

Recent Changes in the Korean Publicly Offered Fund Market and its Implications

Kim, Jongmin*

Since the global financial crisis, the growth of publicly offered funds has stalled compared to privately placed funds and discretionary investments (PF &DI), and a large number of retail investors are moving away from the publicly offered equity fund market. Although some of the capital outflows moved to other types of publicly offered or privately placed funds, most of them seem to have fled the fund market. In addition, there has been a persistent pattern in the post-crisis era where capital inflows occur during the stock market downturn, and outflows during the upturn. This implies that the central pillar of the asset management market is shifting towards PF&DI. More importantly, publicly offered funds are losing its key demand base as retail investors increasingly avoid publicly offered funds. Hence, both the financial authorities and the industries should make efforts to pursue a balanced development between publicly offered funds and PF&DI.

As of the end of April 2017, Korea's asset management market for publicly offered funds, privately placed funds, and discretionary investment services grew 1.86-fold to KRW 1,006 trillion from KRW 541 trillion in 2011. This corresponds to a CAGR of 12.3% since 2012. A breakdown reveals that publicly offered funds expanded at a CAGR of 6.5%, while that of privately placed funds and discretionary investments stood at 17.7% and 13.2%, respectively.¹⁾ This made the

* All opinions expressed in this paper represent the author's personal views and thus should not be interpreted as Korea Capital Market Institute's official position.

* Ph.D., Research Fellow, Fund & Pension Department, Tel: 82-2-3771-0822, E-mail: jongminkim@kcmi.re.kr

1) In terms of fund size, publicly offered funds grew by 1.4-fold from KRW 169 trillion to KRW 236 trillion (NAV), privately placed funds by 2.4-fold from KRW 111 trillion to KRW 265 trillion (NAV), and discretionary investments by 1.9-fold from KRW 265 trillion to KRW 505 trillion (AUM).

market size of privately placed funds exceed that of publicly offered funds. This suggests that PF&DI rose as a new growth driver in Korea’s asset management market in the post-crisis era. In that vein, this article explores the changes in Korea’s publicly offered fund market whose growth has stalled compared to PF&DI, with the focus placed on asset composition and fund flows. Then, the implications are to be discussed.

Changes in fund asset composition

Table 1 demonstrates the changes in asset composition of Korea’s privately placed and publicly offered funds from the end of 2011 to the end of April 2017. First, privately placed funds increased in all asset types, except for hybrid funds. Among privately placed funds, funds investing in real assets (real estate, special assets, etc.) and other assets (MMFs, hybrid assets, etc.) showed remarkable growth during the period. Indeed, the CAGR of those funds (44.9% for MMFs, 24.6% for real estate, 23.6% for special assets, and 20.6% for others) overwhelmed that of bonds (16.8%) and equity (9.4%). Accordingly, the share of equity and bond funds in privately placed funds decreased, while a dramatic jump was seen in that of MMFs, funds investing in real assets such as real estate and special assets, and hedge funds.

Table 1. Changing fund asset composition

Type	Privately Placed Funds				Publicly Offered Funds			
	December 2011		April 2017		December 2011		April 2017	
	NAV (KRW tn)	%	NAV (KRW tn)	%	NAV (KRW tn)	%	NAV (KRW tn)	%
Equity	7.9	7.1%	12.7	4.7%	79.6	47.1%	53.7	22.8%
Hybrid	17.0	15.3%	12.0	4.5%	11.7	6.9%	20.4	8.7%
Bonds	35.7	32.2%	81.5	30.5%	9.6	5.7%	23.0	9.8%
MMF	2.5	2.2%	17.9	6.7%	51.4	30.4%	111.6	47.4%
Real Estate	15.6	14.1%	50.3	18.8%	0.9	0.5%	1.6	0.7%
Special Assets	15.5	14.0%	47.9	17.9%	2.6	1.5%	4.5	1.9%
Others	16.7	15.1%	45.2	16.9%	13.4	7.9%	20.6	8.8%
Total	110.7	100.0%	267.4	100.0%	169.2	100.0%	235.6	100.0%

Note: “Others” include funds of funds, derivatives, hedge funds, PEFs, etc.

Source: KOFIA



In case of publicly offered funds, bond funds and other types such as MMFs, real estate, and special assets showed remarkable growth as did in privately placed funds. For example, bond funds grew at a CAGR of 17.7%, and MMFs at 15.6%, real estate funds at 12.8%, and special asset funds at 11.2%. However, equity funds reduced in size from KRW 79.6 trillion to KRW 53.7 trillion, with its share in publicly offered funds total abruptly shrinking from 47.1% to 22.8%. This translates to the average annual rate of decrease in the publicly offered equity funds market standing at 7.1% since 2012.²⁾ In aggregate, funds investing in safe assets and real assets grew fast in both publicly offered and privately placed funds, whereas publicly offered equity funds have shrunk abruptly in the post crisis era.

Changes in publicly offered fund flows

Table 2 maps out changes in sales of publicly offered and privately placed funds to retail investors as of the end of March 2017. Sales of privately placed funds to retail investors shot up by KRW 7.9 trillion from KRW 8.4 trillion to KRW 16.3 trillion. On the other hand, sales of publicly offered funds to retail investors slipped by KRW 24.9 trillion or 21.5% from KRW 115.6 trillion to KRW 90.7 trillion. Especially, publicly offered equity and domestic equity fund sales to retail investors decreased by KRW 42.1 trillion and KRW 25.9 trillion, representing most of the total reductions of KRW 44.4 trillion and KRW 27.8 trillion, respectively. This means most investments that fled publicly offered equity or domestic equity funds belonged to retail investors. Although some of the investments moved to other publicly offered or privately placed funds, most of them, as the data imply, appeared to have fled the fund market.

2) Korea's domestic-equity type ETFs continued its growth from KRW 8.6 trillion to KRW 16.9 trillion during the same period, contrary to the decline of the publicly offered equity funds.

Table 2. Changes in fund sales to retail investors

(Unit: KRW trillion, %)

Timing	Investor Type	Publicly Offered Funds			Privately Placed Funds	Total
		Total	Equity	Domestic Equity		
End of 2011	Retail (A)	115.6	77.8	50.5	8.4	123.9
	Total (B)	175.2	88.3	57.8	108.1	283.3
	A/B	66.0%	88.1%	87.3%	7.7%	43.7%
March 2017	Retail (A)	90.7	35.7	24.6	16.3	107.0
	Total (B)	198.8	43.9	30.0	256.4	455.2
	A/B	45.6%	81.1%	82.1%	6.3%	23.5%
Changes in Total Sales		23.6	-44.4	-27.8	148.3	171.9
Changes in Sales to Retail Investors		-24.9	-42.1	-25.9	7.9	-17.0

Source: KOFIA

The following data depict how investments in publicly offered funds left the market, with the focus on publicly offered domestic equity funds.³⁾ Figure 1 tracks down net inflows to publicly offered domestic equity funds excluding ETFs from May 2006 and April 2017, and KOSPI trends during the same period. According to the data, the market for publicly offered domestic equity funds saw a net inflow of KRW 29.3 trillion between May 2006 and September 2008. After that, however, the market’s net outflow until April 2017 reached KRW 51.6 trillion as the stock market recovered substantially from the severe declines caused by the collapse of Lehman Brothers. The market’s net outflow amounts to KRW 22.3 trillion if compared to the May 2006 level, and KRW 28.5 trillion if the analysis is limited to the post-2012 period as shown in Table 2.

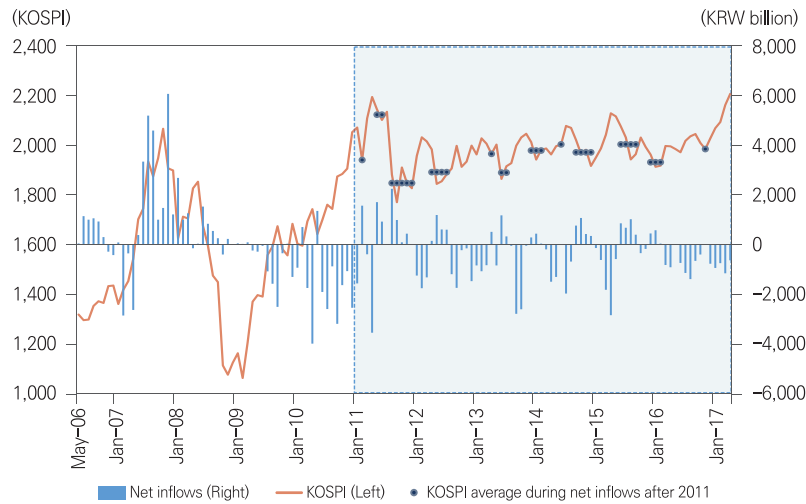
Furthermore, the dotted line in Figure 1 shows a repeated pattern of temporary inflows at the bottom of the bear market and outflows during the rallies as the KOSPI has been trapped in a tight range since 2011. More concretely, Figure 2 confirms a clear negative correlation, where the correlation coefficient between monthly inflows to publicly offered domestic equity funds and monthly KOSPI returns after May 2011 stood at -0.68.⁴⁾ Simply put, there is a persistent pattern of capital inflows during the downturn, and outflows during the upturn.

3) The pattern of fund flows remains similar even if the data are widened to include all publicly offered equity funds.

4) The result is similar in publicly offered equity funds whose correlation coefficient stands at -0.63.



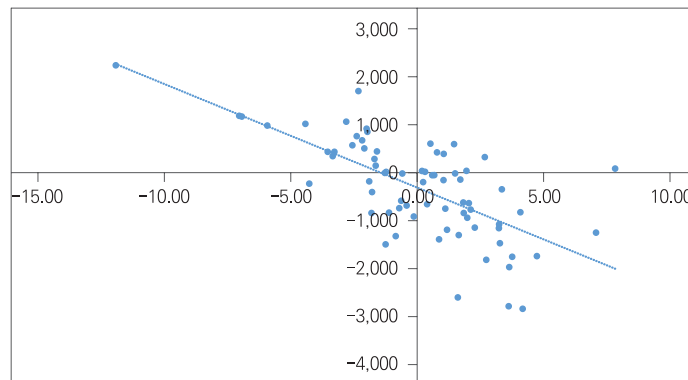
Figure 1. Net inflows to publicly offered domestic equity funds (excluding ETFs)



Note: Dots indicate the average level of KOSPI during net inflow periods.

Source: KOFIA

Figure 2. KOSPI returns and net inflows to publicly offered domestic equity funds



Note: 1) The horizontal axis indicates monthly KOSPI returns, whereas the vertical axis refers to monthly net fund inflows (in KRW billion).

2) The chart is based on monthly data between May 2011 and April 2017, and the dotted line indicates the trend.

Source: KOFIA

Implications

The aforementioned data analyzed the changes in Korea’s publicly offered fund market in the post-crisis era with the focus on fund asset composition and fund flows. Major results are summed up as the followings. First, the growth of publicly offered funds has slowed as compared to privately placed funds, and a large number of retail investors are moving away

from the publicly offered equity fund market. Second, although some of the outflows went to different types of publicly offered or privately placed funds, most of those appear to have fled the fund market. Third, there has been a persistent pattern in the post-crisis era where inflows occur during the stock market downturn, and outflows during the upturn.

Such changes in asset composition and fund flows in the publicly offered funds market points to two directions. First, the central pillar of the asset management market is shifting toward PF&DI. Second, publicly offered funds are losing their key demand base as retail investors are turning their back on those funds. Such directions imply an undermining of confidence in fund investments, and are undesirable given publicly offered funds' intended role as an efficient wealth management tool. Moreover, as the privately placed market grows further, this in the long run could predispose asset management companies' incentive scheme to be biased toward PF&DI, which will in turn lower returns of publicly offered funds and accelerate the exodus of retail investors. Although those issues are not a cause for major concern at this stage, the weakening demand base for publicly offered funds in the post-crisis era is something that should not be overlooked.

Among others, Korean financial investment companies, including asset managers, must channel more efforts into regaining confidence among retail investors by bolstering their investment management capabilities and developing differentiated fund products. Rather than chasing fads and focusing on a narrow range of products, it is wise to strengthen their ETF and publicly offered fund lineups that would customize portfolio management services to suit individual investors' needs. Demand for financial investment products has been on the constant rise amid Korea's low-growth and population ageing trends. Also on the rise is the online, low-cost, and customized wealth management platform that is easily accessible such as robo-advisors in today's ICT advancement. The government authorities should seek to identify concrete policy goals related to such trends to achieve proper regulatory reform, and pursue a balance in further developing publicly offered funds, privately placed funds, and discretionary investments.