

# Mega Funds

*<1% of funds control >50% of  
worldwide mutual fund assets.*

*August 2015*

propinquity 

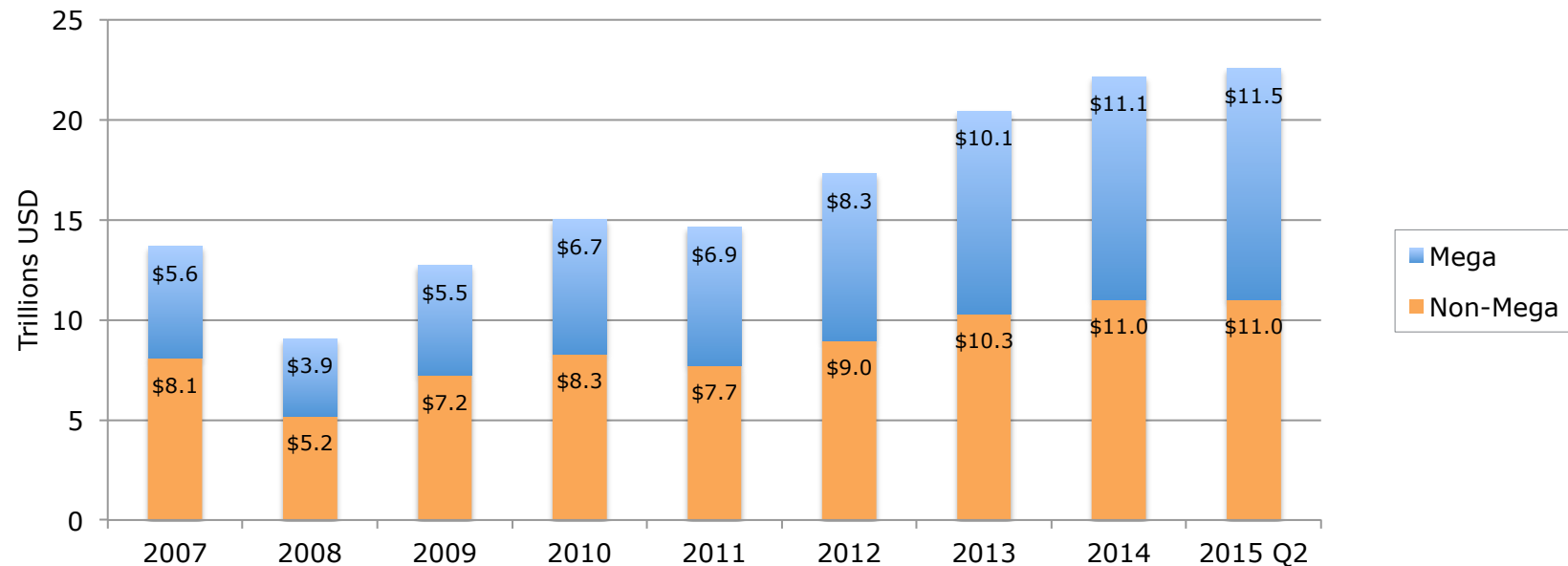
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## Table of Contents

<b>Areas of Focus</b>	<b>Pages</b>
Worldwide Mutual Fund Universe - Overview	3 – 6
The Big get Bigger – Growth: 2007-Q2 2015	7 – 12
Active vs. Passive	13 – 16
Concentration	17 – 19
Category in Focus: US Equity Large Cap Blend	20 – 24
Peak AuM? The Rise and Fall of Mega Funds	25 – 26
Notes & Contact	27 – 28

## Worldwide Mutual Fund Universe

### AuM: Mega Funds vs. Non-Mega Funds



- The mega fund universe is a subset of the worldwide mutual fund universe defined as those funds with an AuM of \$5 billion or more. For purposes of analysis, money market and 'unclassified' funds are excluded.
- By the end of 2007, \$5.6 of the total mutual fund industry assets of \$13.7 trillion (40.9%) were concentrated in mega funds. As of Q2 2015, the share of industry assets controlled by mega funds grew to 51.1%.
- ***A total of 774 of ~83,500 funds available in all reporting jurisdictions worldwide (0.9%) are considered mega. These funds control more than 50% of the assets.***

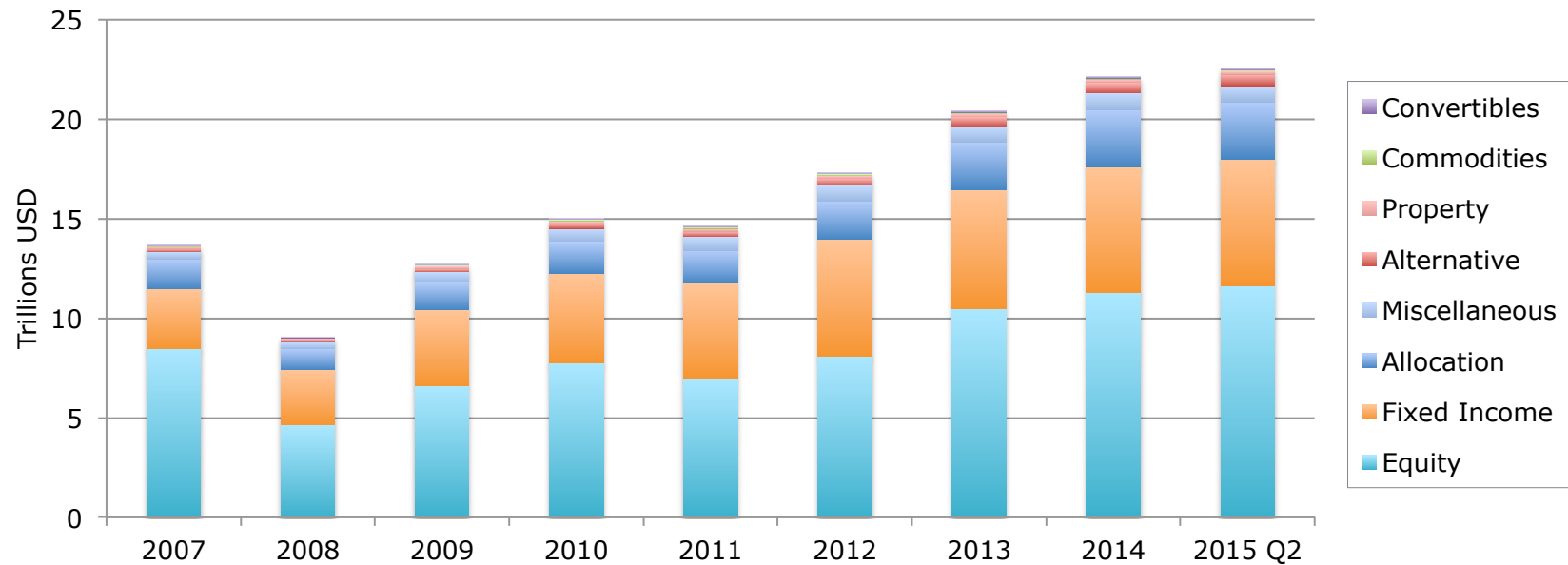
## Mega Funds in Context



- **Number of Funds:** There are ~83,500 funds in the worldwide mutual fund universe and 744 of those are mega funds (0.9%).
- **Assets:** Mega funds control \$11.5 of the \$22.6 trillion in the worldwide mutual fund universe. This amounts to 51.1% of assets.
- **Post 2007 Growth of Total Net Assets:** Since the end of 2007 Mega funds added \$5.9 trillion to total net assets while the worldwide mutual fund universe as a whole added \$8.9 trillion. Thus 66.8% of that growth came from mega funds.

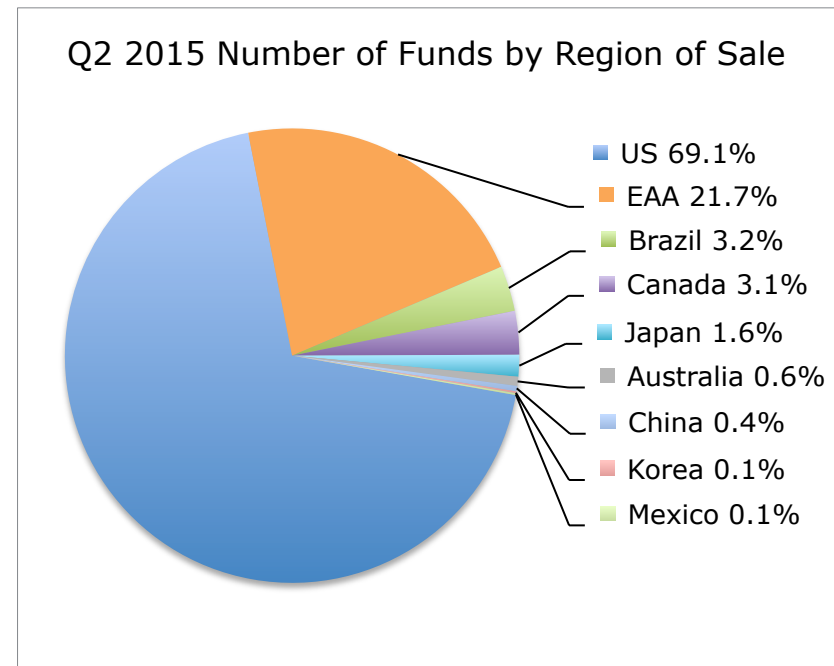
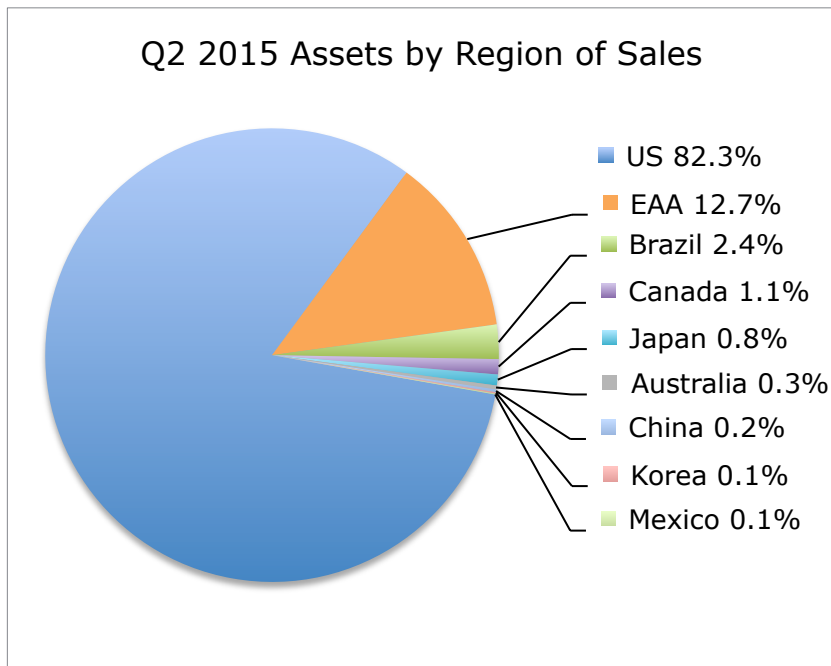
## Worldwide Mutual Fund Assets

### End of Period Assets by Global Broad Category Group



- Worldwide mutual fund assets have grown from \$13.7 to \$22.6 trillion from 2007 to Q2 2015 (1.7x). This excludes 'Money Market' and 'Unclassified' funds.
- 'Equity' assets have increased from \$8.5 to \$11.6 trillion from 2007 to Q2 2015 (1.4x). The share of the worldwide mutual fund universe in 'Equity' has decreased from 61.9% to 51.6% by total assets since 2007.
- The 'Alternative' category has grown the fastest from \$166.2 billion to \$574.8 billion (3.5x) over the same period, but still only makes up 1.2% of the worldwide mutual fund universe by assets.

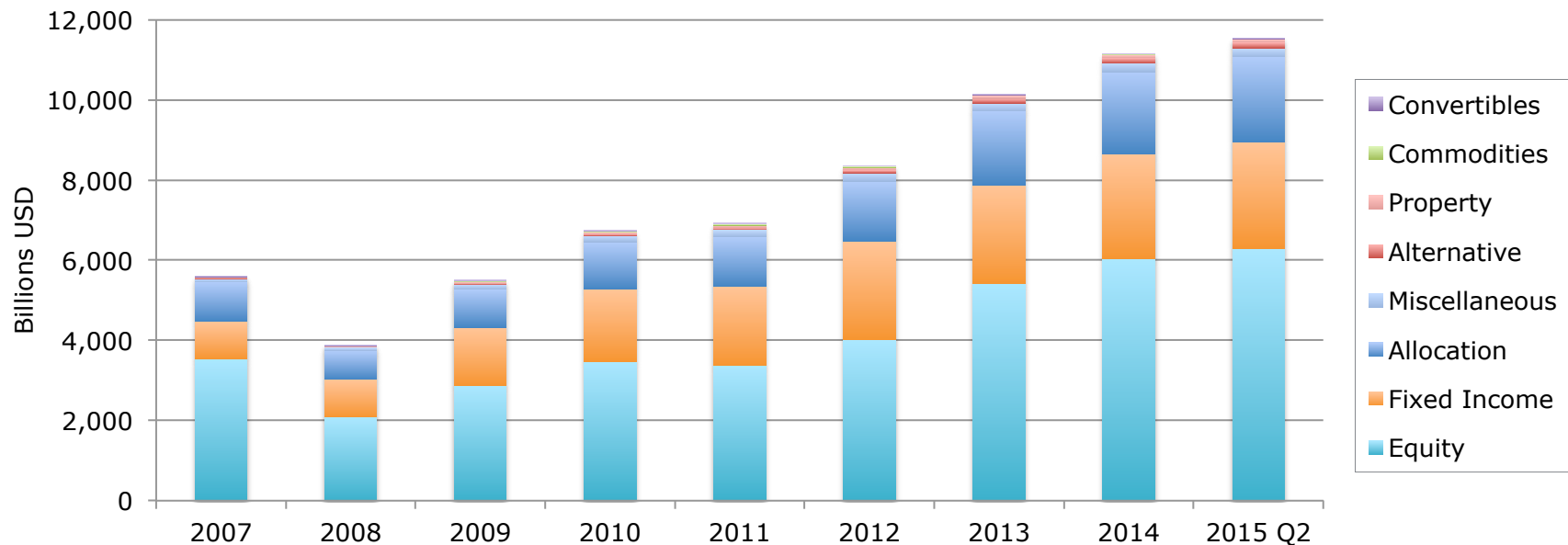
## Where in the World



- The United States houses 535 of the 774 funds (69.1%) in the mega fund universe (69.1%), while its share of the assets is 82.3%.
- Cross Border funds sold in Europe and Asia account for 168 (21.7%) of the funds in the mega fund universe but only 12.7% of the assets.
- The share of mega funds is globalizing: in 2007, 86.9% of the assets in the mega fund universe were US domiciled compared to 82.3% at Q2 2015.

## Mega Funds Dominate Worldwide Industry Growth

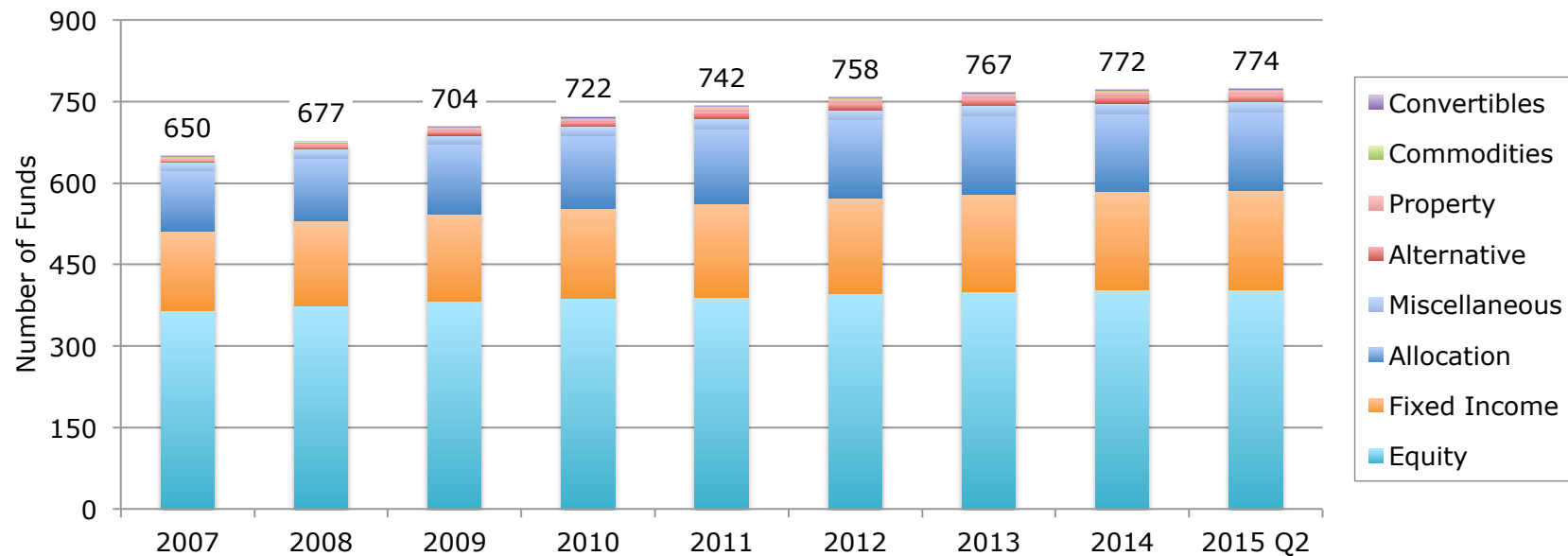
### End of Period Assets by Global Broad Category Group



- Globally, total assets in mega funds (those with USD \$5+ billion in AuM) rose from \$5.6 to \$11.5 trillion (2.1x) between 2007 and Q2 2015. Mega funds are responsible for 66.8% of the growth in the total global fund industry since 2007.
- Since the end of 2008, 'Equity' mega funds have tripled (from \$2.1 to \$6.3 trillion) – primarily driven by strong market performance in the U.S. since 2008.
- Mega funds categorized as 'Alternative' have grown from \$15.0 billion to \$143.9 billion (9.6x) over the 2008 to Q2 2015 period.

## How many Funds are Mega?

Number of Mega Funds by Global Broad Category Group

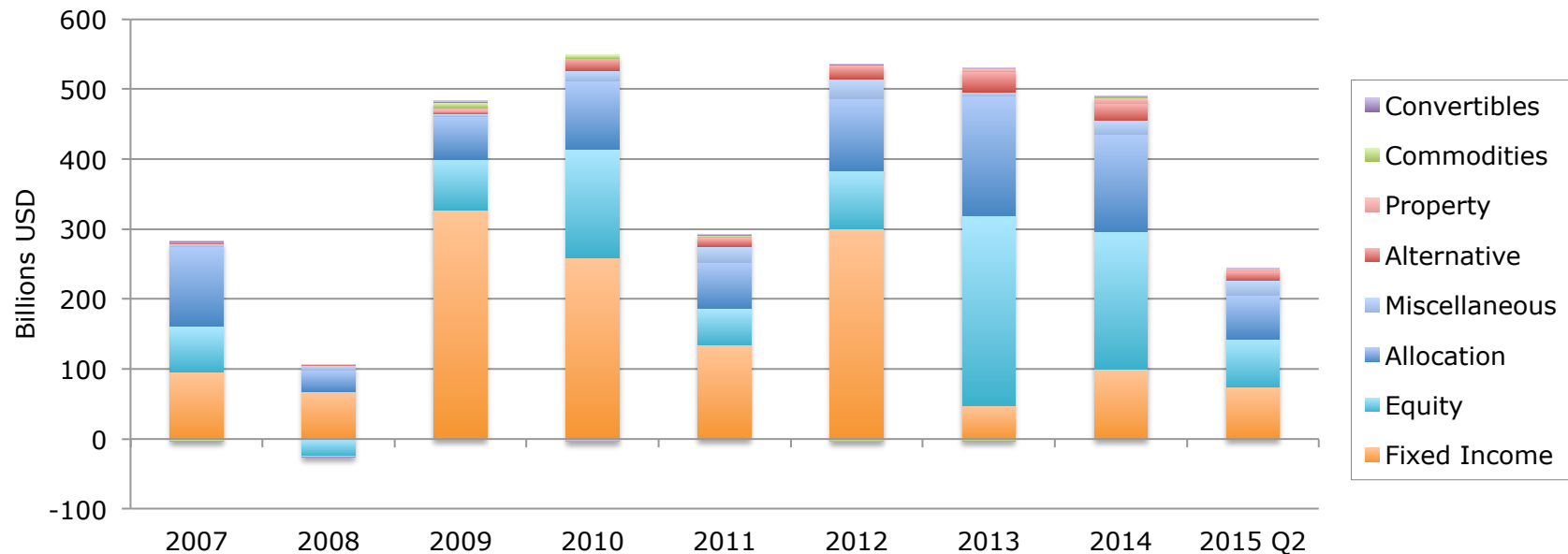


- While the AuM within the mega fund universe has doubled since 2007 the number of funds holding those assets has only grown from 650 in 2007 to 774 as of Q2 2015 (1.2x). Assets are highly concentrated.
- Mega funds categorized as 'Alternative' had the highest growth rate – five funds to 14 funds (2.8x) from 2007 to Q2 2015. 'Allocation' expanded with the overall universe – 110 to 144 funds (1.3x) over the same period.
- From 2007 to 2011, 92 funds reached "mega" status. Only 32 reached this threshold from the end of 2011 to Q2 2015. 'Equity' claims 14 of those 32 while 11 were categorized as 'Fixed Income'.



## Where is the Money going?

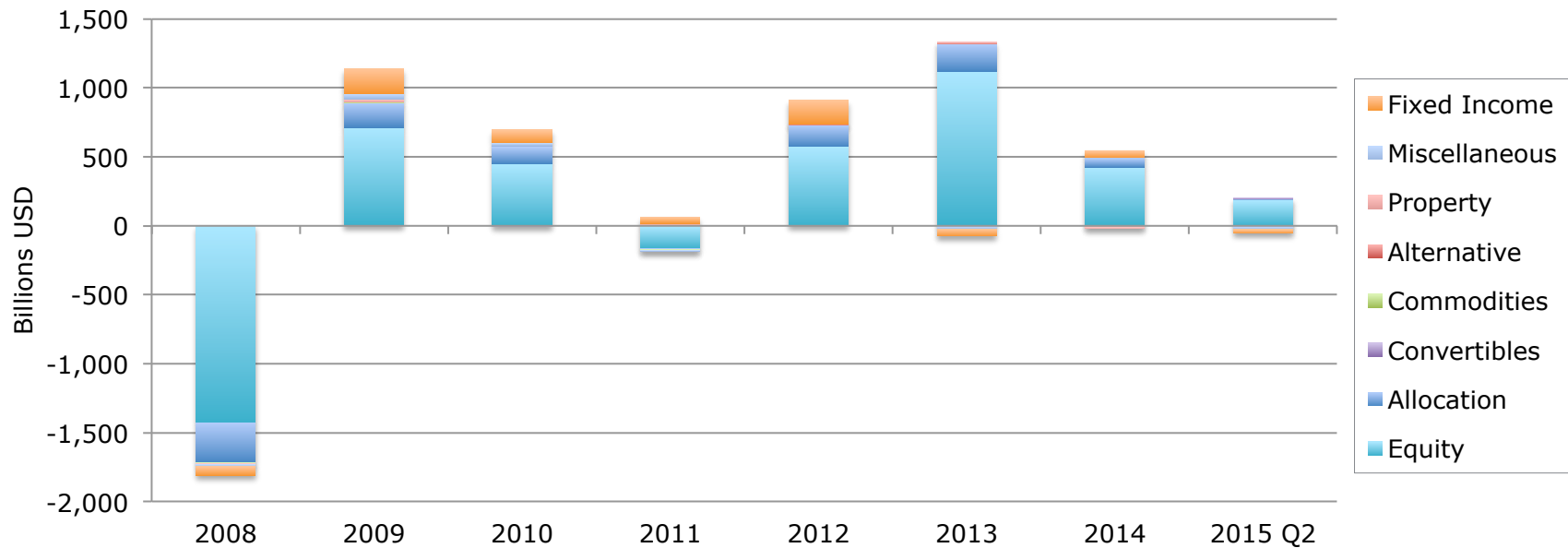
Estimated Net Flows by Global Broad Category Group



- Total flows into mega funds have been remarkably consistent since 2009 (with the exception of 2011). Flows have accounted for \$3.2 trillion (53.8%) of the growth in the size of AuM of the mega fund universe since the end of 2007.
- **The mega fund universe saw net flows of *positive* \$81.9 billion in 2008 in all categories with the exception of 'Commodities', 'Convertibles' and 'Equity' that each lost assets. In comparison, the non-mega fund universe lost \$517.8 billion as a whole in 2008.**
- 'Fixed Income' has been the clear flow winner – mega funds in 'Fixed Income' categories collected \$1,405.7 billion (40.4% of total flows) since 2007, while 'Equity' collected \$942.0 billion (27.1% of total flows) in the same period.

## The Importance of Market Growth

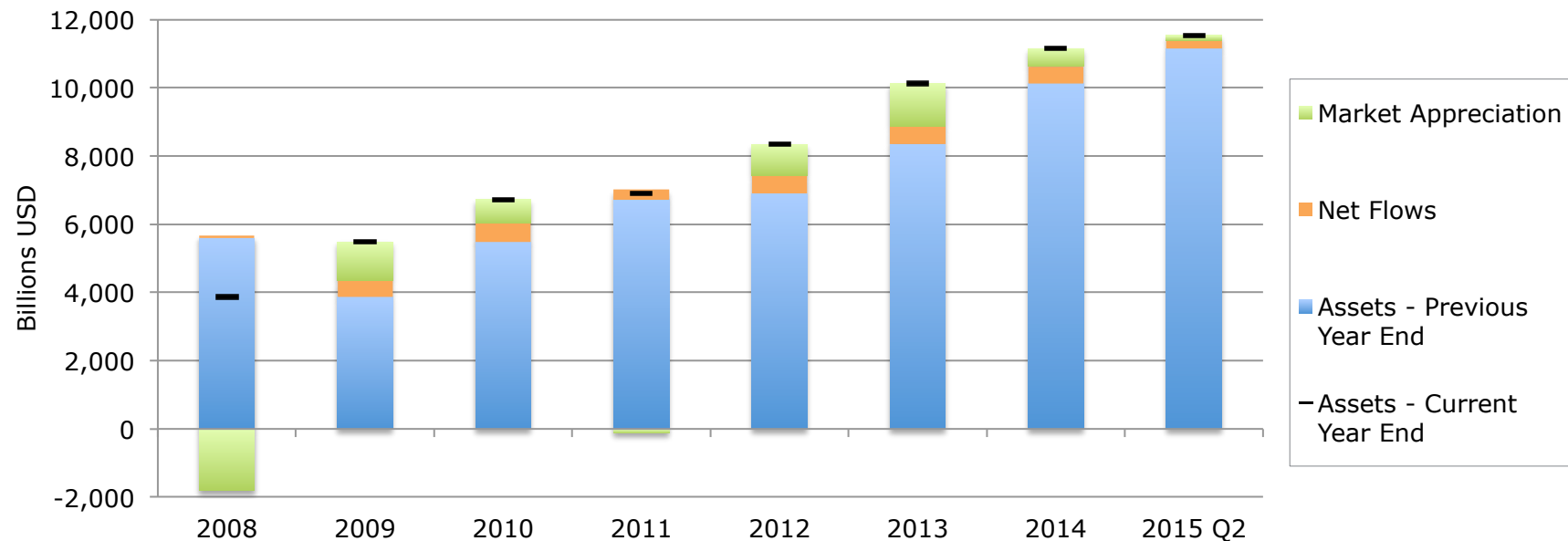
'Market Appreciation' by Global Broad Category Group



- Since the end of 2007, market appreciation has accounted for \$2.7 trillion of the growth (46.2%) in the mega fund universe. Since 2009 market appreciation has accounted for \$4.6 trillion of the growth (59.4%). This sharp difference can be attributed to a loss of \$1.8 trillion from market depreciation in 2008.
- 'Equity' AuM levels are largely dependent on market appreciation/depreciation. While 'Fixed Income' may be dominating flows, 'Equity' has controlled market appreciation since 2009 lifting the size of the mega fund universe and the industry as a whole.

## What is Driving Annual Growth?

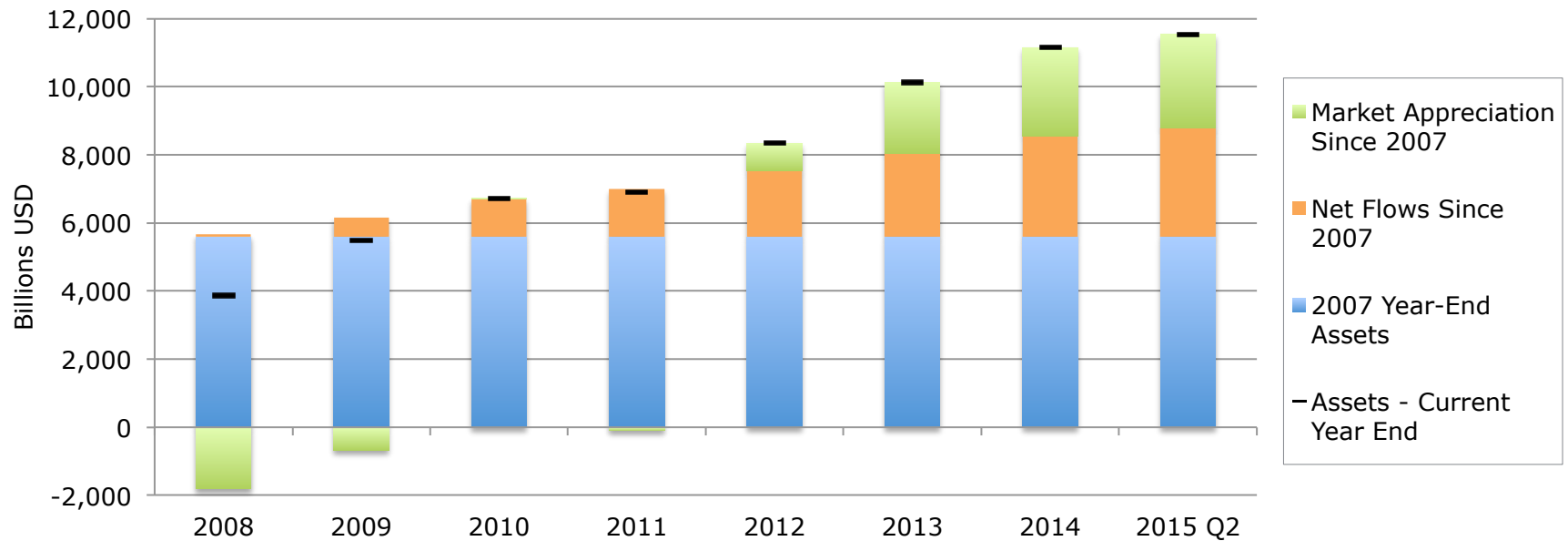
### Yearly Growth - Market Appreciation vs. Net Flows



- The difference between the top of the blue column (starting assets) and the black line (ending assets) marks the movement in assets for the given year. This change is decomposed into market appreciation (green) and net flows (orange).
- Net flows for the mega funds universe remained positive *even in 2008 with inflows of \$81.9 billion* while the rest of the industry (non-mega funds) *experienced outflows of \$517.8 billion*. Thus the industry as a whole netted \$435.9 billion in outflows for the year.
- The magnitude of the market appreciation is normally larger than that of net flows, regardless of direction.

## What is Driving Cumulative Growth?

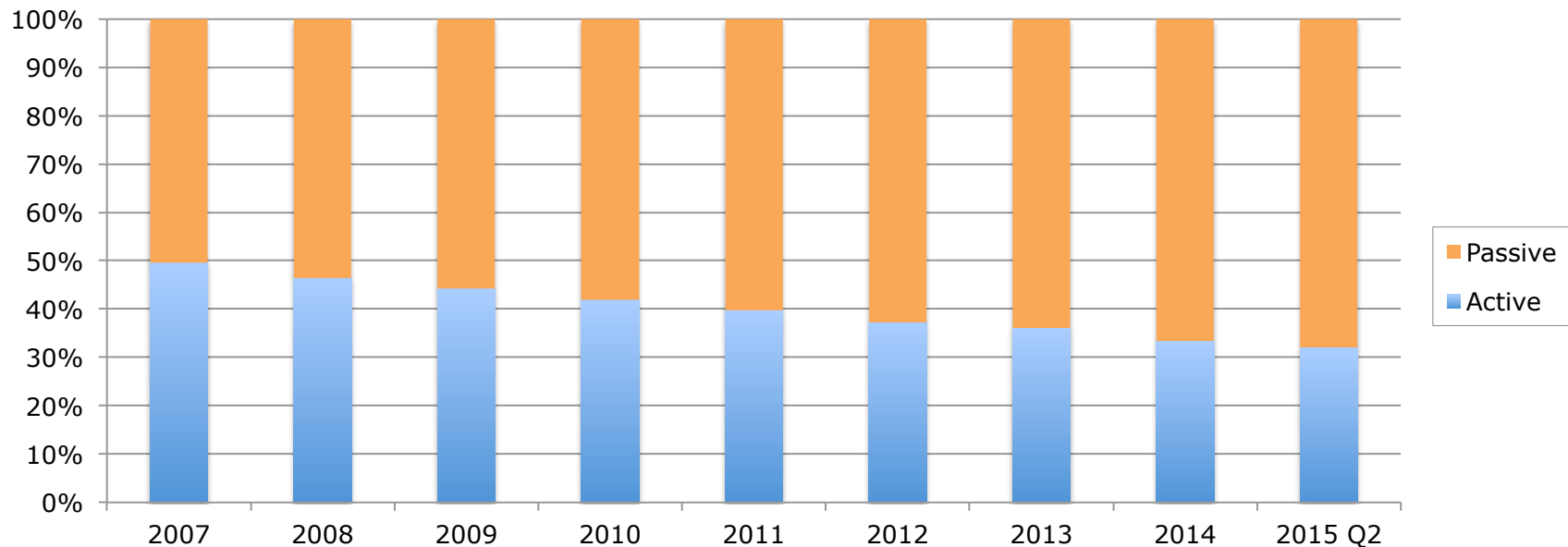
Cumulative Growth since 2007 - Market Appreciation vs. Net Flows



- In this chart, the blue column indicates 2007 year-end assets. Cumulative growth since the end of 2007 in terms of market appreciation and net flows are shown in green and orange respectively.
- While flows within the mega fund universe remained positive through 08-09, 'market appreciation' didn't recover (to 2007 levels) until 2012.
- The flows within the mega fund universe are more insulated from market dynamics than those funds outside the mega fund universe.

## The Shift from Active to Passive in Mega Funds

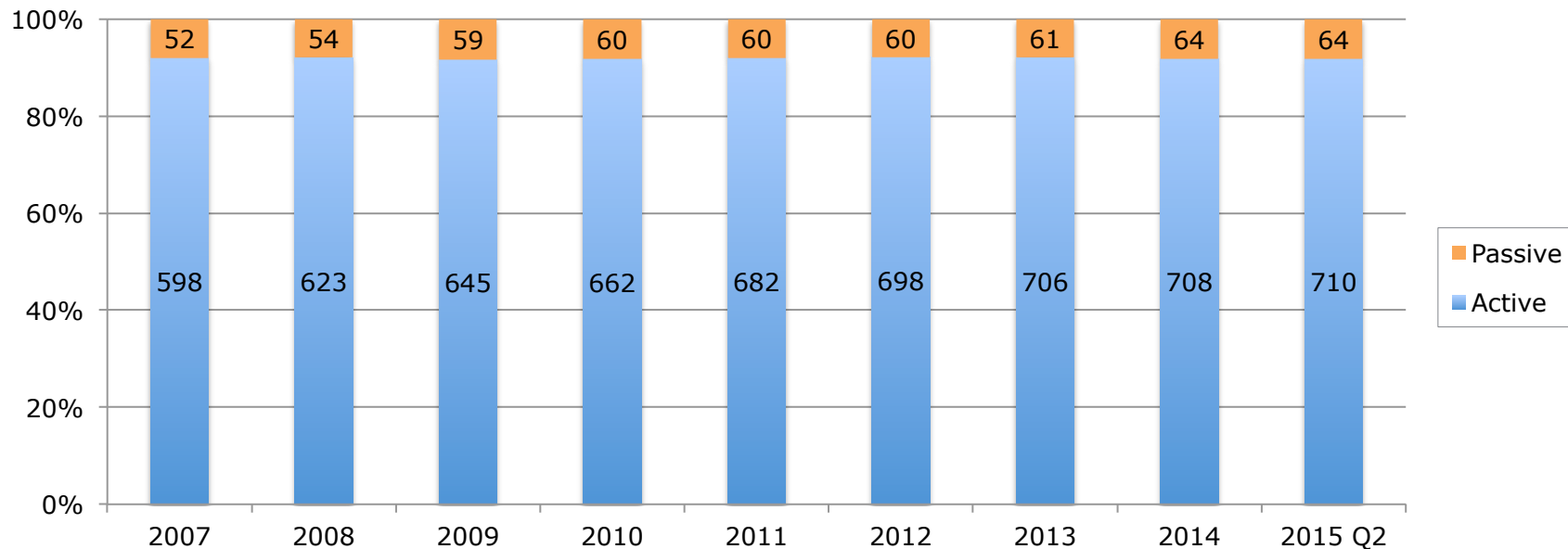
### US Equity Large Cap Blend Assets - Active vs. Passive



- In 2007 50% of mega fund assets in the category 'US Equity Large Cap Blend' were passively managed. As of Q2 2015, they are 68.0% of assets...this does not account for the rise of indexed ETF assets!
- Investors are not willing to pay substantially higher fees for pseudo-active strategies that fail to deliver relative results.
- The game of access vs. alpha is being re-written.

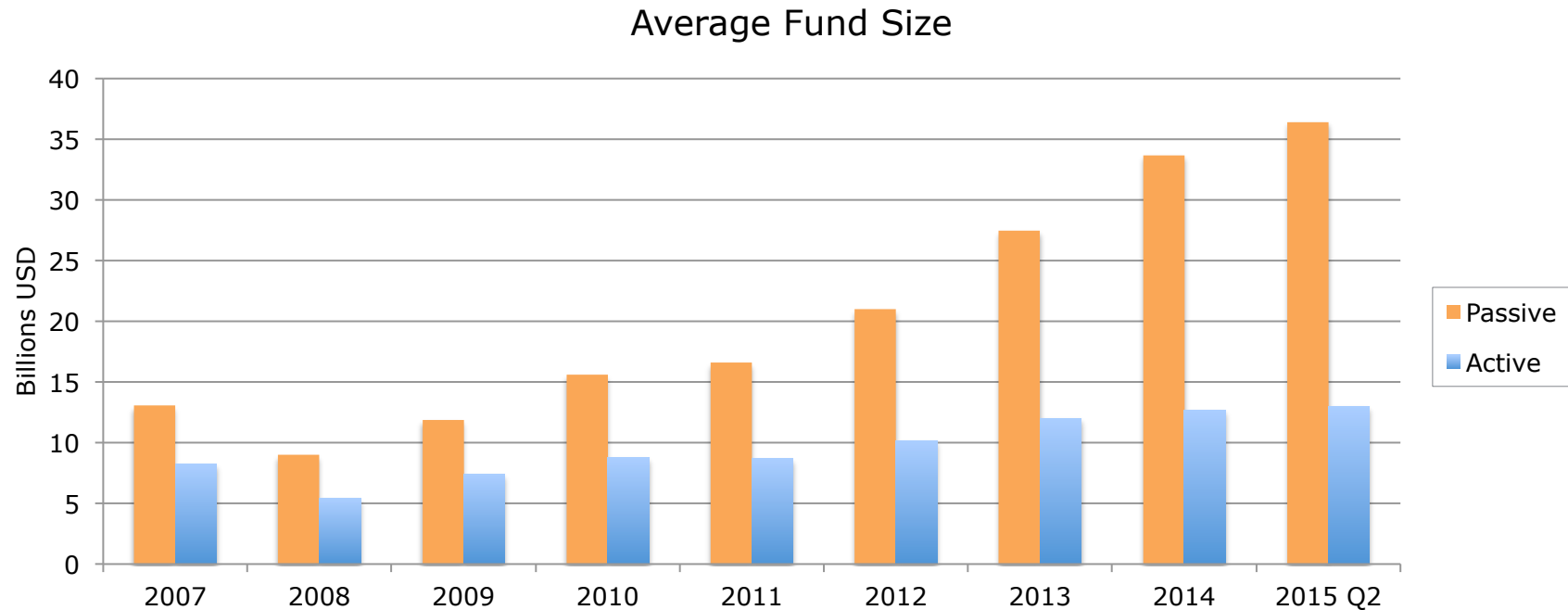
## Passive Funds are Gaining Ground

Number of Funds by Active/Passive



- **The number of passive funds has grown from 52 to 64 (1.2x) since the end of 2007; a much slower rate than the passively managed mega fund assets have grown (3.4x).**
- The number of actively managed funds has grown at a similar rate (1.2x) during the same time period (albeit from a far larger base of 598 funds).
- Even though passively managed funds are growing AuM faster than their actively managed counterparts, the divide in the number of funds is largely unchanged.

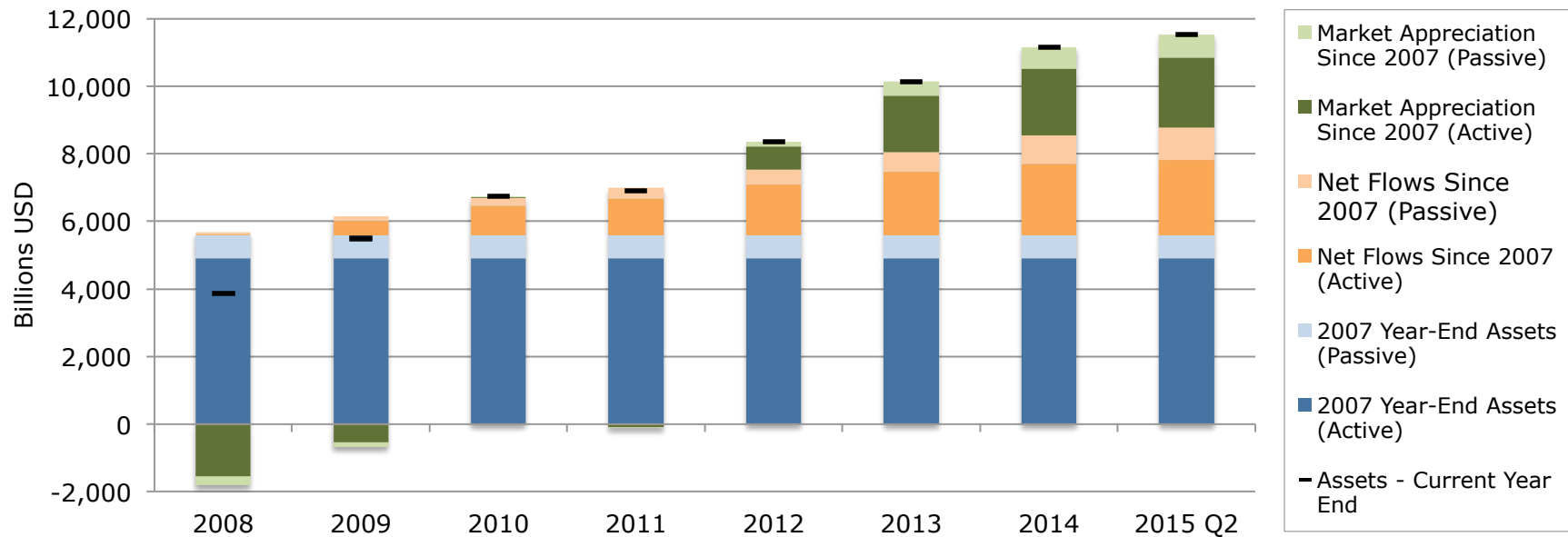
## Why are Passive Funds so much larger than Active Funds?



- As of Q2 2015, the average active fund had \$13.0 billion in assets while its passive counterpart had \$36.4 billion (2.8x). This difference has grown from 1.6x in 2007.
- The greatest economies of scale are found in passive strategies, while fees are slim, barriers to entry are huge.
- As the mega fund universe has been represented by more passively managed products, the level of hyper-concentration heightens.

## Active vs. Passive Routes to Growth

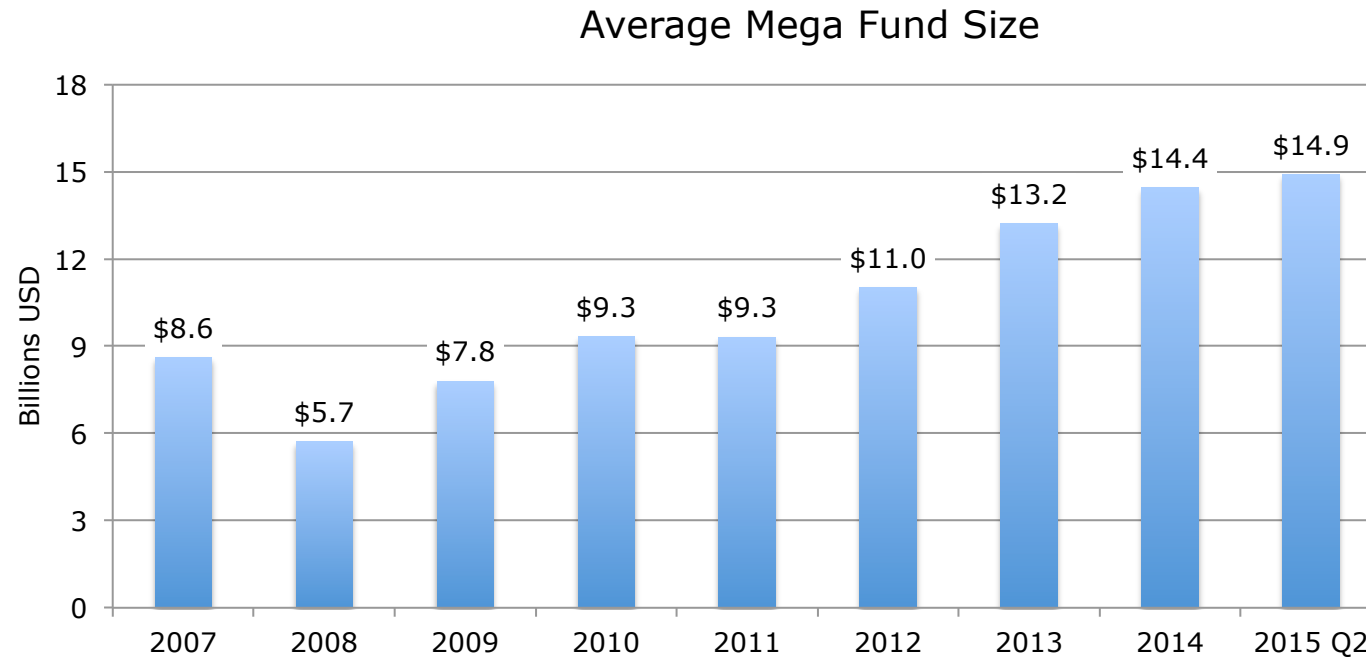
### Market Appreciation vs. Net Flows



- At the end of 2007, passively managed funds (represented in lighter colors) accounted for 12.1% (\$677.8 billion) of the total mega fund universe and grew to 19.3% (Q2 2015).
- From 2007 to Q2 2015, passively managed funds accounted for 27.8% (\$1,652.6 billion) of the total growth in the mega fund universe's AuM.
- Passively managed assets grew from \$677.8 to \$2,330.4 billion (3.4x) from the end of 2007 to Q2 2015. Actively managed assets grew from \$4,912.4 to \$9,203.5 billion (1.9x) during the same period.



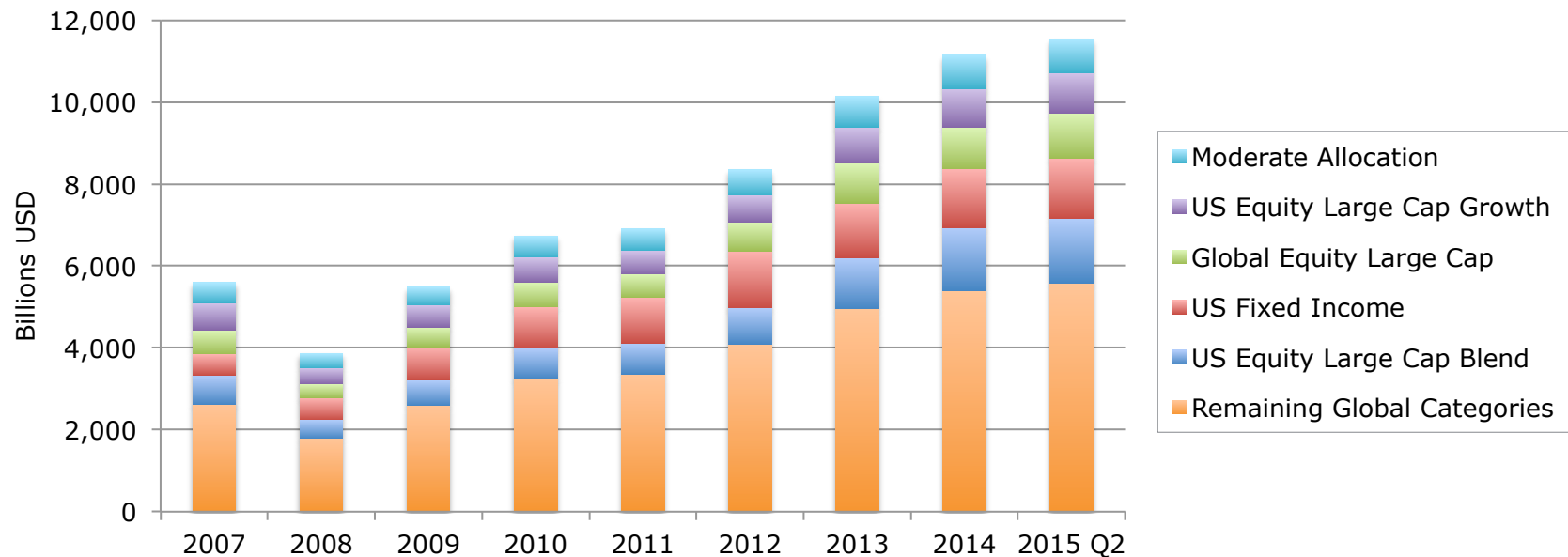
## Hyper-concentration?



- The big get bigger.
- From the end of 2011 to Q2 2015, 32 additional funds reached 'mega' status while the average assets within those funds grew from \$9.3 to \$14.9 billion (1.6x).
- What are the implications of hyper-concentration?

## Where are the Assets Concentrated?

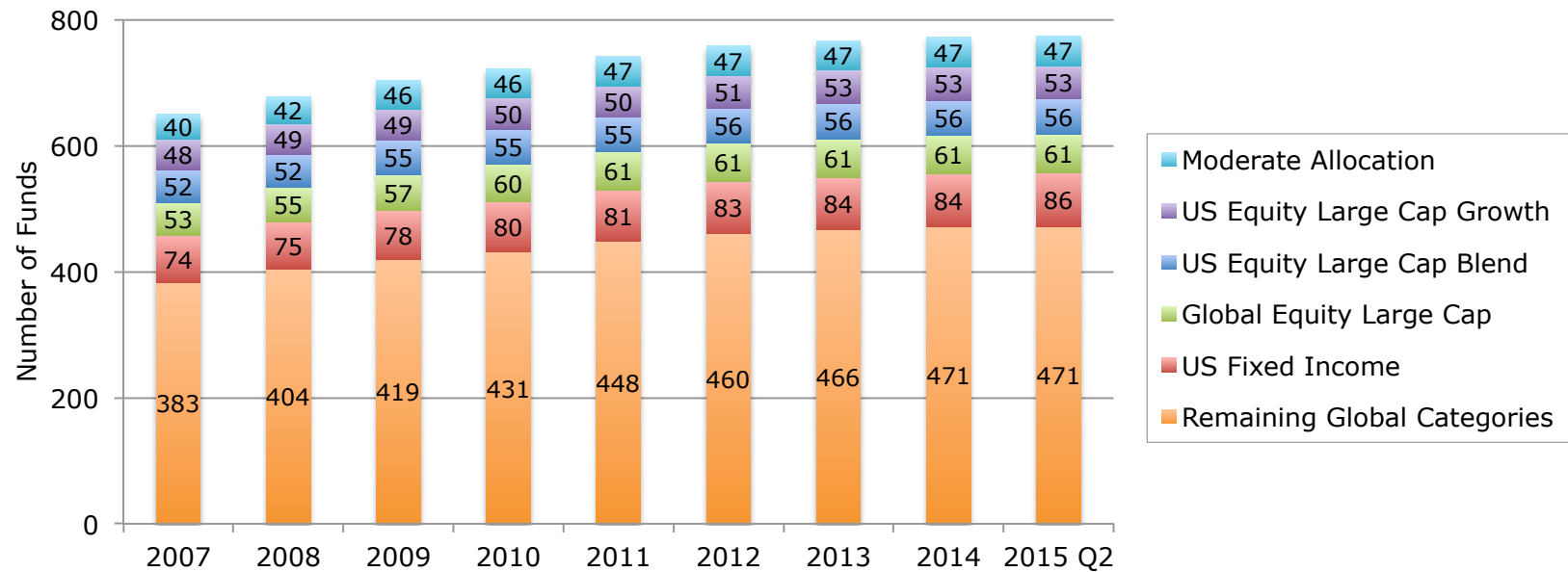
### End of Period Mega Fund Assets by Top Five Global Categories



- The top five global categories made up 53.1% of all mega fund assets in 2007 and 51.7% as of Q2 2015. This statistic has remained between 51.0% and 53.6% for the past 8 years.
- 'US Equity Large Cap Blend' (Q2 2015 assets of \$1,578.5 billion) was the largest global category in 2007, 2014, & 2015 (through Q2). 'US Fixed Income' held the top spot from 2008-2013 during the credit crisis and subsequent recovery.
- 'US Fixed Income' was the fourth largest global category in 2007 and was the only one of the top five global categories to increase during 2008 (\$516.2 billion at the end of 2007 up to \$539.1 billion by the end of 2008).

## Where are the Assets Concentrated?

Number of Funds by Global Category



- The top five global categories (by assets) have all added funds at a slower pace than the average for the mega funds universe.
- 'Moderate Allocation' grew the fastest among the top five in terms of the number of funds – seven new funds joined the ranks during the past eight years (1.2x)
- 'US Fixed Income' added the most funds, in absolute terms, of the top five global categories: 12 new mega funds since the end of 2007.

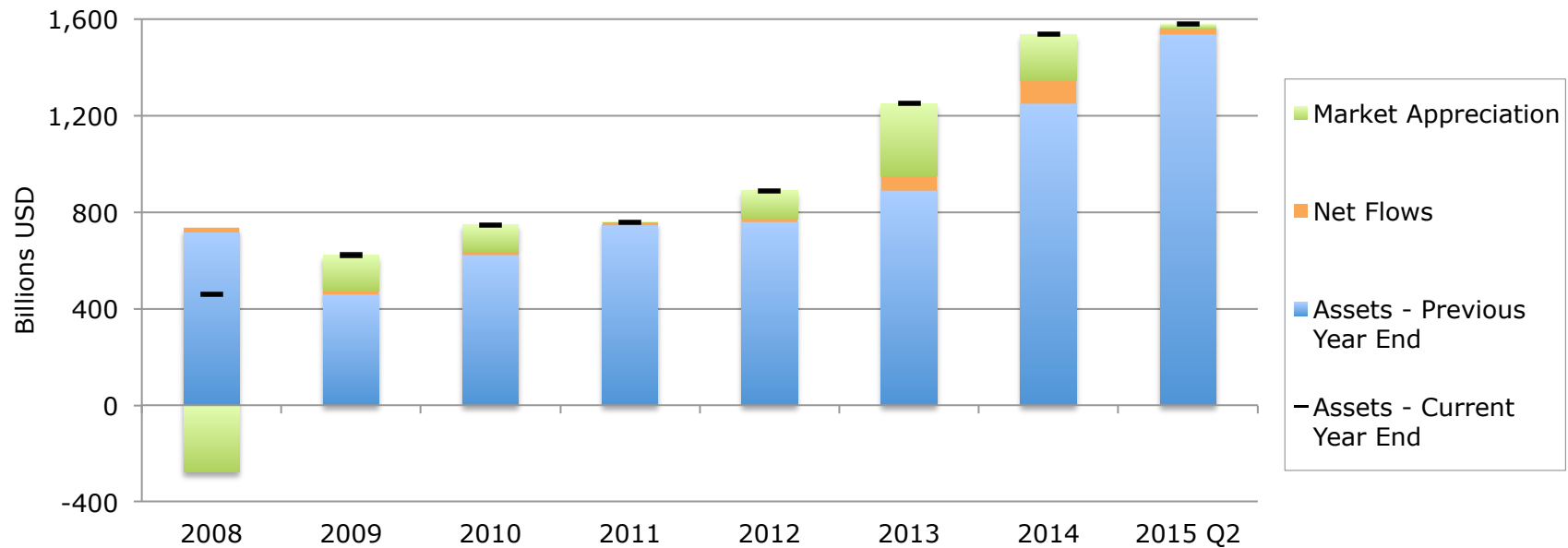
## Passive Dominance in US Large Cap

Global Category: US Equity Large Cap Blend Top 10 Funds by Size (Assets in Billions USD)												
Fund	Fund Size Rank 2015 Q2	Inception Date	Morningstar Category	2007	2008	2009	2010	2011	2012	2013	2014	2015 Q2
Passive Fund 1	1	4/27/92	US OE Large Blend	101.7	78.2	115.3	145.3	161.2	202.3	296.5	383.0	402.9
Passive Fund 2	2	8/31/76	US OE Large Blend	100.4	61.8	76.7	83.6	80.3	91.2	125.2	198.7	209.3
Passive Fund 3	3	7/31/90	US OE Large Blend	71.6	49.2	69.2	88.3	93.5	117.3	162.8	187.7	195.3
Passive Fund 4	14	2/17/88	US OE Large Blend	29.2	18.3	23.0	40.9	41.1	49.0	69.5	85.1	89.5
Active Fund A	19	1/2/34	US OE Large Blend	89.3	53.1	61.6	62.1	54.8	57.2	69.9	75.5	75.3
Active Fund B	20	8/1/78	US OE Large Blend	50.4	34.0	45.1	49.8	46.9	52.0	67.7	71.7	73.0
Passive Fund 5	48	5/31/01	US OE Large Blend	9.9	7.7	12.2	15.2	19.0	23.7	36.5	41.5	42.6
Passive Fund 6	68	11/5/97	US OE Large Blend	8.5	6.6	9.1	11.1	10.9	14.4	22.6	28.0	30.0
Passive Fund 7	90	3/30/90	US OE Large Blend	10.2	7.5	11.3	13.2	13.4	15.6	20.3	24.4	25.3
Active Fund C	95	5/15/92	US OE Large Blend	1.4	1.8	2.8	4.7	7.7	11.8	19.7	23.4	24.4
Fund Size - Top Five Funds				392.3	260.5	345.7	420.2	430.8	517.1	723.8	930.0	972.3
Fund Size - All 56 Funds				714.5	458.8	620.6	746.1	758.9	890.2	1,248.5	1,535.8	1,578.5

- 'US Equity Large Cap Blend' makes up 13.7% (\$1.6 trillion) of the mega fund universe and is its largest Global Category. The top five funds within this category (Passive 1-4, & Active A) make up 61.6% of the category AuM).
- Thus the top five funds make up 8.4% of the total mega fund universe by assets, even though these five funds account for only 0.6% of the mega funds universe in terms of number of funds.
- When looking at the worldwide mutual fund universe as a whole, these top five funds make up 4.3% of the total assets, but only 0.006% by the number of funds.

## Still Growing

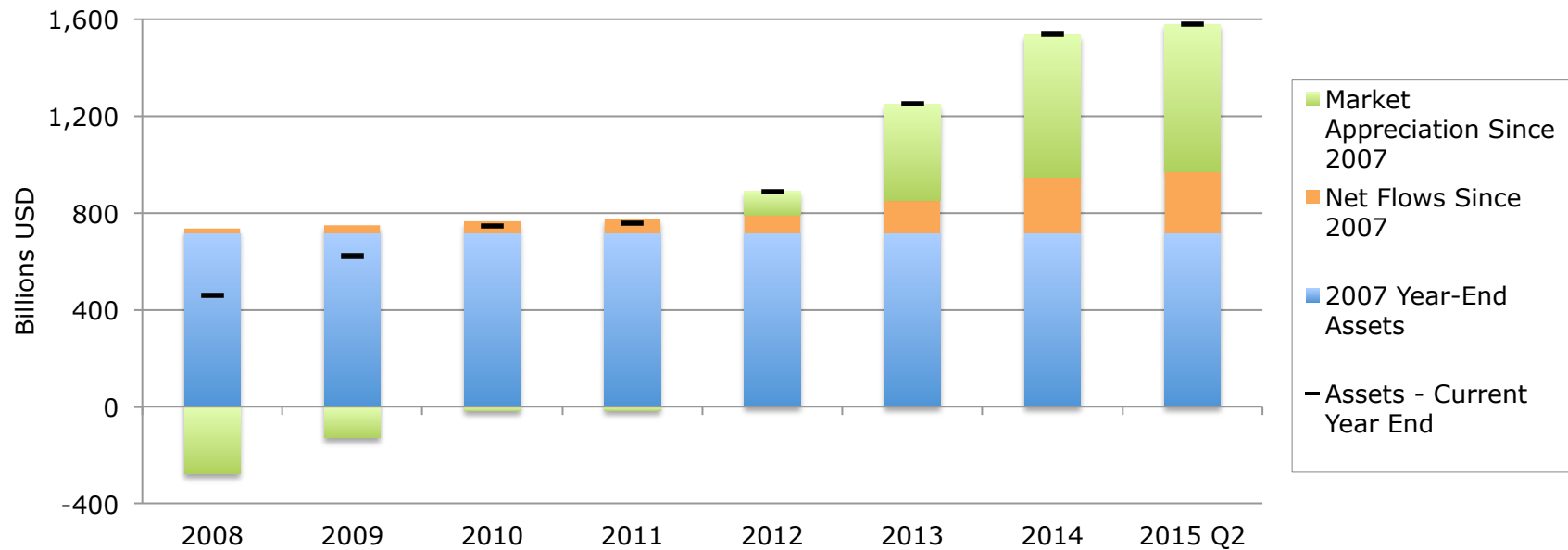
### Yearly Growth in Category US Equity Large Cap Blend



- Since the end of 2007, the 'US Equity Large Cap Blend' category grew from \$714.5 to \$1,578.5 billion (2.2x). This is slightly above the average multiplier for all mega funds (2.1x).
- As was the case for the whole mega fund universe, flows remained positive for the entire period – including 2008 in which passively managed funds continued to see inflows.

## What has Driven Cumulative Growth?

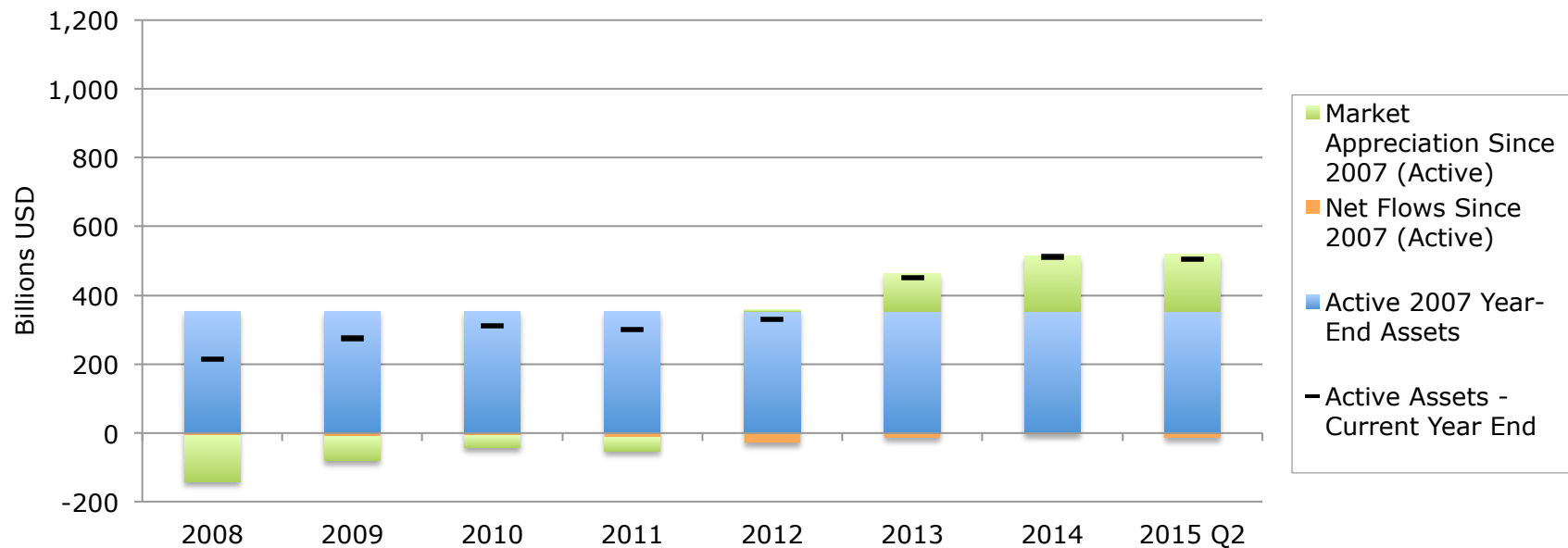
Cumulative Growth since 2007 within US Equity Large Cap Blend



- In this chart, the blue column shows 2007 year-end assets. Cumulative growth since the end of 2007 for market appreciation and net flows are shown in green and orange respectively.
- Even though net flows remained positive throughout the observed period, they had a lower relative impact on AuM growth than other categories. The main source of growth came from market movements – wholly outside of managers' control (with the exception of the contribution from alpha).

## A Different Story for Active Funds...

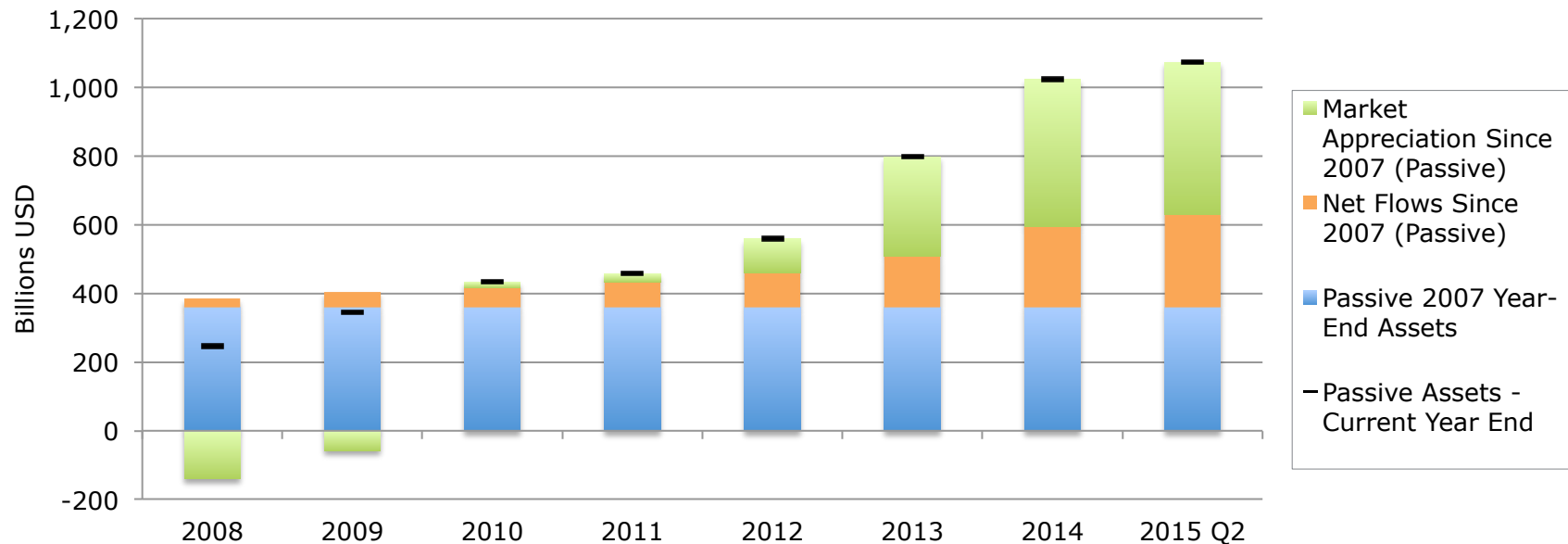
Cumulative Growth since 2007 within US Equity Large Cap Blend



- Flows for actively managed funds within 'US Equity Large Cap Blend' have been negative. Since the end of 2007, there have been cumulative net outflows of \$14.1 billion.
- Market appreciation has saved this group of actively managed funds by providing \$165.5 billion in assets since the end of 2007.
- Actively managed funds within 'US Equity Large Cap Blend' did not recover to their 2007 AuM until 2013.

## What is Driving Passive Cumulative Growth?

Cumulative Passive Growth since 2007 within US Equity Large Cap Blend

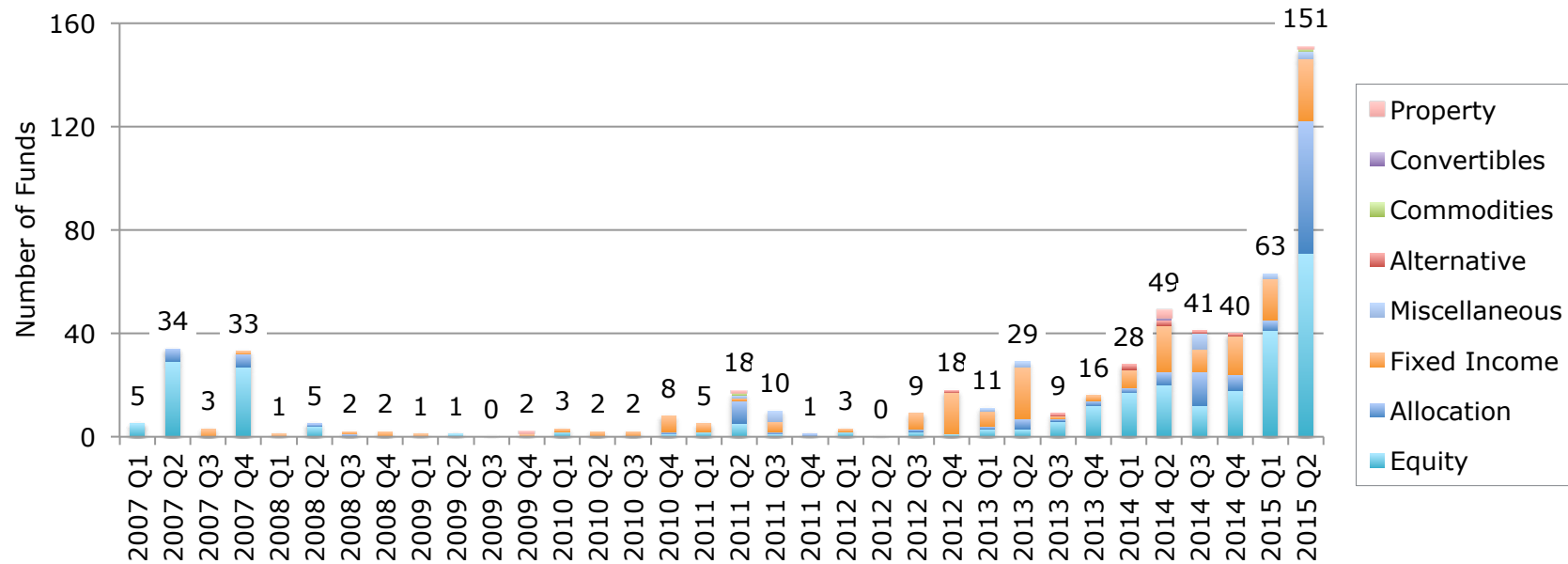


- All of the net positive flows for funds in the 'US Equity Large Cap Blend' category have come from passively managed funds. There have been \$270.0 billion in flows since the end of 2007 (as opposed to the negative \$14.1 billion for actively managed funds).
- The passive assets have grown from \$360.4 to \$1,073.0 billion (3.0x) since the end of 2007. This multiplier better than doubles the 1.4x figure for active assets.



## Peak or just Recent Highs?

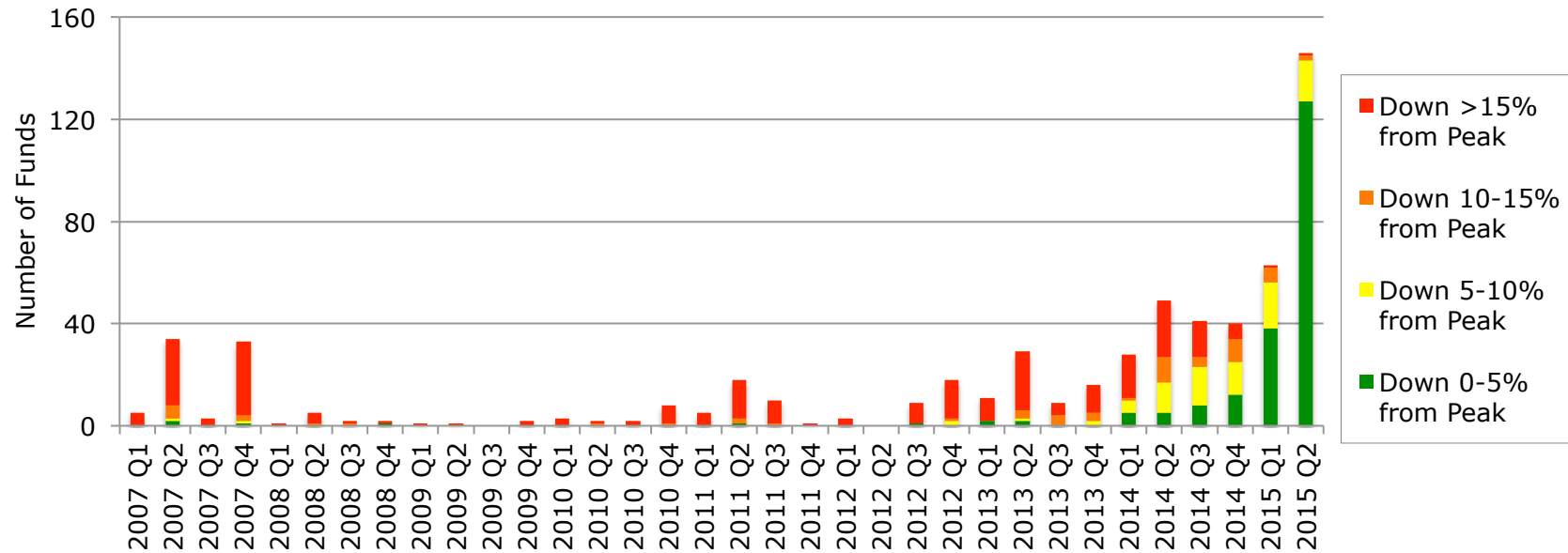
### Highs by Global Broad Category Group



- Each of the 774 mega funds has either 'peaked' or reached recent highs (in some cases, they are the same) during the period of analysis. For example PIMCO's Total Return Fund hit its peak in April of 2013 at \$292 billion. This fund accounts for 1 of the 29 funds that peaked in 2013 Q2.
- 151 mega funds reached their highs during Q2 2015, whether these are peaks or just most recent highs is yet to be seen. 169 funds are currently at their all time highs.
- The fall of mega funds often provides huge opportunities for competitively positioned strategies to capture dislodged assets.

## Which Mega Funds Already Peaked?

Levels of AuM Decline since Highs



- Using preliminary data for July 2015, 127 of the 151 funds that are below AuM highs reached in Q2 2015 are down between 0-5%.
- As of July 31, 2015 one fund is down more than 15% from it's Q2 2015 peak. Another two funds are down between 10-15%.
- The probability that a fund will recover declines drastically as time progresses. 23 of the 29 funds that peaked in Q2 2013 are still more than 15% below their peak asset levels.

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## About

*Propinquity provides strategic research and advice to investment management companies seeking to measure, optimize and thoughtfully grow their businesses. In support of our clients' objectives, Propinquity conducts original research into the evolving themes driving the direction of the investment management industry. Propinquity assists its clients in understanding the drivers of these themes and positioning their capabilities and products in the global distribution markets.*

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## Notes

### ***Definitions***

- Worldwide Mutual Fund Universe – a collection of funds whose (1) investment type, as defined by Morningstar, is open-ended and (2) the global broad category group is not Money Market or 'Unclassified'.
- Mega Fund Universe – a subset of funds from the worldwide mutual fund universe whose assets totaled \$5 billion or more on June 30, 2015.
- 'Fixed Income' – For purposes of this report and related analytics, we have combined the Morningstar global categories 'Fixed Income' and 'Tax Preferred' into a single category – 'Fixed Income'.

### **Data**

All data was pulled between August 10, 2015 and August 19, 2015 from Morningstar Direct. The 'peak' AuM analysis uses fund size ending July 31, 2015 to determine proper peak months. All other data uses June 30, 2015 as an end date.