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VIEWPOINT

Newsflash

A new month and the 62nd issue of Viewpoint from PPi.

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The ongoing debt crisis in Europe dominated markets throughout November. Whilst the periphery was the focus of concerns at the start of the month – following Greece's brief dalliance with the idea of a national referendum on their continued participation in the euro project – as November progressed the markets' attention shifted towards the core. Governments in Italy and Spain were replaced, and French yields began to move out.

Hopes for an orderly restructuring of Greece's outstanding debts were cast into doubt as Athens descended into political infighting at the start of the month. Prime minister George Papandreou announced plans to hold a referendum over the country's latest bailout from the international community, to the chagrin of fellow euro area leaders, who together had brokered the deal with the banking sector to aid Greece. Mr. Papandreou was duly called to a meeting in Cannes on the eve of the G20 summit, before making way for a government of national unity. Lucas Papademos, a former vice-president of the European Central Bank (ECB), received the nomination for presidency.

Political upheaval in Europe did not stop there, however. Italian prime minister Silvio Berlusconi resigned on 16 November, after Italy's parliament successfully passed large parts of the reforms package demanded by the international community. Italy's rising cost of borrowing (combined with persistent speculation over his private life) eventually loosened Mr. Berlusconi's grip on power.

Mario Monti, former European Commissioner, was appointed by President Napolitano to form a new government, tasked with leading the country out of its debt crisis.

Finally, in a more conventional political transition, Spain's incumbent government was roundly beaten in the general election. The country's new leader, Mariano Rajoy, asked investors to reserve their judgment of the new administration for one hundred days, a luxury which others have not been afforded. Empathy was not in evidence earlier in the month, with Mario Monti, Italy's new leader, enjoying a single day's grace before the market pushed Italian bond yields higher. Spanish yields duly drifted out for five consecutive days following the election, before falling towards the end of the month. Mr. Rajoy's rhetoric has consistently emphasised the need for sacrifice in order for Spain to pay back its borrowings.

Eurozone data was weak during November, with unemployment reaching 16 million. The ECB duly cut rates by a quarter point to 1.25% in line with market expectations. President Draghi emphasised that recent inflation pressures in the region had abated, prompting the loosening of monetary policy. It is possible, however, that the new President's tenure may see a less dogmatic focus on inflation targeting from Europe's central bank, in a move away from Mr. Draghi's predecessor, Jean Claude Trichet.

Europe's core also became susceptible to market anxiety, with France's 10 year bond yield moving above 3.7%. Speculation continues over France's AAA rating, a situation that was not helped by the downgrade 'notification' sent out in error by S&P earlier in the month. French prime minister François Fillon unveiled a new five year plan during November to placate worried investors, the second such plan in three months. Even Germany appeared vulnerable to the spread of fears. A EUR 6 billion German bund auction at the end of November resulted in the Bundesbank effectively buying the unsold portion of EUR 2.4 billion. The result was due in part to Germany's auction method, in which the state acts more as a price setter than a price taker; had the price of the bund at issue been slightly lower it is likely that the auction would have been successful. Overall market participants appeared to be spooked over Europe as a whole rather than purely its weaker parts.

The idea of a Greek referendum has fuelled speculation over the prospect of a breakup of the Union. Whilst this extreme scenario has gained traction, so has the opposite solution of greater fiscal coordination. Either move would result in significant upheaval and would probably require extensive changes to the Union's treaties. Lately, the more likely scenario appears to be an enhanced level of Union rather than a separation. Either way, it would appear that a simple continuation of the status quo becomes less and less likely as the market continues to push for decisive action. On the final day of November the central banks of the US, Europe, UK, Japan, Canada and Switzerland agreed to lower the cost of temporary USD liquidity lines by 50 basis points, in a move aimed at easing some of the dollar funding stresses in Europe.

Elsewhere in the world, The US Congressional Budgetary Committee failed to reach a bipartisan deficit reduction agreement following three months of negotiations. In doing so the US demonstrated the kind of political intransigence that has been plaguing Europe of late. Furthermore, with the US Presidential election only one year away, the build up to this event could witness a degree of political nonfeasance in the US.

There was a large volume of solid macroeconomic data from the US, however, as US consumers spent a record USD 54.2 billion over the Thanksgiving weekend. Furthermore, the US Commerce Department released data on November 22 which showed US consumer spending up by 2.3% year on year in the third quarter. The US consumer accounts for circa 70% of US GDP and therefore any glimmers of positive news will be welcomed by the markets. US initial jobless claims, housing starts and building permits came in above expectations. Retail sales grew by 0.5% in October, ahead of consensus forecasts for growth of 0.3%. Conference Board Consumer Confidence rose to 56.0 in November, up from 40.9 in October, whilst the Jobs Hard to Get index fell to 42.1 from 46.9 previously.

Source: Momentum Global Investment Management October 2011

Despite this, Chinese officials did little to help sentiment, with Vice-Premier Qishan predicting that the global economy would slip into a long term recession. Beijing remains concerned about the cooling of the domestic property market coupled with the need for prolonged austerity in its two main export destinations: the US and Europe. China's HSBC Flash Manufacturing Purchasing Managers' index (PMI) fell to a 32 month low in October.

Equities fell by 2.4% during November, having been 6.2% behind until the last day of the month, when the coordinated intervention by global Central Banks prompted a 4.0% rally. The S&P 500 outperformed other major markets in local currency terms, albeit still down by 0.3%. Equities in Asia Pacific excluding Japan fell by 7.9% over the period, whilst emerging markets declined by 6.7% on concerns over the outlook for Western demand. Global government bonds fell by 1.1% in US dollar terms, as measured by the JP Morgan Global aggregate. Losses were attributed in large part to the strength of the dollar, as US Treasuries added 0.7%, whilst UK Gilts rose by 2.2% and Japanese government bonds held their value. Corporate debt, which is more sensitive to the economic outlook, underperformed, losing ground in the US, the UK and Europe. Global property securities fell by 5.6%, underperforming the broader equity markets, with property companies in developed Asia and Europe underperforming other regions.

In the foreign exchange markets the Bank of Japan intervened at the start of November, selling yen as it rose to a nominal postwar high of 75.35 per US Dollar. Early indications place the size of the Ministry of Finance's intervention at JPY 7.5 trillion, making it the biggest single day selling in history. Over the month the US dollar gained against the majority of other major currencies, other than the yen which added 0.4% in spite of the Bank of Japan's actions; year to date the yen has appreciated by 4.5% versus the greenback. The euro fell by 3.5% versus the US Dollar over the period. The Russell commodities index fell by 1.2%, with agricultural commodities declining by 6.5%. Oil fell by 0.2% whilst gold added 1.4%.

Source: Momentum Global Investment Management November 2011

Asset Class Performances

		To 30 November 2011		
Asset Class/Region	**Index**	**Currency**	**Month**	**Year to date**
Equities				
United States	S&P 500 NR	**USD**	-0.3	0.5
United Kingdom	FTSE All Share TR	**GBP**	-0.4	-4.3
Continental Europe	MSCI Europe ex UK NR	**EUR**	-2.1	-13.4
Japan	Topix TR	**JPY**	-4.7	-17.1
Asia Pacific (ex Japan)	MSCI AC Asia Pacific (ex Japan) TR	**USD**	-7.9	-15.4
Global	MSCI World NR	**USD**	-2.4	-5.5
Global Emerging Markets	MSCI World Emerging Markets TR	**USD**	-6.7	-17.4
Bonds				
US Treasuries	JP Morgan United States Government Bond Index TR	**USD**	0.7	8.9
US Treasuries (inflation protected)	Barclays Capital U.S. Government Inflation Linked TR	**USD**	0.8	13.9
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	**USD**	-2.0	5.9
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	**USD**	-2.2	2.2
UK Gilts	JP Morgan United Kingdom Government Bond Index TR	**GBP**	2.2	14.5
UK Corporate (investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	**GBP**	-1.4	5.0
Euro Government Bonds	Citigroup EMU GBI TR	**EUR**	-2.5	-0.6
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	**EUR**	-3.1	-1.1
Euro High Yield	BofA Merrill Lynch Euro High Yield 3% Constrained TR	**EUR**	-5.3	-5.3
Japanese Government	JP Morgan Japan Government Bond Index TR	**JPY**	0.0	1.6
Australian Government	JP Morgan Australia GBI TR	**AUD**	3.5	13.5
Global Government Bonds	JP Morgan Global GBI	**USD**	-1.1	6.1
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	**USD**	-1.8	5.0
Global Convertible Bonds	UBS Global Convertible Bond	**USD**	-3.3	-6.4
Emerging Market Bonds	JP Morgan EMBI +	**USD**	-0.5	7.8

Source: Momentum Global Investment Management / Bloomberg / Lipper Hindsight. November 2011.

		To 30 November 2011		
Asset Class/Region	**Index**	**Currency**	**Month**	**Year to date**
Property				
US Property Securities	MSCI US REIT TR	**USD**	-3.8	2.8
UK Property Securities	FTSE EPRA/NAREIT United Kingdom TR	**GBP**	-2.2	-3.0
Europe ex UK Property Securities	FTSE EPRA/NAREIT Developed Europe ex UK TR	**EUR**	-5.9	-12.0
Asia Property Securities	FTSE EPRA/NAREIT Developed Asia TR	**USD**	2.6	0.6
Australian Property Securities	FTSE EPRA/NAREIT Australia TR	**AUD**	-7.6	-18.0
Global Property Securities	FTSE EPRA/NAREIT Developed CR	**USD**	-5.6	-6.7
Currencies				
Euro		**USD**	-3.5	0.3
Sterling		**USD**	-2.6	0.5
Yen		**USD**	0.4	4.5
Australian Dollar		**USD**	-3.2	0.2
Rand		**USD**	-2.5	-18.3
Commodities				
Commodities	RICI TR	**USD**	-1.2	-5.2
Agricultural Commodities	RICI Agriculture TR	**USD**	-6.5	-17.6
Oil	Brent Crude Index (ICE) CR	**USD**	-0.2	18.1
Gold	Gold index	**USD**	1.4	23.7
Commodities			**Current rate**	**Change at meeting**
United States	2 November 2011	**USD**	0.25%	-
United Kingdom	10 November 2011	**GBP**	0.50%	-
Eurozone	3 November 2011	**EUR**	1.25%	-0.25%
Japan	16 November 2011	**JPY**	0.10%	-
Australia	1 November 2011	**AUD**	4.50%	-0.25%
South Africa	11 November 2011	**ZAR**	5.50%	-

Source: Momentum Global Investment Management / Bloomberg / Lipper Hindsight. November 2011.

Focus: thinking about the future - fund platforms

We recently produced a research paper reviewing the role of platforms in the retail investment industry, with some insights into the possible evolution of this important part of the investor value chain in coming years. Although the report was somewhat UK centric, particularly with respect to the likely impact of the FSA's Retail Distribution Review which is due to be implemented at the end of 2012, we felt the broad conclusions have direct relevance to retail investors and intermediaries in many other regions so we include a condensed version as the Focus section of this month's Viewpoint. Should any reader wish to receive the report in full or discuss further with us please contact Lucy Richardson.

In a recent survey of wealth managers and independent wealth advisors undertaken by the Scorpio Partnership on behalf of Momentum Global Investment Management, it was identified that growth in the usage of fund platforms by retail investors was an area of increasing importance, activity and innovation.
Our research had the following key findings:

- Platform-based AUM have grown significantly in UK, Ireland and Luxembourg
- Platforms provide an ease of management for retail investors and advisors
- Discounted fees and charges are common
- The ability to aggregate multiple clients under a single platform structure provides IFAs with a more efficient and consistent proposition
- "Open architecture" platforms offer clients and advisors a much wider investment choice across firms and products
- The FSA's Retail Distribution Review is likely to re-shape the Platform industry
- Platform profit margins are expected to become significantly pressurised

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This paper summarises platforms' role to date in the retail investment industry and offers a view of what may be on the horizon.

Platforms

Platforms are internet based services (not products) traditionally provided by wealth managers, private banks, life insurance companies and asset managers and are used to view and administer investments.

When taking a high level view of both onshore and offshore fund platforms, we see three categories:

(i) Fund Supermarkets
(ii) Fund Wraps and
(iii) Discretionary Fund Manager Platforms (DFM)

Fund Supermarkets: These platforms are designed to service the retail market, both directly and via retail investment advisors. With access to transact a wide range of investment funds, it provides funds under one account and at wholesale prices.

Fund Wraps: These are designed to go one step further and provide the retail market, with 'off the shelf' tax-efficient investment products i.e. 'wrappers'. Including Individual Savings Accounts (ISAs), Self Invested Personal Pensions (SIPPs), Personal Equity Plans (PEPs) and Insurance Bonds, these platforms utilise a wide range of investment funds and in some cases individual stocks and shares as well. Akin to fund supermarkets, Fund Wraps also provide solutions under a single account and at wholesale prices.

Discretionary Fund Manager Platforms (DFM): Providing a similar service to Fund Wrap platforms, these services are built around the provision of a discretionary asset management solution. A DFM platform will typically support advisors who offer a proprietary discretionary service to customers or provide access to their own discretionary asset management solution, using the administration platform and tax wrapper capability as the selling points. These platform operators usually have a brokerage history or are discretionary asset management businesses looking for distribution.

Source: Momentum Global Investment Management November 2011

Platform Appeal

Fund platforms have revolutionised the investment fund industry. While enabling financial advisors to manage assets from their homes or offices more efficiently and with greater flexibility they have also changed the sentiment of retail investment, with regards to investing clients' long-term assets, savings and pensions.

The results of such a change in sentiment are so significant that the percentage of assets under advice invested via fund platforms in the United Kingdom has increased from sub £20 billion in 2001 to a value in excess of £160 billion in Q3 2011.

Even though each platform's fee structure and funds must be assessed for suitability according to client needs, the main advantages of using fund platforms to advisors and investors irrespective of which platform are:

- Discounted fees & charges: investment managers will often share their fee with platforms for the administration services provided and as distribution inducements, in turn many platforms will pass this on to the client directly or through a platform fee subsidy
- Convenience of dealing (administratively and legally): this should reduce cost and risk to the client
- On-line data storage (transaction history): this should also reduce costs and increase efficiency
- Cheaper fees / charges allows for potentially greater margins: margin compression is clearly topical and an area of focus for IFA's in light of new market regulations and legislation
- Portfolio data and breakdown analysis: the ability to view positions on a real-time basis and analyse investments online provides IFA's with better information and enables them to deliver higher quality client service
- Facilitates wider independence: open architecture offers clients and advisors a much wider investment choice across firms and products
- Multiple tax wrapper offerings: most platforms offer some if not all products including Guaranteed Investment Account (GIA), Cash ISA, Stocks & Shares ISA, SIPP, Portfolio Bonds, Qualifying Recognised Overseas Pension Schemes (QROPS) etc
- Client consolidation: the ability to aggregate multiple clients under a single platform structure provides IFAs with a more efficient and consistent proposition
- Potential access to the portfolio decision makers (under a DFM arrangement): the ability to access the portfolio manager through a platform relationship can provide a much better understanding of the underlying product and its philosophy and process
- Ease of client charging through asset divestment and more efficient remuneration administration (dependent on the final outcome of the retail distribution review (RDR)): highly topical and increasingly important in view of the need for greater transparency in the market.

But it's not all rosy: whilst platforms bring obvious benefits to retail investors, the biggest drawback which has hindered their development and acceptance is the issue of slow and difficult re-registering of existing assets. Although this may be more a result of the inefficiencies of the market than anything, it is a continual constraint on the platform industry and an ongoing frustration to platform users, something that needs more analysis.

The Retail Distribution Review (RDR): the game changer

As a major component part of the retail investment industry, fund platforms will be significantly impacted by the RDR. The FSA's RDR programme, initially created in June 2006, has a target date for full implementation by 31 December 2012. The main ethos of the RDR is to ensure that retail consumers are provided with clear professional services and are charged fairly and transparently.

Some of the more talked about measures being taken to ensure the ethos is achieved are the increasing minimum qualifications required by financial advisors and wealth managers, the clear distinction between independent (full market) advice and restricted advice, the outright banning of advisory commission payments by investment managers and the full transparency requirements of all charges whether advice related, service related or product related.

Charging models, the imposition of compulsory re-registration availability, and the continuously increasing cost

Source: Momentum Global Investment Management November 2011

of development and compliance will be right at the top of any platform providers' agenda. Any platform failing to fully prepare for the implementation of the RDR, will surely be preparing to fail.

Future Margin Pressure

Since 2008, the world has woken up to true cost management and margin recognition. This is the case from one end of the value chain (the consumer) all the way through to the investment manager at the other end of the chain. There is now much greater focus on challenging the cost of a product or a service rather than accept it or find an alternative option. The result of this has been a consistent squeeze on the fees across the board.

It is important to remember that the advisor is the gatekeeper of client assets and platforms and investment managers would forget that at their peril. Fee pressure is likely to be applied from the source (i.e. the gatekeepers) and pushed down.

When building a client proposition, an advisor is likely to have a total fee experience in mind, such as 2% per annum. The advisor will then set out to ensure that the cost of the product and the platform (administration) is at a level that maintains a sub 2% experience whilst leaving enough of a fee for themselves for their advisory services and advice.

Pre-RDR, the use of commissions and rebates were available for platforms and advisors to boost their revenue stream. The change in landscape now means advisors will be looking to investment managers and platforms to reduce fees to allow margins to be maintained.

With the abolition of initial and ongoing commissions imposed by RDR and the move to unbundled service/advice driven fees, the squeeze is only likely to get tighter. Given the fact that profits have been few and far between in the UK Platform industry (largely through initial development costs accepted as the downward phase of the revenue to cost J-Curve), this may result in a review of the commercial viability of the platforms.

The pre-requisite for survival will be the retaining of large scalable long-term clients that year on year add a handful of basis points to the bottom line. This along with the probable changes to capital adequacy is likely to result in a number of platforms reviewing their commercial viability with a view to finding a suitable M&A partner or simply exiting the market completely.

Why platforms are crucial to the success of the investment manager

The relationship between the fund platform and the investment manager is to become more critical over time as the quantum of assets under advice that is invested via a platform increases. Here, the investment manager will view that relationship as a means of enhancing their proposition rather than being purely an administration function. With this in mind, a common theme when discussing a proposition with a potential distribution partner (client), whether an IFA, a broker, a consultant or a Board of Trustees (collectively known as the 'gatekeepers'), is accessibility. Each gatekeeper will undoubtedly have their preferred method of transacting and increasingly those preferences are one or more fund platforms.

Like many UK Investment Managers, Momentum has a long history of strategic partnerships with Wealth Managers and Advisors. Bespoke solutions are designed using an open architecture structure and leverage off the internal capabilities of the firm to meet the ultimate needs of the clients.
As these partnerships develop over the coming months and years, Momentum Global Investment Management sees fund platforms emerging as even more important conduits between the client, the advisor and the solutions we offer. Platforms are regarded as a key component of our solutions and a key relationship for our proposition.

Areas for future consideration and development

In order to remain relevant in a post RDR world all three participants of the value chain, the advisor, the platform and the investment manager will need to give serious consideration to their proposition and operating model. The below are what we believe to be the key development areas under consideration;

Source: Momentum Global Investment Management November 2011

The growth and development of platforms offer real solutions for retail investors

The implications of the RDR are likely to result in a sharp reduction in the number of platforms operating in the UK post its implementation, however the percentage of advised assets flowing through those platforms is expected to grow.

As the dust settles on a post RDR world and the industry begins to take on its future shape, the expectation is that what we will be left with is a lean mean operating model allowing the retail consumer to receive appropriate investment advice which can be implemented quickly and efficiently using the right solution.

Source: Momentum Global Investment Management November 2011

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