Markit Economic Research

28/01/2015

Global markets

Growth and policy divergences mean investors shift focus from US to eurozone

- **January sees net outflow from US-exposed equity ETFs amid growth worries**
- **Investors flock to eurozone-exposed equity and fixed income ETFs**
- **Japan sees renewed investor interest amid signs of recession ending**

Exchange traded funds (ETF) provide investors with easy, liquid exposure to various markets. Fund flows consequently provide a valuable and very timely insight into how investor appetite towards different markets is changing. Recent data show a marked change in sentiment away from an exposure to US markets, and to a lesser extent UK equities, towards the eurozone and Japan in January.

So far this year, US-exposed equity funds have suffered a $13bn outpouring, the first such outflow since May and representing a marked contrast to a record net inflow in the fourth quarter. Overseas investors have meanwhile pulled a net $27m from UK-exposed funds so far in January, most of which were equity-focused, building on a record quarterly net outflow in Q4.

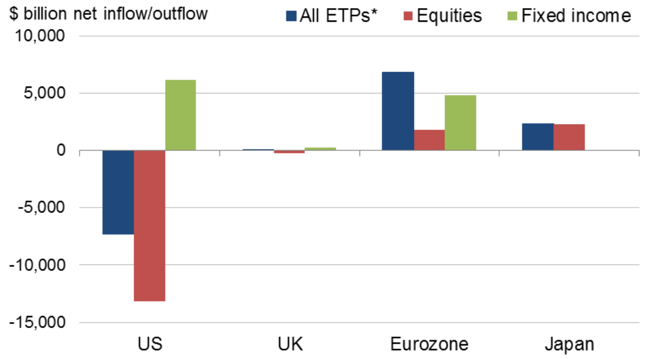
Eurozone-exposed ETFs have so far this year seen a $4.8bn net inflow into fixed income funds and a further $1.8bn inflow into equity funds.

This shift in sentiment most likely reflects a number of factors, including signs of slower economic growth in the US and the UK, which will hit corporate earnings, while at the same time the ECB's announcement of €60bn monthly asset purchases and signs of stronger economic growth have reinvigorated investor interest in being exposed to euro area equities, as well as sovereign debt. It's notable that the interest in investor sentiment in the eurozone is focused on currency-hedged ETFs, indicating that growth is expected to be fuelled by a weakened currency as QE drives the euro lower. Similarly, investors have also moved into US fixed income funds, reflecting recent bond market gains.

Sentiment has also improved towards Japan, reflecting the fact that the country appears to have pulled out of the mini recession that was induced by last April's sales tax rise. Ongoing stimulus and the weaker yen should also foster stronger earnings growth. ETFs have seen a resumption of inflows in November and December, with the latter showing the largest monthly gain for 18 months. Strong inflows have also continued to be seen in January so far, currently totalling $2.3bn against December's $4.1bn rise.

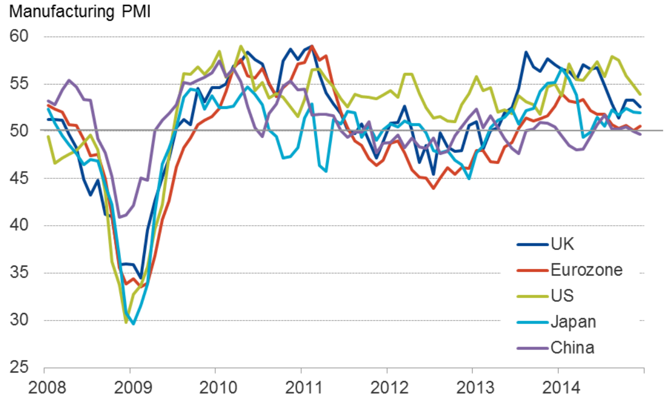
China-exposed ETFs have meanwhile seen an exodus of investment finds, though this in part reflects investors now being able to invest directly in mainland A shares via the Shanghai-Hong Kong Connect as well as concerns about the economic slowdown.

ETF flows in January



* Includes currency and alternative ETPs as well as equity and fixed income
Source: Markit.

Markit manufacturing PMI surveys*



* includes flash January data for the US, China, Japan and Eurozone
Sources: Markit, HSBC.

Continued…

US ETFs see outpouring after record inflows in 2014

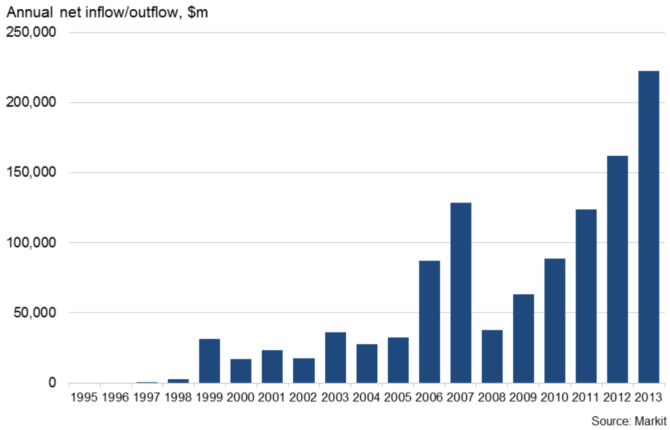
US-exposed ETFs saw the largest net inflows on record in 2014, with appetite growing as the year proceeded. The fourth quarter saw by far the biggest quarterly net inflow on record, buoyed by a monthly record in December. Funds saw a net inflow of some $222,547bn, smashing the previous high of $161,823bn seen in 2013.

Net inflows from US-exposed funds based outside of the US totalled $31,387bn in 2014, also a new all-time high and up from 2013's prior record of $13,232bn.

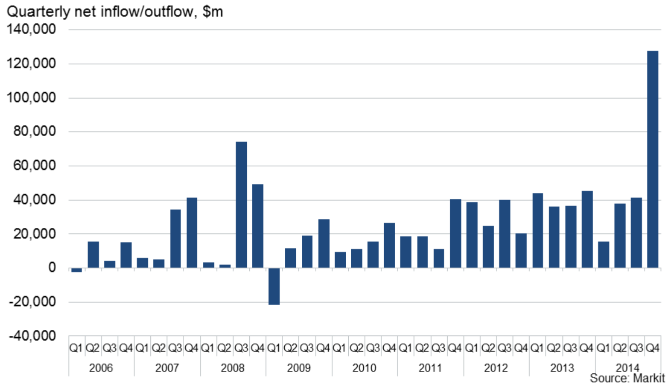
Equity and fixed income funds both saw record net inflows as investors sought increased exposure to the US economic upturn and the rising dollar. In both bases, these inflows rose especially sharply in the final quarter of the year, signalling increased investor appetite for exposure to the US markets towards the end of 2014.

Sentiment appears to have turned in 2015, however, with January so far having seen net outflows from US-exposed ETFs. This would be the first month since January 2014 that net outflows have been recorded. A $6bn inflow into fixed income ETFs has so far been countered by a $13bn outpouring from equity funds.

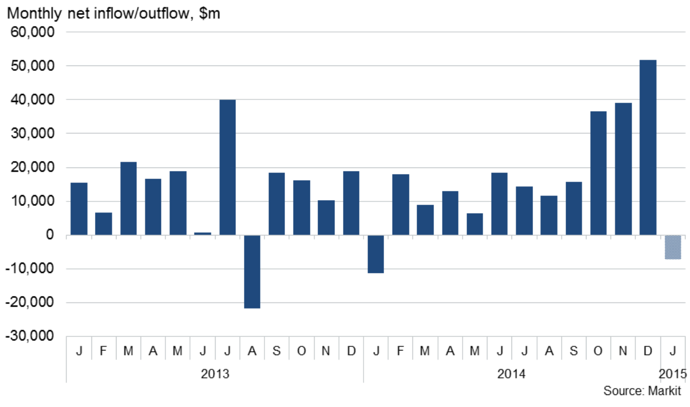
US-exposed ETF fund flows (annual)



US-exposed ETF fund flows (quarterly)



US-exposed ETF fund flows (monthly)



Notes: Shaded bars denote partial month only (up to 26 January inclusive).

Data exclude leveraged an inverse funds but including equity, fixed income, currency and alternative funds.

UK ETF inflows hit nine-year low

UK-exposed ETFs saw their weakest net inflows for nine years in 2014, indicating a reduced appetite for exposure to UK markets among investors. Funds saw a net inflow of $1,761bn, down some 42% from $3,026bn in 2013, which had been the best year on record since 2008.

Equity funds saw less than half of the net inflow recorded in 2013, which had been a record year as investors bet on economic recovery. Fixed income funds meanwhile also saw a net inflow, which made up for almost half of the outflow seen in 2013. The 2013 fixed income outflow had been the first recorded since data were first available in 2004 and coincided with an end to Bank of England asset purchases under its quantitative easing programme.

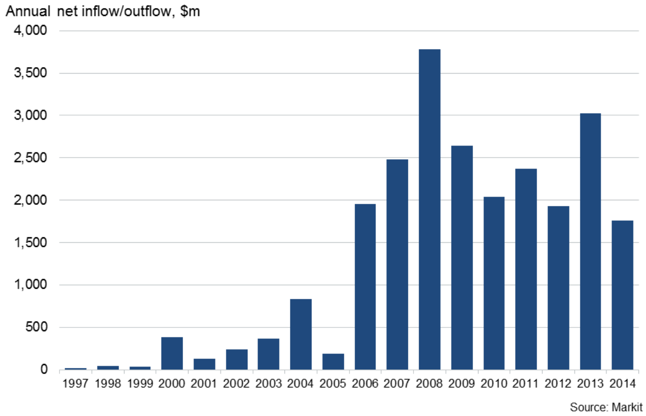
Net inflows from non-UK domiciled funds fell by half in 2014, down from $1,624bn in 2013 to $859bn last year. Much reduced inflows to equity funds were countered by the second largest increase in fixed income inflows seen over the past eight years, which reversing a modest decline in 2013.

However, the fund flow data indicated a reversal of appetite for UK-exposed funds over the course of the year. Outflows in the final two months of the year contrasted with net inflows in 17 of the prior 18 months, with December seeing the largest net outflow for almost two years. The overall quarterly net outflow in the fourth quarter was the largest on record, as a record outflow from funds based in other countries dwarfed a net inflow from UK funds.

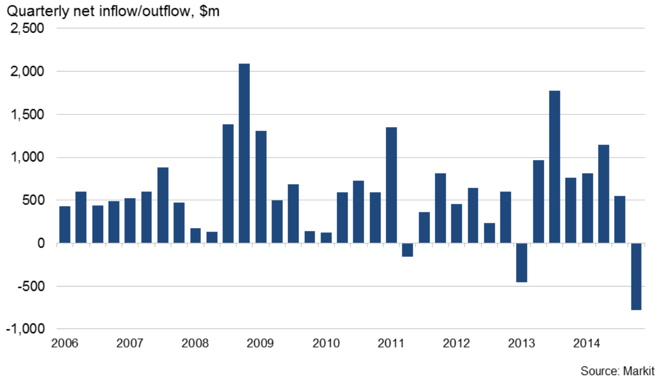
The outflows in the fourth quarter largely reflected a record outflow from UK-exposed equity funds based in other countries, as well as net outflows from UK-based fixed income funds.

Sentiment towards the UK has been cautious as we moved into 2015, with data for January so far indicating only a marginal a net inflow of $18m, with domestic investors offsetting a $27m withdrawal from overseas-based funds. The outflows have been focused on equity funds, with fixed income funds in contrast seeing net inflows.

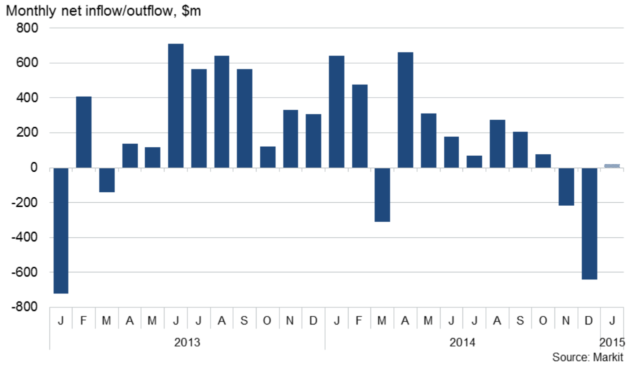
UK-exposed ETF fund flows (annual)



UK-exposed ETF fund flows (quarterly)



UK-exposed ETF fund flows (monthly)



Notes: Shaded bars denote partial month only (up to 26 January inclusive).

Data exclude leveraged an inverse funds but including equity, fixed income, currency and alternative funds.

Eurozone-exposed ETFs

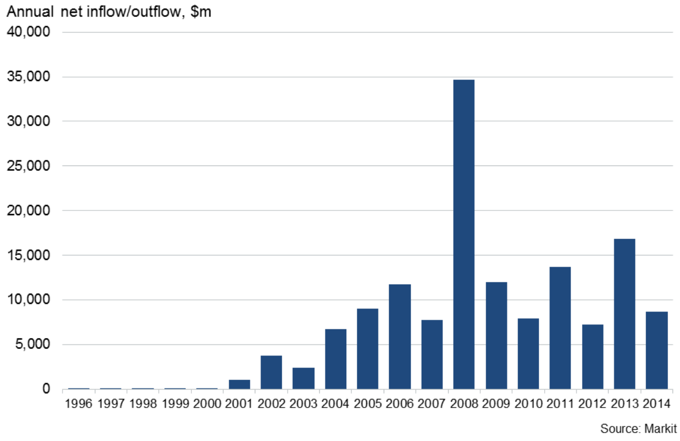
Eurozone-exposed ETFs saw inflows halve in 2014 compared to 2013. While 2013 had seen inflows of some $16,806bn, the second largest on record (data extend back to 1995), inflows totalled just $8,673bn last year.

However, eurozone-exposed funds not based within the region enjoyed the second largest inflows on record last year, albeit down from a peak of $18,573bn in 2013 to $13,206bn, indicated historically strong appetite for exposure to the eurozone from foreign investors.

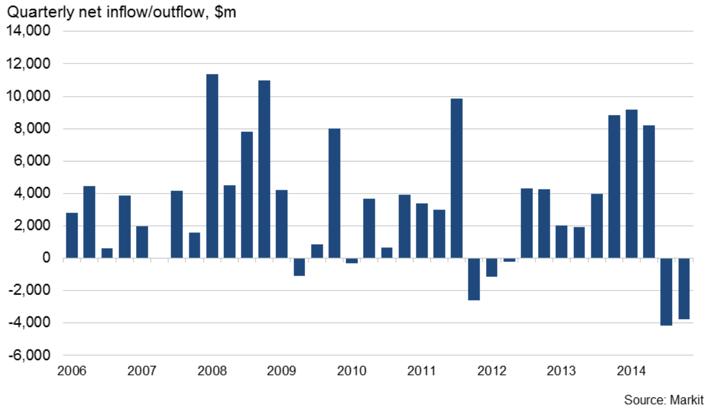
Looking deeper into the data shows that fixed income funds saw the largest net inflow since 2008, but equity funds suffered the first net annual outflow on record. The data therefore highlight investor appetite for exposure to Eurozone bonds in the expectation of the ECB stepping up its policy stimulus via full-scale quantitative easing, including the purchase of government debt.

So far in 2015, sentiment towards the Eurozone has improved further, with January so far seeing some $4.8bn net inflows into fixed equity funds and $1.8bn of net inflow into equity funds.

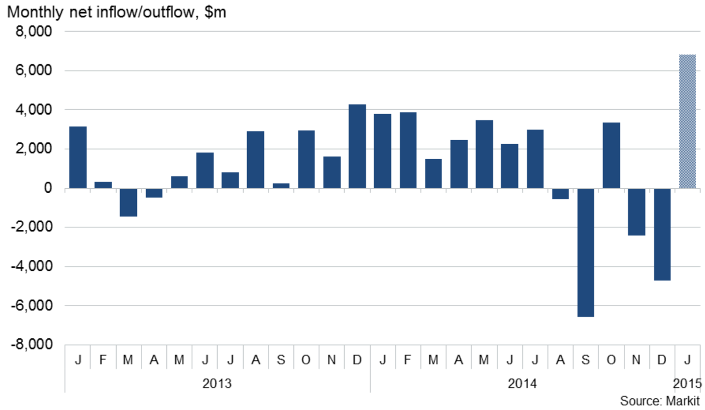
Eurozone-exposed ETF fund flows (annual)



Eurozone-exposed ETF fund flows (quarterly)



Eurozone-exposed ETF fund flows (monthly)



Notes: Shaded bars denote partial month only (up to 26 January inclusive).

Data exclude leveraged an inverse funds but including equity, fixed income, currency and alternative funds.

Japan-exposed ETFs see renewed inflows

Exchange-traded funds with an exposure to Japan saw strong net inflows in recent years, gaining momentum through 2013 and early 2014 on the back of the promise of renewed and aggressive policy stimulus in the form of 'Abenomics'. Prime Minister Abe's policies included plans to double the balance sheet of the central bank via quantitative easing alongside an infrastructure spending boost and structural reforms.

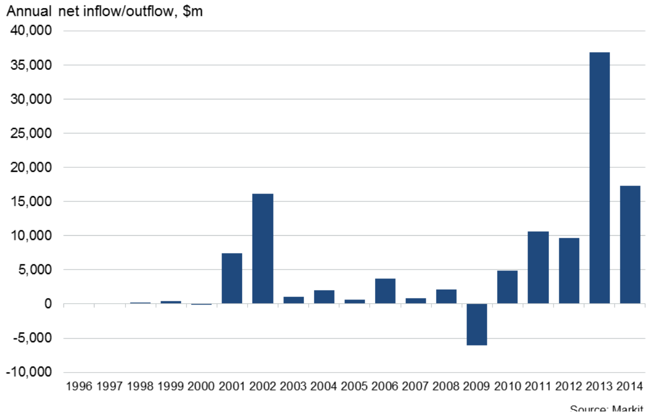
Inflows hit a record high in 2013 at $36,834bn, the vast majority of which are equity focused.

However, inflows then assumed a general downward trend since peaking in the second quarter of 2013 as investors have taken a more markedly cautious approach to investing in Japan. The fourth quarter saw the smallest net inflow for two years, with net outflows even being recorded in September and October as the full impact of the rise in the sales tax from 5% to 8% in April became apparent. Japan's fourth recession since the final crisis was declared after GDP fell 0.5% in the third quarter.

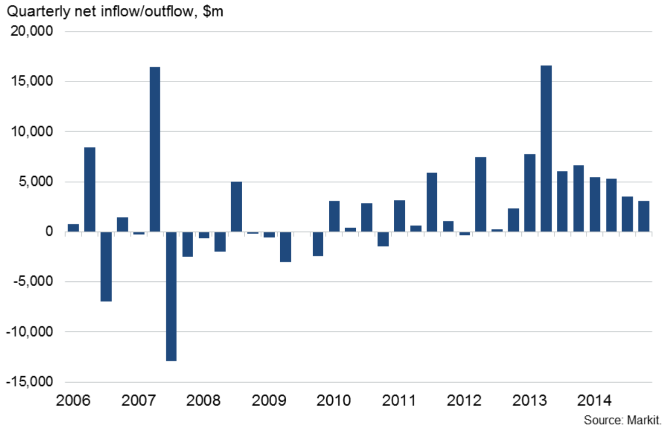
More recently, ETFs have signalled renewed investor sentiment to Japan, with inflows having resumed in November and December then recording the largest net inflow for 18 months. Strong inflows have also continued to be seen in January so far, currently totalling $2.3bn against December's $4.1bn rise.

The improvement in sentiment most likely reflects more upbeat economic data in recent months, including the PMI surveys, which suggest that Japan has pulled out of recession.

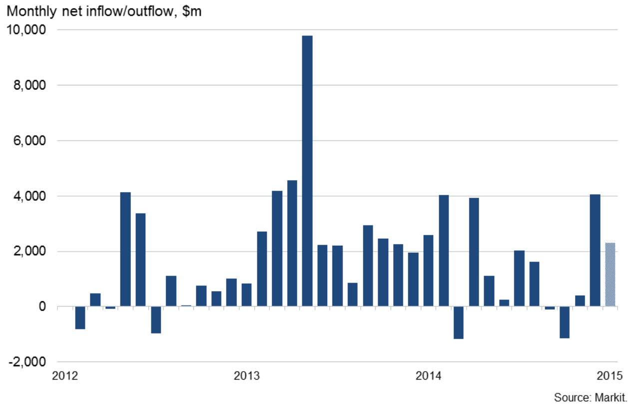
Japan-exposed ETF fund flows (annual)



Japan-exposed ETF fund flows (quarterly)



Japan-exposed ETF fund flows (monthly)



Notes: Shaded bars denote partial month only (up to 26 January inclusive).

Data exclude leveraged an inverse funds but including equity, fixed income, currency and alternative funds.

Chris Williamson

Chief Economist, Markit
Tel: +44 207 260 2329
Email: chris.williamson@markit.com
Twitter: @WilliamsonChris

Click here for more PMI and economic commentary.
For further information, please visit www.markit.com