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The Clifford Chance/*AsianInvestor* Asset Management Survey 2010

AsianInvestor

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Asset management business normalizes to a new environment

Our survey of buy-side market participants shows that investor risk appetites have returned to pre-crisis levels, but in a changed world.

By Jame DiBiasio

In association with:

CLIFFORD CHANCE

The good news is that business in the asset-management industry is quickly returning to normal. The interesting news is that 'normal' isn't what it used to be.

That's the general conclusion from a survey of buy-side participants developed by *AsianInvestor* and Clifford Chance, and executed in March by Ipsos. The survey, conducted online and through interviews, received responses from 249 investment professionals.

Of these 33% are from independent asset-management companies, 15% from bank- or insurance-affiliated asset managers, 12% from service providers to the buy side, 12% from investment banks or sell-side brokers, 11% from institutional investors, 8% from distributors and 2% from government or quasi-government institutions.

Among our respondents, 33% are senior managers or partners, while 25% are in business development, 14% manage portfolios, 8% are analysts, and 8% are from compliance. The majority, 57%, is based in either Hong Kong or Singapore, but respondents come from all over the world.

The first half of the survey repeated questions posed one year ago in a similar poll. Looking at expectations of expected investment destinations, fund flows and asset-class preferences, the survey reveals the extent to which risk appetites have revived.

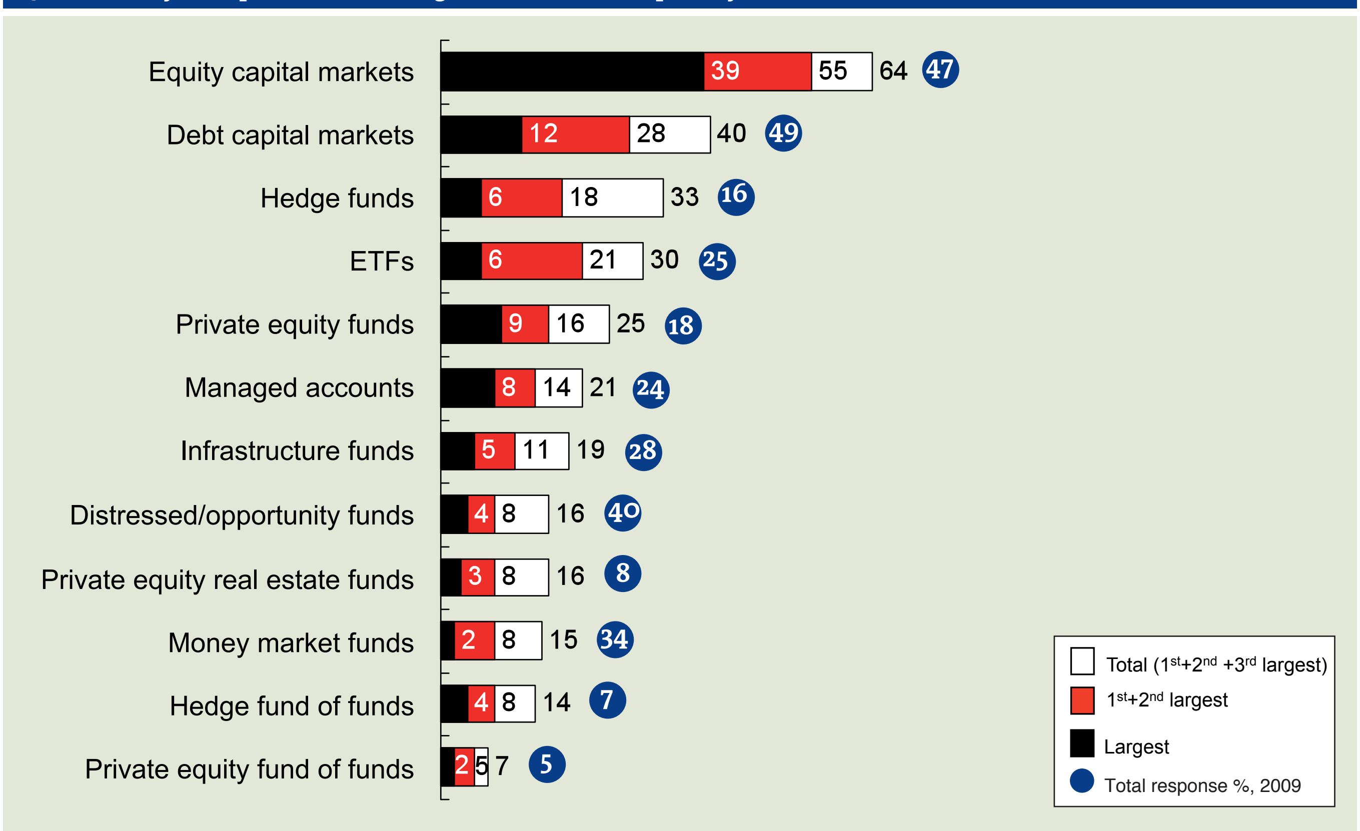
Equities and hedge funds in favour

For example, question 1 asks, "Where do you expect to see the largest allocation of capital by institutional investors to Asia over the next 12 months?"

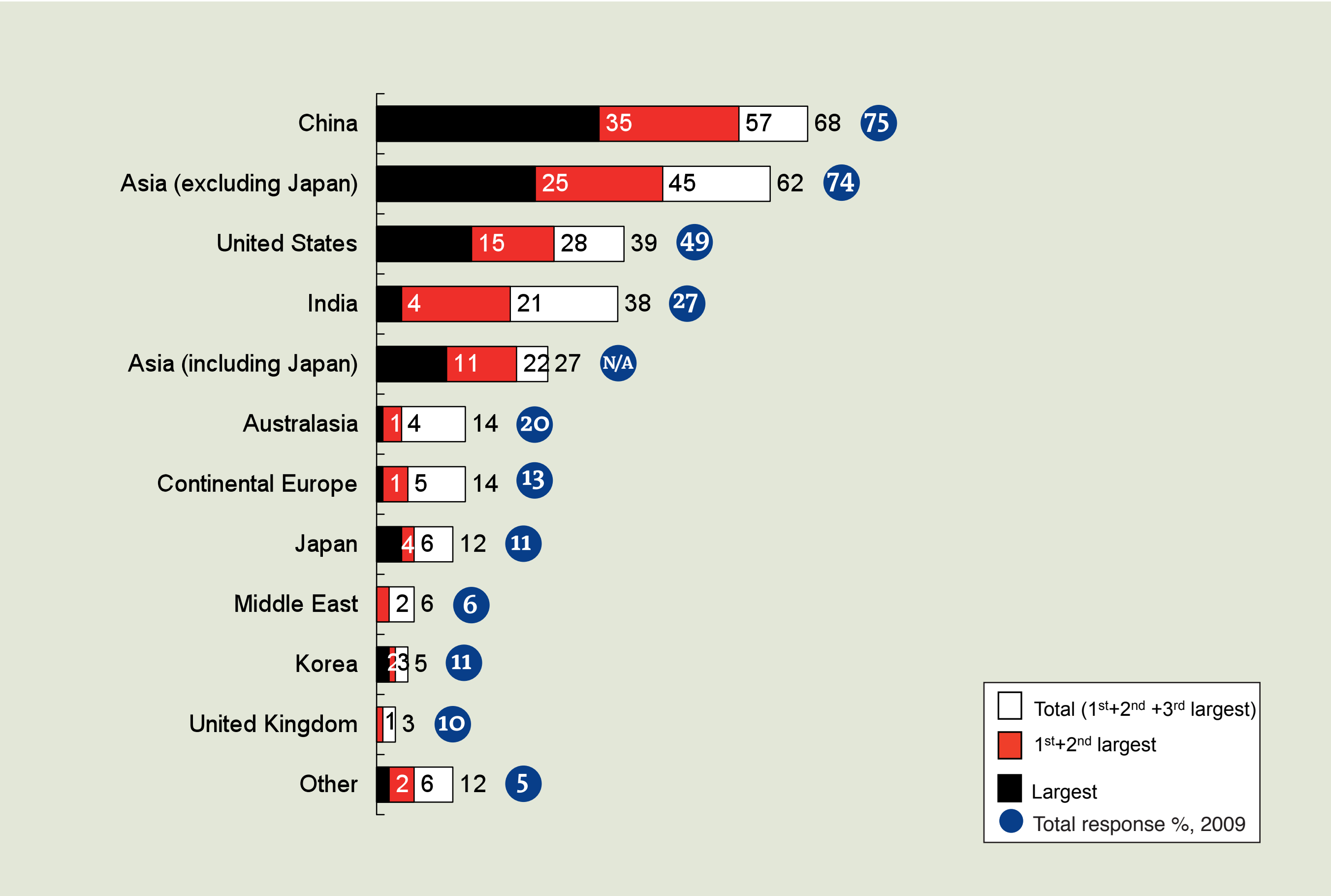
Investors clearly prefer (or are expected to prefer) equity capital markets when tapping the Asia story.

Respondents were allowed to select up to three types of instruments, and 64% included equities in their answer. This is well

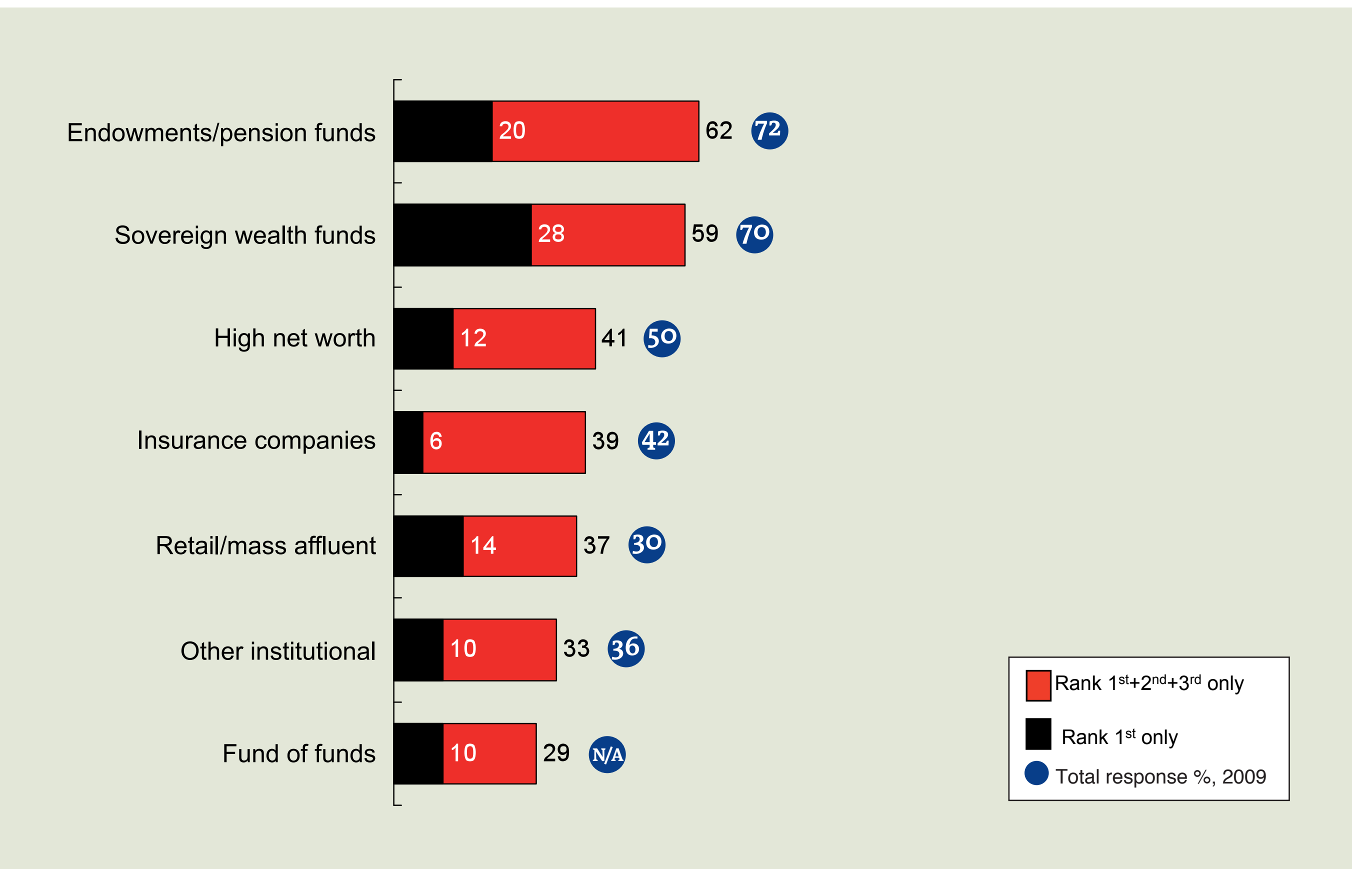
Q1 Where do you expect to see the largest allocation of capital by institutional investors to Asia in the next 12 months?



Q2 Which countries/territories will be the most popular destinations for investment in the next 12 months?



Q3 In Asia (including Japan), which market segment will provide the most new inflows to fund managers?



up from spring 2009, when only 47% said that investors would get Asia exposure via equities. A year ago, the preferred vehicles included bonds and distressed/opportunity funds.

In percentage terms, the biggest change was with regard to hedge funds. Whereas in 2009 only 16% of respondents thought these would receive inflows, now 33% say these are on the table.

"The negative feeling toward hedge funds is over," says Matthias Feldmann, partner at Clifford Chance's funds practice.

James Walker, another partner at the firm, says this shows the Asia hedge-fund industry has matured. "It shows a coming of age," he says. "We see this in our own business flows, particularly with regard to China. Most of the spin-offs we've worked on for Asia hedge funds are now focused on attracting institutional investors."

In contrast, the survey suggests there are low expectations for managed accounts, which last year were being hailed as holy grails.

Walker attributes last year's preference for managed accounts as a reaction to the Bernie Madoff scandal. "But now people have seen how hard these are to implement," he says. "We see more staying power in Ucits-3 funds."

Distressed and infrastructure funds seem to be running out of support, which isn't a surprise given the string of losses being reported by big private-equity managers.

"Financing in Asia has held up well, so distressed plays have been less visible and slower to play out," adds Feldmann.

Money-market funds are also out of favour, again confirming that investor flows to Asia are headed for equities and hedge funds, as well as to bonds, exchange-traded funds and private equity.

Destination India

The second question shows not just that Asia and emerging markets are popular, but the extent to which there is interest in India.

"Which countries and territories will be the most popular destinations for investment in the next 12 months?" we asked, again with respondents allowed to choose up to three answers.

China and Asia ex-Japan were clear favourites (attracting 68% and 62% of respondents' favour, respectively). The United States and India tied for the silver, at 39% and 38%, respectively.

The odd thing is that comparing this to last year's responses actually shows a modest decline for China and Asia ex-Japan, and a more severe drop for the US. But India ranks higher this year, from 27% to 38%.

Mark Shipman, partner at Clifford Chance, explains that this year, the questionnaire included a category, 'Asia including Japan', which didn't exist in 2009. This broader category attracted 27% of the total vote, and reflects an even broader interest in the region. It inevitably took away some votes therefore from Asia ex-Japan and China.

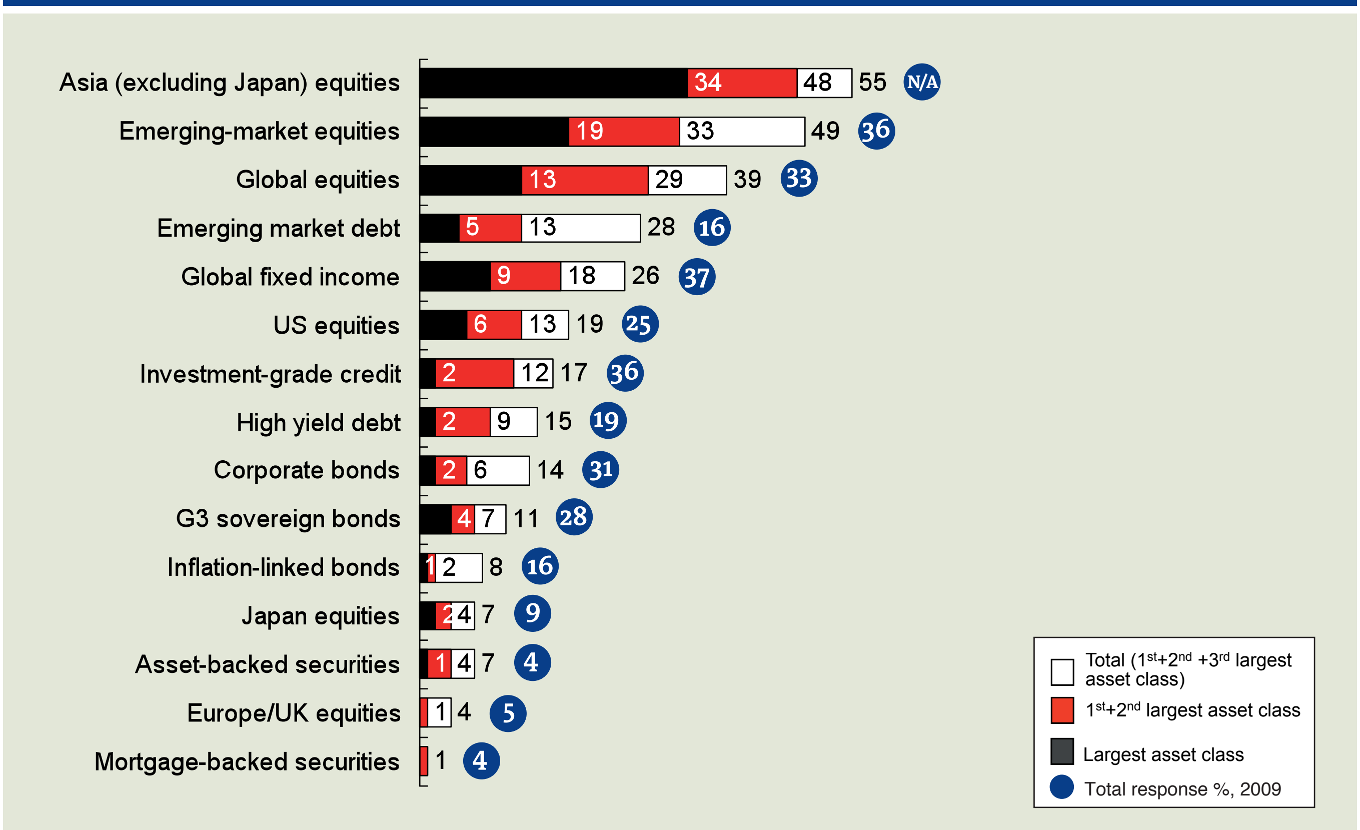
Shipman says the true message from this question: "India's the mover."

Meanwhile, Europe, the Middle East and Korea appear to have lost favour, while Japan remains static. Throwing in the support for 'Asia including Japan', and this suggests a possible rising interest in that market, but that's not a conclusion that can be decisively concluded.

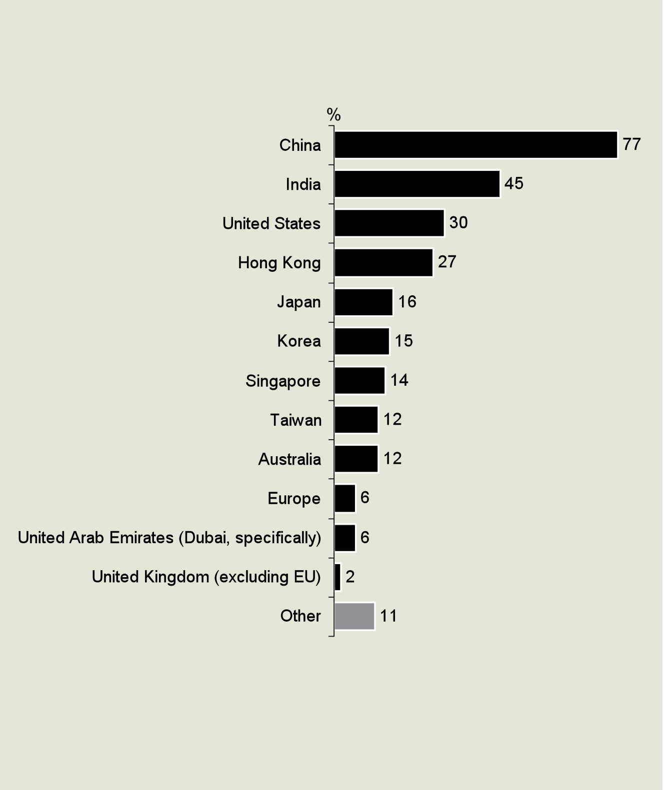
The results of Q2 are reinforced by those of Q4, in which we asked which asset classes will receive the greatest investment flows from Asia's own institutions (as opposed to from global investors, in Q2).

This examined instruments more than countries but Asia ex-Japan equities was named by 55% of respondents, followed by emerging-market equities (49%). Global equities and emerging-market debt are also expected to receive Asia-originated flows. All

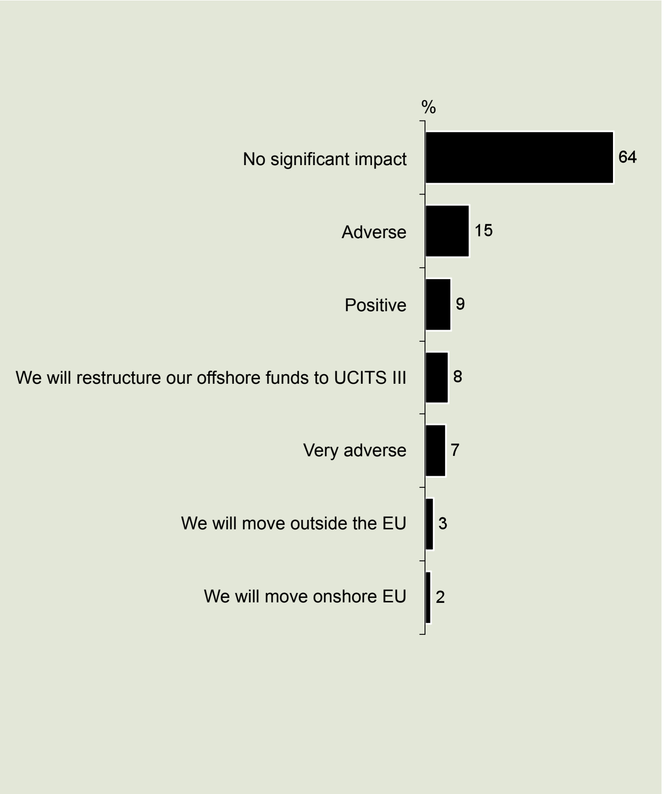
Q4 Over the next 12 months, which asset class will receive the most investment by Asian institutional investors?



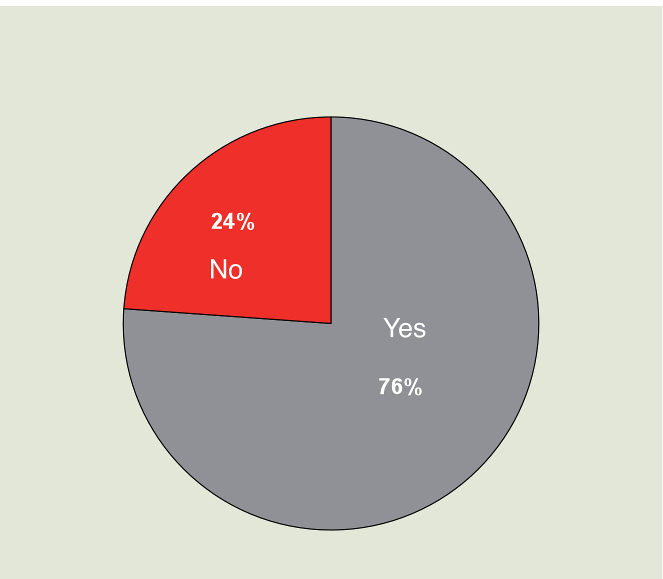
Q5: Which countries/territories will be the most popular destinations for investment in the next 12 months?



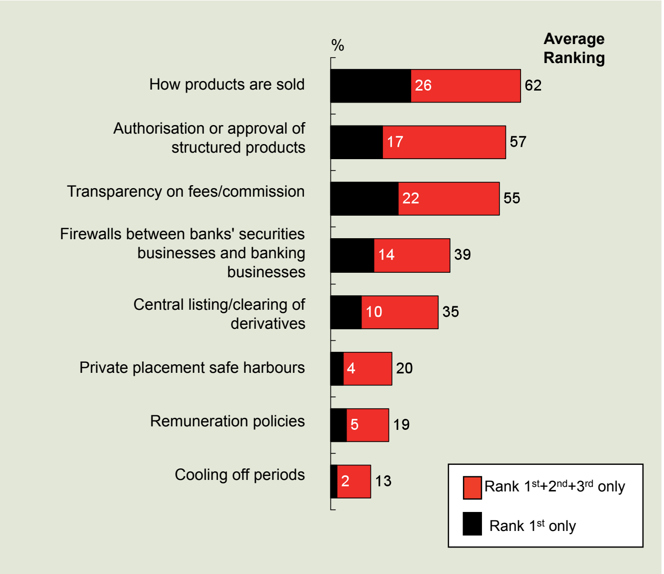
Q6: How significant will be the impact on your business if the EU adopts the AIFM Directive?



Q7: Will you register with the US SEC if the US removes the 15-person exemption for fund advisers?



Q8: What areas of regulation need change in Asia?



of these areas are more favoured than in 2009, while US equities and investment-grade credit are among those asset classes where expectations for Asian flows have fallen.

"From these results we can see a clear polarization, with expectations for flows to the US reduced and flows to Asia, from either global or regional investors, expected to rise," says James Walker.

One surprising result is the decline in expected flows from Asia to global inflation-linked bonds. Certainly demand for US Treasury Inflation-Protected Securities is steep; the survey result may reflect reduced fears about inflation in general.

While a steep decline in interest in G3 bonds is no surprise, the Clifford Chance team didn't expect such a steep fall-off in expectations for corporate bonds. Spreads have obviously come in, however, and the results may show that although credit is still attractive, it is not going to see massive inflows from this point.

Where are Asian flows going to come from? Respondents expect the most to derive from endowments, pension funds and sovereign wealth funds. Respondents surprised, with 59%

choosing SWFs as the main source of new flows – down from 70% who picked these in 2009.

One explanation is that pension funds remain significant players, even if they don't get the media attention of SWFs, suggests Matthias Feldmann.

Mark Shipman notes that fund of funds came in last, with only 29% of respondents including it in their top-three picks. "Normally I would have expected fund of funds to be expected to play a bigger role," he says. "This shows the challenges that this segment of the industry still faces."

Regulatory puzzles

The second half of the survey concentrated on a variety of regulatory issues.

Q6 asked how significant respondents expect the impact on business to be if the European Commission adopts the AIFM Directive in its current proposed form, while Q7 asked if funds will register with the US Securities & Exchange Commission if the US removes the 15-person exemption for fund advisors.

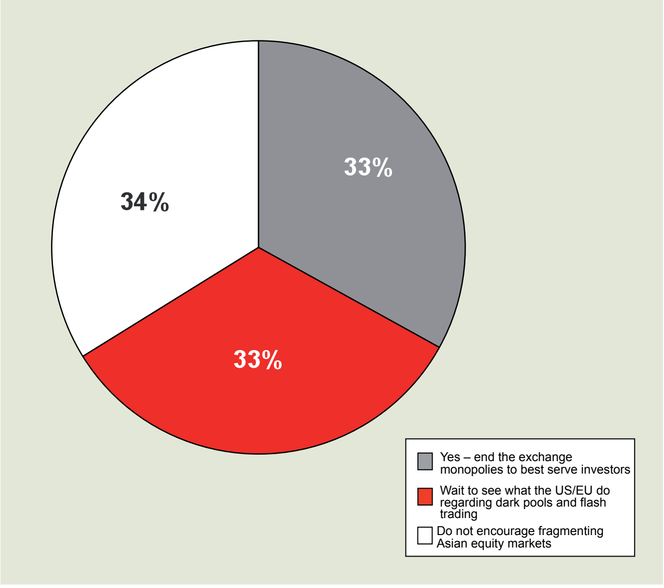
Clifford Chance noticed a strange reversal in the expected results. To Q6, 64% of respondents say AIFM won't impact their business; while 76% say they will register with the SEC if required.

Shipman believes this shows that market participants in Asia still don't appreciate the influence of European regulation, and remain focused on the US. AIFM is going to require registration and licensing for all hedge funds, private-equity firms and funds of funds seeking to manage European money.

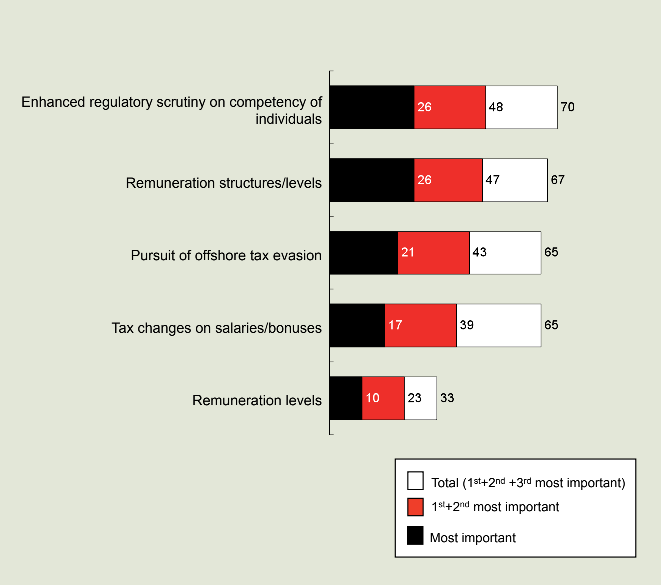
Feldmann suggests people in Asia only see this as a faraway bureaucracy looking to implement reforms in 2012, in a move that the US Treasury is trying to blunt. But too few people in Asia have a handle on what is actually going on.

"Foreign participants will be able to market to Europe if there's regulatory reciprocity and tax and information exchanges between stock markets and governments," Feldmann says. "But what does 'reciprocity' mean, and how will it work? How hard is it going to be to actually comply?"

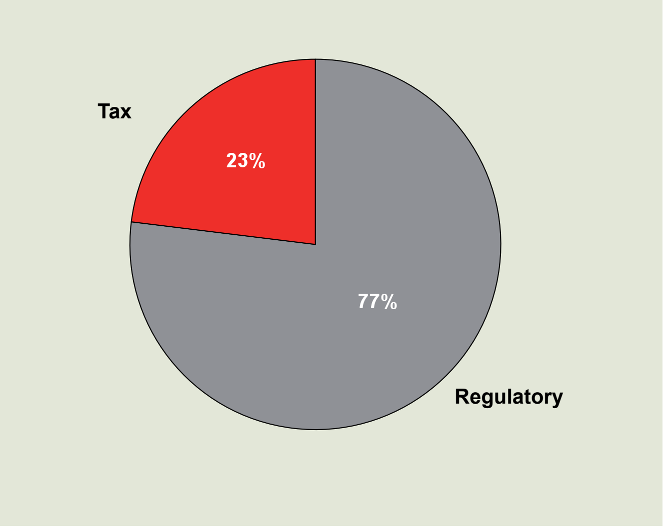
Q9: Should Asian stock exchanges encourage dark pools and other competing/fragmenting sources of liquidity?



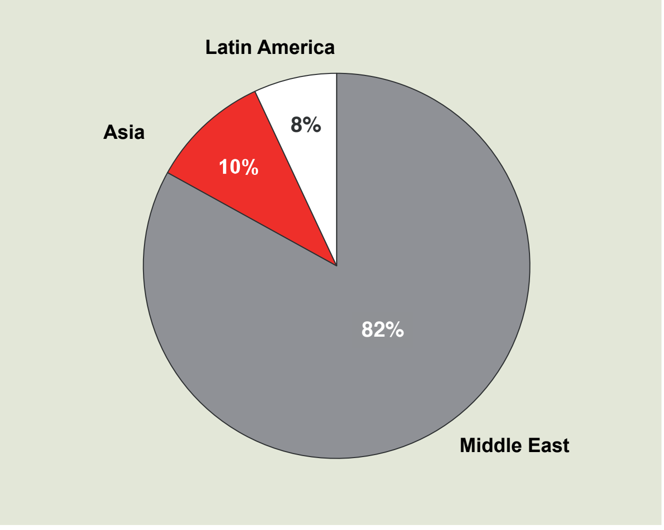
Q10: What tax or regulatory changes will have the biggest industy impact in the next 12-18 months?



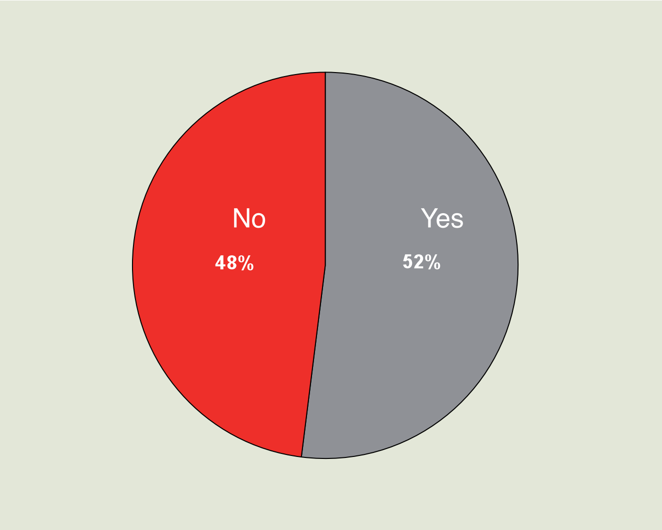
Q11: Will the greatest change to the investment-management industry arise from tax or regulation?



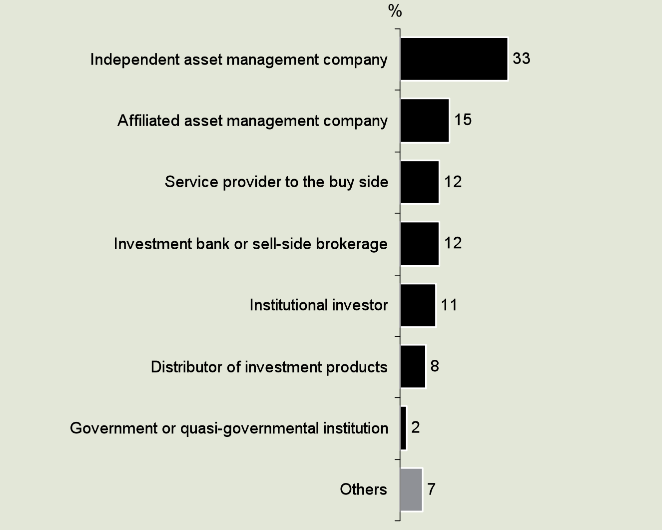
Q12: Which region do you see increasing the most in terms of Ucits held by investors, in the next 3-5 years?



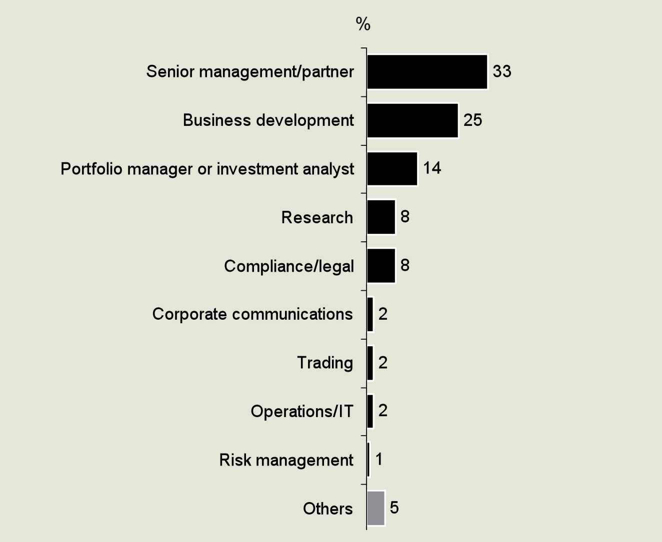
Q13: Are hedge funds in Asia likely to set up as Ucits-3 funds or re-domicile from Caymans to Ucit vehicles?



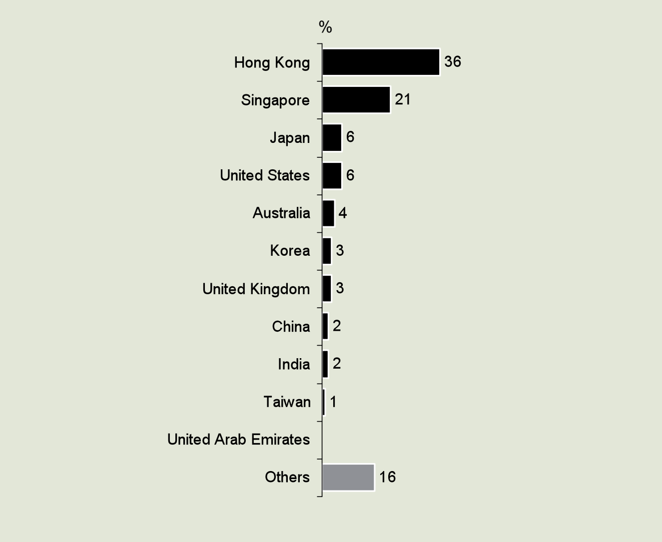
Background: At what kind of organisation do you work?



Background: What kind of role do you perform?



Background: In which country/territory are you based?



In contrast, the market here seems ready – perhaps, resigned – to do the SEC's bidding. The last time the SEC attempted to get funds to register, hardly any bothered, and it created a major stir.

Feldmann says, "It seems as though participants in Asia are focused on what changes are coming up in the US but not in Europe. They may need to reconsider their priorities."

The next question, Q8, asked what area of regulations need to change in Asia. The biggest response was "how products are sold", which 62% of respondents flagged as one of three allowed choices. Another 57% named authorization or approval of structured products.

"This is helpful," says James Walker, "because it shows this year there is now an alignment of interests between the market and the regulators. It's not just politics driving better regulation of distribution, but market demand."

We asked two more questions that defied easy comment: on whether Asian stock exchanges should encourage dark pools, and the most important changes affecting the industry. In both cases, the respondents were evenly split between our suggested replies.

This suggests either no trend is apparent, or that there are so many regulatory and technological factors changing the business, that it's impossible for participants to focus on just one thing.

Some of our final questions threw up some intriguing responses. Q11 asked what will change the investment management industry the most, tax or regulation. Regulation is by far deemed more important, with 77% of the vote.

"In Europe, it's all about tax," says Mark Shipman. "This probably reflects the fact that most respondents were in Singapore and Hong Kong, where tax regimes are so easy."

In a bizarre twist, 82% of respondents say that the Middle East's investors will increase Ucits holdings the most in the next three-to-five years, versus 10% for Asia and 8% for Latin America.

Maybe this reflects an expectation that Asia Ucits investing is saturated and that the Middle East is a natural growth area for the structure. The lawyers suggest this reflects growing demand for Ucits frameworks.

This gut feeling may be confirmed by Q13, which asks if hedge funds in Asia are likely to set up as Ucits-3 funds, and/or restructure Cayman-domiciled funds into Ucits vehicles. 52% say yes.

"Hedge funds in Asia are taking seriously the idea of using the Ucit structure," says Walker. "This requires some regulatory work, but there's clearly a demand." ■