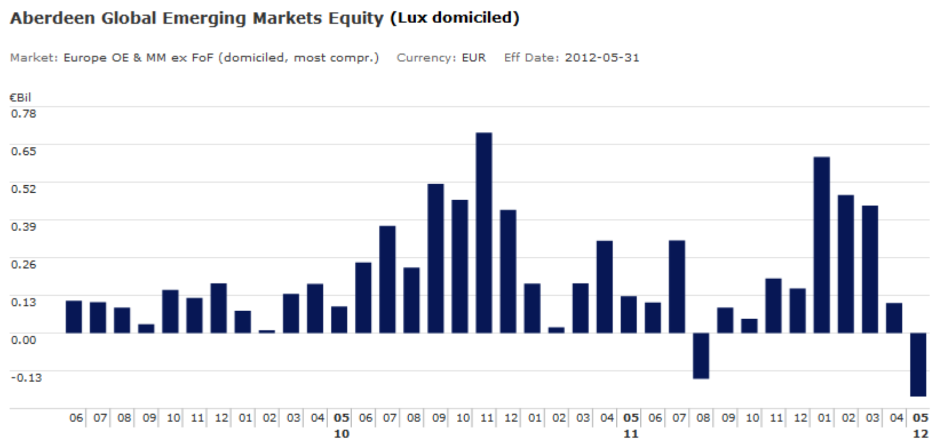
The ‘Risk-Off’ Trade Hits Emerging Markets

While Europe has been out of favor for some time, emerging-markets equities funds have been quite fashionable. Global emerging-markets equity is the most popular equity category in Morningstar’s European database for 2012, attracting €5.4 billion in investor capital. But risk aversion in May saw flows to the category turn negative for the first time since November 2011.

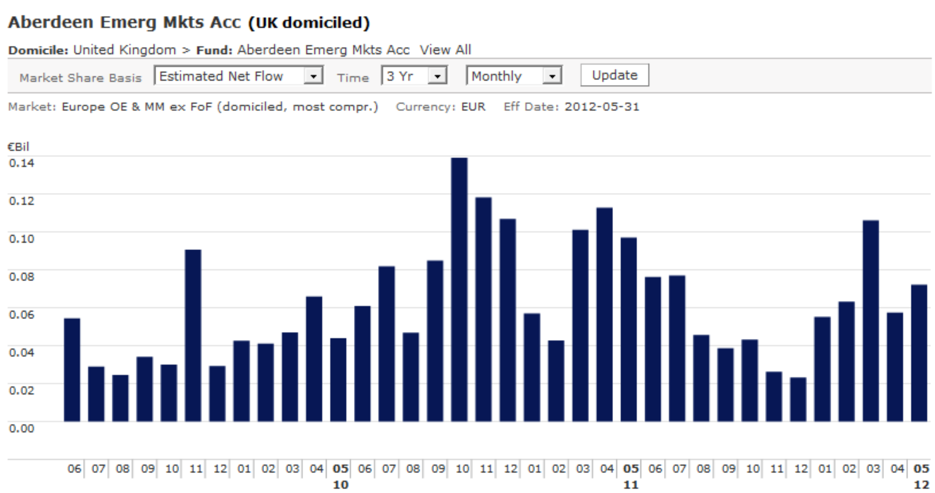
Beyond the diversified emerging-markets equity category, narrower emerging-markets-focused categories also experienced big outflows. China equity led the way with €905 million in net redemptions. Asia ex-Japan Equity saw €386 million leave its funds; emerging Europe equity saw outflows of €263 million; Russia equity, €214 million; India equity, €210 million; BRIC equity, €155 million, and Latin America equity, €137 million.

At the fund level, the most notable casualty was Luxembourg-domiciled Aberdeen Global Emerging Markets, one of the most popular European funds in recent years. Before May, it had enjoyed inflows in 34 of the 35 previous months, but it suffered €220 million in net investor redemptions in May—its first month of outflows since August 2011 and its largest monthly outflow on record. (Morningstar’s Europe asset flows data extends back to 2007.) The fund’s intake of more than €7 billion since the start of 2009 is cause for concern given the relatively illiquid nature of emerging-markets equities, though the fund still carries a Morningstar Analyst Rating of Gold, reflecting our analysts’ conviction in its prospects.



The UK Is among the Pockets of Relative Calm

Of course, the Luxembourg-domiciled fund is only one of the many vehicles through which Aberdeen offers its emerging-markets equities capability. In an interesting contrast, the UK-domiciled OEIC Aberdeen Emerging Markets attracted €72 million in inflows in May. Nor did that fund see any outflows in August 2011.



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This is part of a larger trend. The Morningstar Asset Flows Region of Sale feature shows that risk aversion gripped some investor bases more than others.

Though UK investors redeemed €244 million in May, YTD they have contributed a net €3,721 million. This stands in stark contrast to Spain, where investors have pulled €2,489 million from long-term funds from an asset base that is one-fifth the size of the UK's.

Investors in Countries with Safe-Haven Currencies Have Stayed the Course

Top Regions of Sale by Long-term Net Assets

Region of Sale*	**Estimated Net Flow** €Mil	**Net Assets** €Bil	**Currency Safe-Haven**
European Cross-Border	(523)	947	
Global Cross-Border	(5,692)	947	
United Kingdom	(244)	530	✓
France	(815)	208	
Pure Offshore	1,662	202	
Germany	(663)	193	
Switzerland	439	174	✓
Italy	(2,327)	172	
Spain	(964)	119	
Denmark	315	67	✓

* Region of Sale (RoS) is determined by each fund's domicile and availability for sale (AFS). If a share class is domiciled offshore and only AFS in one non-offshore country, its RoS is that country.

Source: Morningstar Direct Asset Flows

Risk Aversion Evident in Bond Land

There was evidence of risk aversion among bond fund flows as well. Prior to May, bond funds focused on corporate debt (especially high-yield) and emerging-markets debt had been in vogue, as investors hunted for yield and looked for alternatives to equities. In May, however, this changed sharply. The emerging-markets bond – local currency category suffered its largest outflow on record, thanks to a €1.4 billion outflow from Investec Emerging Markets Local Currency Debt. GBP corporate bond also recorded an outflow, but this was because a significant proportion of assets were removed from Threadneedle Short Dated Corporate Bond and invested in a similar (non-mutual fund) vehicle at the same house. Flows to the global high-yield bond category also turned negative in May, with €435 million in redemptions.

This was a trans-Atlantic trend. High-yield bond funds domiciled in the US saw net outflows of $1.6 billion in May. Senior fixed-income analyst Miriam Sjoblom argues that periodic outflows from high-yield bonds over the past few years have been more about sentiment than fundamentals.

Europe's largest long-term fund, Silver-rated Templeton Global Bond, saw its ninth consecutive month of outflows in May. Investor sentiment has still not caught up with the fund's rebound in performance. The fund's volatile nature, due to its heavy emerging-markets exposure, might also be scaring some investors off.

By contrast, Gold-rated PIMCO GIS Total Return Bond, Bill Gross' European vehicle, attracted nearly €800 million in May—the fund's strongest month of inflows since October 2010.

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Morgan Stanley INVF Global Brands Still Going Strong

Europe's most popular equity fund in 2011 is on pace to surpass last year's intake in just the first six months of 2012. After attracting €1.7 billion in 2011, Morgan Stanley INVF Global Brands took in €311 million in May and €1.5 billion for the first five months of the year, making it again Europe's most popular equity fund. Investors have certainly noticed its strong absolute returns, despite the loss of its longtime manager in 2009. In these uncertain times it's hard not to see the appeal of a portfolio of blue-chip consumer staples companies, such as Nestle, British American Tobacco, and Procter & Gamble.

ETF Flows Parallel Traditional Fund Flows—with One Exception

By Ali Masarwah, European Research Team

Risk-averse investors withdrew €960 million from commodity and alternative ETFs domiciled in Europe, and added €300 million to money market ETFs in May. Fixed-income ETFs gathered close to €1 billion.

But flows to equity ETFs were positive, in a departure from trend. Digging into the numbers, it's clear that the €856 million inflow to equity ETFs in May was powered by a €3 billion inflow into the iShares DAX, the largest equity ETF in Europe. This inflow was less about positive investor sentiment to equities, however, and more about taxes. For more on the iShares DAX April outflow, click here.

Outflows from emerging-markets equity ETFs were more in keeping with the trend. Emerging-markets ETFs saw €255 million in outflows. European equity ETFs lost €413 million in May, after €798 million in redemptions in April. Eurozone equity ETFs have suffered outflows of nearly €2 billion so far in 2012, the highest level of redemptions across all Morningstar categories.

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