

European Investor Report:

Euro Fixed Income – Core/Aggregate

eVestment Traditional Research
March 2014



Introduction & Table of Contents

The investor summary report uses eVestment’s suite of intelligence to provide an overview of the characteristics of a particular universe which has dramatically increased in its importance to institutional investors domiciled in Europe. The report’s contents are broken down into five primary segments.

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Regional Investor Interest:

Europe-domiciled Institutional Investors

Institutional investors domiciled in Europe allocated more to Euro Fixed Income – Core/Aggregate (EFI-CA) strategies than any other universe in 2013. EFI-CA strategies actively invest across the government and credit markets in Europe and may use both the bond and derivative markets to pursue superior performance.

The EFI-CA universe was of great importance to European investors relative to its current size. The EFI-CA universe accounts for nearly 10% of the reported asset base of Europe-domiciled investors. However, of universes with net inflows from Euro investors in 2013, EFI-CA accounted for 16% of the inflow and 42% of the overall Europe-domiciled net flows in 2013.

The characteristics of asset gainers in EFI-CA, and allocations to US High Yield Fixed Income (the universe with the second highest level of inflows in 2013), illustrate Europe-domiciled investors’ desire for yield.

Figure 1: Institutional assets from European investors (blue, LHS) their overall net flows (green, RHS) and their net flows in/out of the Euro Fixed Income – Core/Aggregate Universe (red, RHS), USD millions

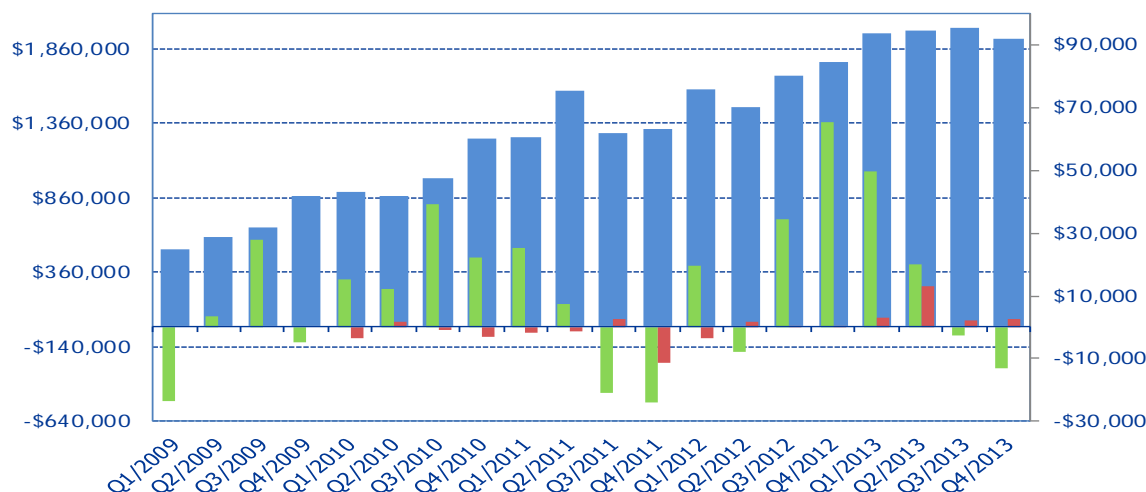
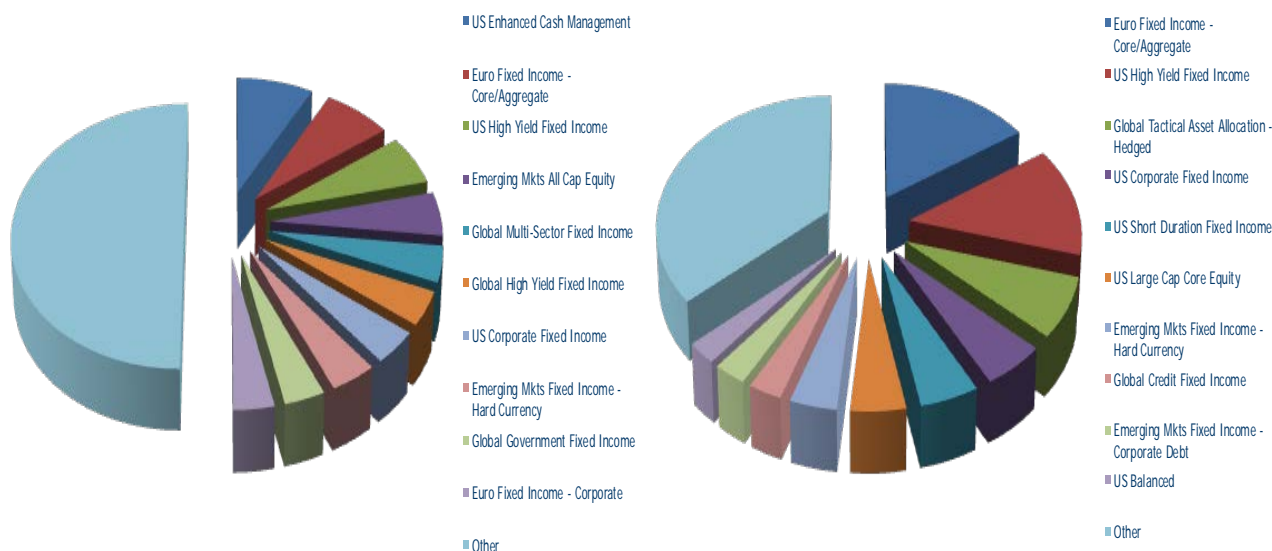


Figure 2: % of total European institutional assets across 10 most concentrated universes (left) as of Q4 2013 and top 10 universes in terms of net inflows from European investors during 2013.



Universe Regional Characteristics: EFI-CA Investor Domicile Trends

Firms reporting to eVestment operating Euro Fixed Income - Core/Aggregate products are predominantly located in the United States, followed by the United Kingdom and Germany. Despite the U.S. & U.K.'s dominance of product offerings, the universe's primary investor base are continental Europe-domiciled institutional investors.

The universe's investor base by domicile has not changed significantly over time. Investors located in continental Europe have traditionally been the largest allocators to the universe with investors in the U.K. and "Other" regions making up the vast majority of the remainder.

It is interesting to note the fluctuation of percentage of total AUM from U.S.-domiciled investors beginning in Q2 2011. The general concentration of U.S. investors varied for several quarters before dying off in Q1 2012, having yet to return to 2011 levels. This may simply be due to more European assets coming in, rather U.S.-based dollars leaving, however the timing of these shifts coincides with the flare of a sovereign debt crisis afflicting several Eurozone countries, meaning the fluctuation could indicate the possibility of short-term, event-driven interest from outside investors.

Figure 3: Breakdown of location of firm operations, (left) and universe assets by investor domicile (right)

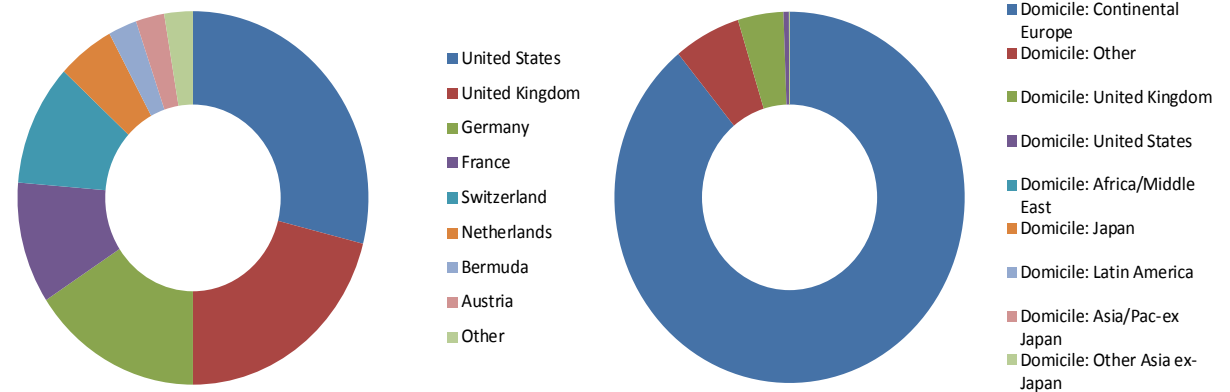
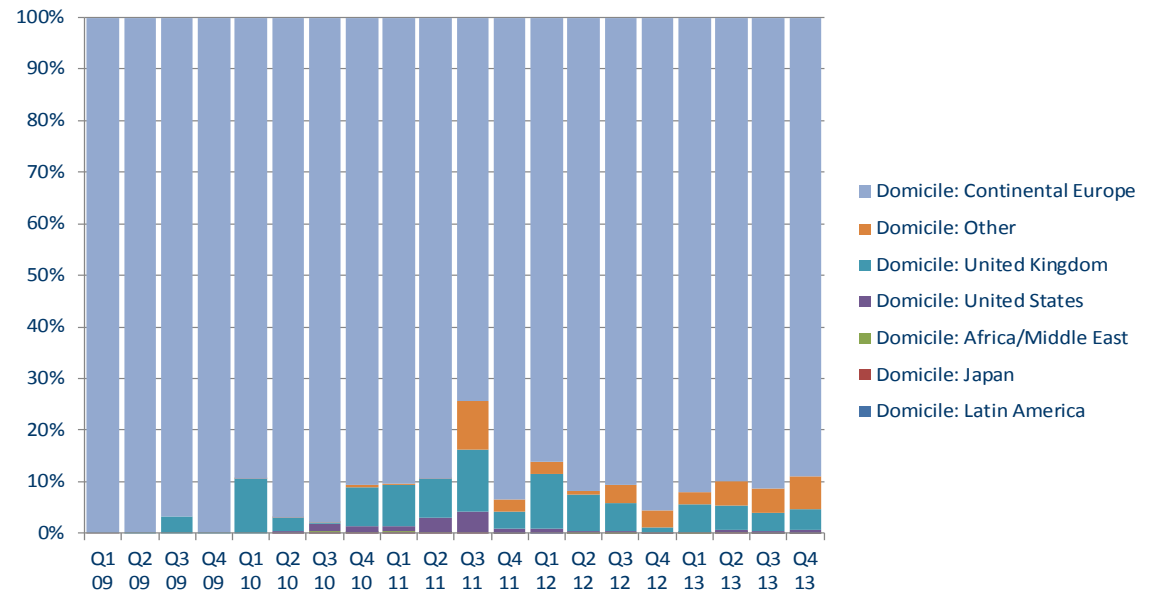


Figure 4: Reported universe total AUM by investor domicile from Q1 2009 through Q4 2013



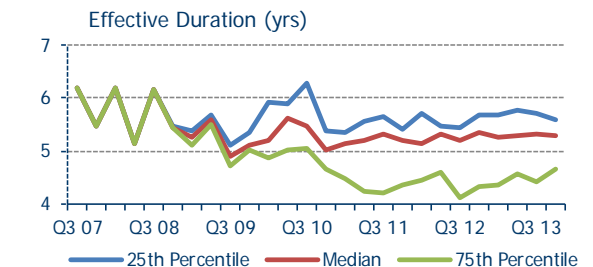
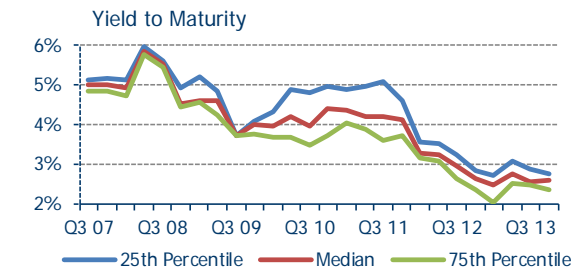
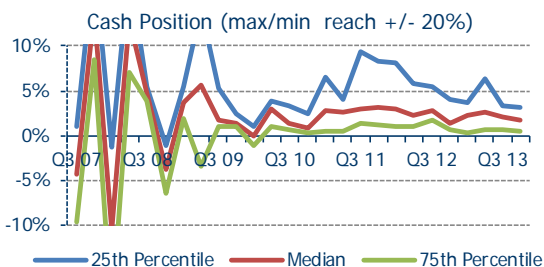
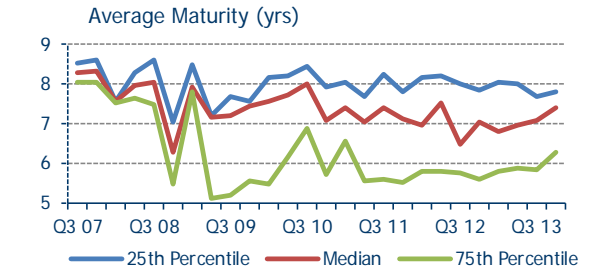
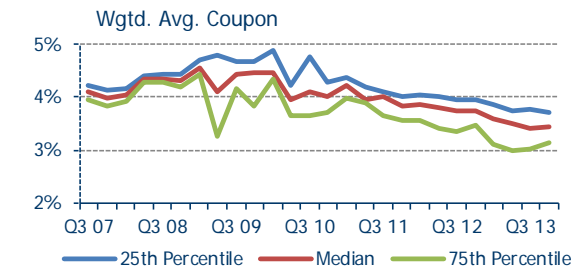
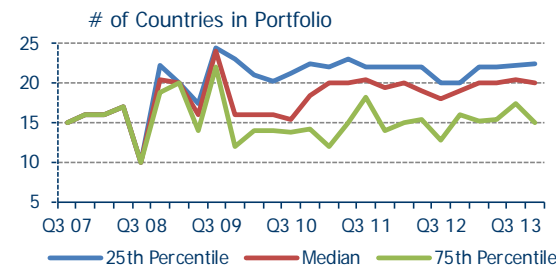
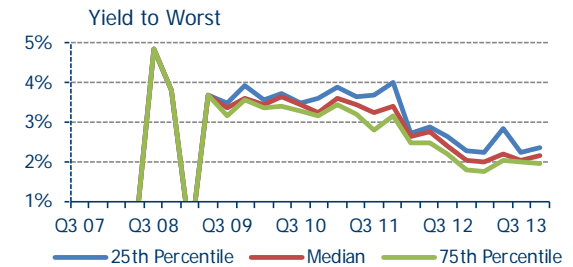
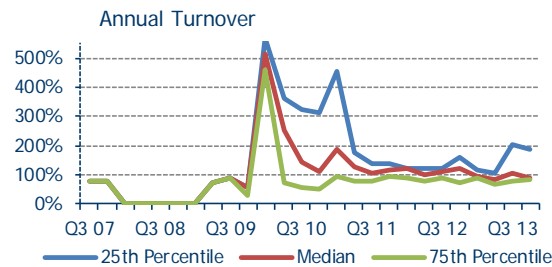
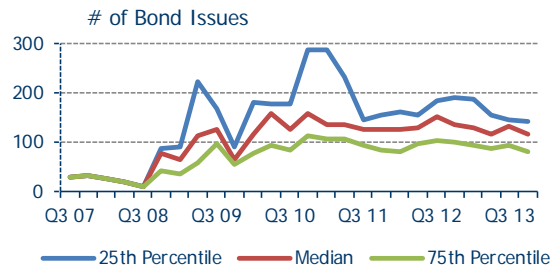
Universe Holdings Characteristics: Current & Historical Trends

Relative to other similar universes, the median cash positions and weighted average coupon (WAC) of EFI-CA strategies is low, while annual portfolio turnover and effective duration is relatively high. The historical change in holdings characteristics show declining yields and WAC's, but a recent uptick in average maturities.

Figure 6: For each holdings characteristic in Figure 5, these charts show the EFI-CA universe's historical path in median and percentile ranges

Figure 5: Median strategy characteristics (green) compared to related US and global universes (gray) and the universe accepting the second highest level of European institutional capital in 2013 (red).

	Euro Fixed Income - Core/ Aggregate	US Core Fixed Income	Global Aggregate Fixed Income	US High Yield Fixed Income
Current # of Bond Issues	116	195	205	225
# of Countries in Portfolio	20	2	28	11
Current Cash Position	1.65%	1.83%	2.51%	2.70%
Annual Turnover	86.96%	57.25%	85.00%	53.66%
Current Wgtd. Avg. Coupon	3.43%	3.68%	3.64%	7.08%
Yield to Maturity	2.10%	2.70%	2.34%	5.99%
Yield to Worst	2.14%	2.65%	2.31%	5.47%
Average Maturity (yrs)	6.90	6.93	7.25	6.03
Effective Duration (yrs)	5.30	5.15	5.08	3.95



Universe Holdings Characteristics: Credit Quality and Regional Exposure

Median universe exposures to comparable U.S. and global universes indicate EFI-CA managers have significantly more current exposure to medium grade segments of the quality spectrum.

Combining the median quality exposures of the two universes to which European investors allocated most heavily in 2013 shows the greatest concentration of those new assets went in the BBB to B rated segment with roughly equal exposures one step to either side (A & CCC), further evidence of European investors' desire for yield.

Given the breakdown of country and sector specific allocations, it appears the EFI-CA's high BBB quality exposure is due to Italian and Spanish sovereign bonds. Italy was downgraded by S&P to BBB in July 2013 with an outlook that remains negative. S&P affirmed Spain's long-term BBB- rating, but raised its outlook from negative to stable in November 2013.

Figure 7: EFI-CA median portfolio allocations by fixed income quality (green) compared to related US and global universes (gray) and the universe accepting the second highest level of European institutional capital in 2013 (red)

	Euro Fixed Income - Core/ Aggregate	US Core Fixed Income	Global Aggregate Fixed Income	US High Yield Fixed Income
AAA	19.48%	22.53%	19.57%	0.00%
AA	13.54%	6.52%	17.44%	0.00%
A	12.86%	15.96%	14.91%	0.00%
BBB	37.95%	18.49%	23.23%	2.97%
BB	2.51%	0.60%	3.81%	32.07%
B	0.00%	0.05%	1.91%	43.56%
CCC	0.00%	0.00%	0.18%	14.31%
CC	0.00%	0.00%	0.00%	0.00%
C	0.00%	0.00%	0.00%	0.00%
Distressed Debt: Current	0.00%	0.00%	0.00%	0.00%
Not Rated: Current	1.03%	0.00%	0.36%	1.28%
Other: Current	0.07%	0.00%	0.00%	0.00%

Figure 8: Ranking of current regional, country specific and sector fixed income portfolio exposures by medians, with percentile bands

Region	25th			75th			Country	25th			75th		
	Percentile	Median	Percentile	Percentile	Median	Percentile		Percentile	Median	Percentile	Percentile	Median	Percentile
Continental Europe	89.3%	85.3%	73.9%	Italy	19.0%	15.7%	13.6%						
United Kingdom	7.2%	5.9%	3.6%	Spain	21.9%	15.1%	10.6%						
North America	4.7%	2.9%	1.9%	France	19.3%	13.5%	9.6%						
Other Dev. Mkt. Regions	3.4%	2.5%	1.3%	Germany	12.3%	6.9%	3.1%						
Emerging Mkts.	5.5%	2.1%	1.1%	United Kingdom	7.2%	5.9%	3.6%						
Asia ex-Japan	1.4%	0.9%	0.5%	Netherlands	9.4%	5.0%	2.4%						
Japan	0.3%	0.1%	0.0%	Belgium	6.3%	4.8%	3.1%						
				Ireland	4.4%	2.9%	1.4%						
				Austria	3.3%	2.4%	1.3%						
				Finland	1.7%	1.2%	0.1%						
				Sweden	1.9%	1.0%	0.6%						
				Switzerland	1.3%	0.9%	0.5%						
				Norway	1.5%	0.9%	0.4%						
				Portugal	3.2%	0.8%	0.1%						
				Denmark	0.8%	0.4%	0.3%						
				Luxembourg	3.1%	0.4%	0.2%						
				Greece	0.0%	0.0%	0.0%						
				United States	3.8%	3.0%	2.0%						
				Other Dev. Mkts.	3.4%	2.2%	1.1%						
				Emerging Markets	5.5%	2.1%	1.1%						

Sector	25th			75th		
	Percentile	Median	Percentile	Percentile	Median	Percentile
Sovereigns: Non-US Dev. Mkt.	67.0%	59.3%	48.4%			
Inv. Grade Corps.: Non-US Dev. Mkt.	33.0%	21.8%	18.6%			
Inv. Grade Corps.: US	6.2%	4.0%	2.4%			
Other: US	20.0%	3.7%	0.5%			
Other: Non-US Dev. Mkt.	6.6%	3.5%	0.9%			
High Yield Corps.: Non-US Dev. Mkt.	7.4%	1.6%	0.0%			
Sovereigns: US	23.1%	0.5%	0.0%			
Inv. Grade Corps.: Emg. Mkt.	0.7%	0.4%	0.0%			
Sovereigns: Emg. Mkt.	2.1%	0.2%	0.0%			
Agencies/Regionals: Total	4.7%	0.0%	0.0%			
High Yield Corps.: US	0.4%	0.0%	0.0%			

Universe Holdings Characteristics: Trends in Credit Quality and Regional Exposures

Sovereign exposure dominates the EFI-CA universe at a level which appears in-line, to slightly above historical norms. There are however two interesting points to note on the evolution of quality and country exposure.

- 1) While median exposure to sovereigns have not materially changed, there has been a shift over time away from AAA, likely in the form of German sovereigns after the financial crisis, to Spain and Italy which combined account for 31% of median portfolio exposure. The sharp shift in quality exposure from A to BBB coincides with the rash of downgrades to Eurozone entities in mid-2012.
- 2) The shift in credit quality has not solely been from German debt to Spain and Italy, but notably away from larger, core Eurozone countries and towards AA-rated Belgium and Austria and BBB-rated Ireland. Median exposure to Ireland is returning to historical norms after declining significantly in mid-2011.

Figure 9: Change in EFI-CA universe median exposures by credit quality (left) and sector (right), from Q3 2007 through Q4 2013

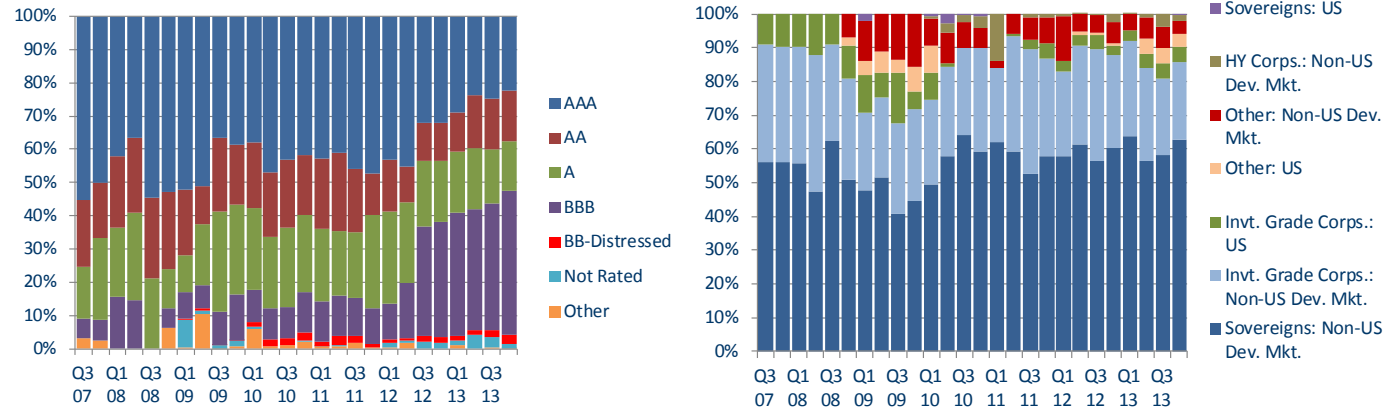
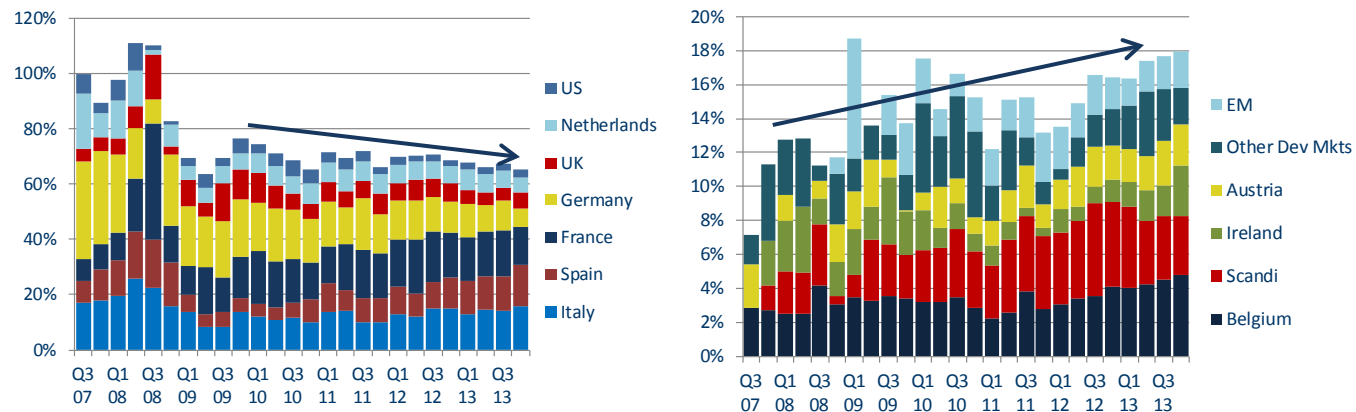


Figure 10: Change in EFI-CA universe median exposures by country major concentrations (left) and lesser concentrations (right), from Q3 2007 through Q4 2013



Investor Allocation Preferences: Product & Holdings Characteristics

Comparing performance between EFI-CA products with positive flows and those with negative flows in 2013 shows money generally moved to those products which performed better in 2012 and 2013. Interestingly, those with net redemptions in 2013 were among the better performing products at the height of the Euro sovereign crisis in 2010 & 2011.

Figure 11: Percentile, median and average data for performance and holdings characteristics for the EFI-CA universe (blue), products within the universe gaining assets in 2013 (green) and those losing assets (red)

Returns	25th			75th			25th	Median	75th
	Percentile	Median	Percentile	Percentile	Median	Percentile	Differential	Differential	Differential
H2 2013	9.3%	8.6%	7.9%	9.0%	8.7%	8.5%	.27	-.08	-.62
2013	8.1%	7.8%	7.4%	7.4%	7.2%	6.7%	.64	.60	.76
2012	13.8%	13.2%	12.4%	13.6%	12.5%	12.1%	.19	.77	.29
2011	0.4%	-0.7%	-1.2%	1.2%	-0.3%	-1.1%	-.80	-.38	-.18
2010	-2.6%	-4.0%	-4.8%	-2.8%	-3.4%	-3.9%	.16	-.51	-.89
2009	13.6%	11.7%	11.2%	13.5%	12.1%	11.2%	.16	-.35	-.01
2008	1.2%	0.8%	-1.6%	2.0%	1.4%	-1.3%	-.82	-.59	-.36
2007	13.1%	13.0%	12.7%	13.1%	12.5%	11.9%	-.01	.44	.78

The lower set of tables illustrate investor preferences in the EFI-CA universe, namely for:

- 1) Larger firms
- 2) Greater diversification
- 3) Lower cash positions
- 4) More convexity
- 5) Lower quality bonds
- 6) Broader country exposure

Characteristics	Universe Median	Asset Gainers	Asset Losers
Firm Inst. AUM	\$151,530	\$442,580	\$219,446
Current # of Bond Issues	116	153	80
# of Countries in Portfolio	20	22	19
Current Cash Position	1.65%	1.29%	2.15%
Annual Turnover	86.96%	86.96%	83.00%
Current Wgtd. Avg. Coupon	3.43%	3.44%	1.96%
Yield to Maturity	2.10%	2.15%	2.20%
Yield to Worst	2.14%	2.15%	2.23%
Average Maturity (yrs)	6.90	6.47	5.77
Effective Duration (yrs)	5.30	5.15	5.60
Convexity	0.60%	0.63%	0.60%

Region	Universe Median	Gainers	Losers
Continental Europe	85.3%	81.5%	87.8%
United Kingdom	5.9%	5.1%	4.3%
North America	2.9%	3.6%	3.1%
Other Dev. Mkt. Regions	2.5%	4.1%	1.7%
Emerging Mkts.	2.1%	2.9%	5.4%
Asia ex-Japan	0.9%	1.5%	0.6%
Japan	0.1%	0.0%	-0.9%

It is clear European investors elected to allocate towards products with greater yield in 2013, however it was interesting to see that in doing so they opted for certain avenues of expected safety, namely size of firm and broader exposure both in terms of number and breadth of holdings.

Quality	Universe Median	Gainers Median	Gainers Average	Losers Median	Losers Average
AAA	19.48%	13.63%	14.81%	25.17%	35.19%
AA	13.54%	20.76%	12.33%	22.00%	20.14%
A	12.86%	15.53%	20.46%	15.58%	13.43%
BBB	37.95%	39.52%	41.52%	25.57%	26.86%
BB	2.51%	4.80%	5.13%	1.47%	1.65%
B	0.00%	0.30%	2.02%	0.00%	0.00%
CCC	0.00%	0.00%	0.00%	0.00%	0.00%
CC	0.00%	0.00%	0.00%	0.00%	0.00%
C	0.00%	0.00%	0.00%	0.00%	0.00%
Distressed	0.00%	0.00%	0.00%	0.00%	0.00%
Not Rated	1.03%	0.00%	10.46%	1.98%	4.08%
Other	0.07%	0.00%	3.68%	1.65%	3.15%

Country	Universe Median	Gainers	Losers
Italy	15.7%	18.7%	14.1%
Spain	15.1%	15.3%	11.6%
France	13.5%	14.3%	11.9%
Germany	6.9%	6.4%	7.9%
United Kingdom	5.9%	5.1%	4.3%
Netherlands	5.0%	5.0%	5.3%
Belgium	4.8%	4.7%	4.6%
Ireland	2.9%	4.4%	2.0%
Austria	2.4%	3.4%	1.9%
Finland	1.2%	1.5%	2.4%
Sweden	1.0%	1.0%	1.5%
Switzerland	0.9%	0.9%	0.6%
Norway	0.9%	0.9%	0.6%
Portugal	0.8%	1.0%	0.6%
Denmark	0.4%	0.6%	0.3%
Luxembourg	0.4%	0.4%	2.7%
Greece	0.0%	0.0%	0.0%
United States	3.0%	3.6%	3.0%
Other Dev. Mkts.	2.2%	4.1%	1.7%
Emerging Markets	2.1%	2.9%	5.4%

Investor Allocation Preferences: Trends in Credit Quality and Regional Exposures

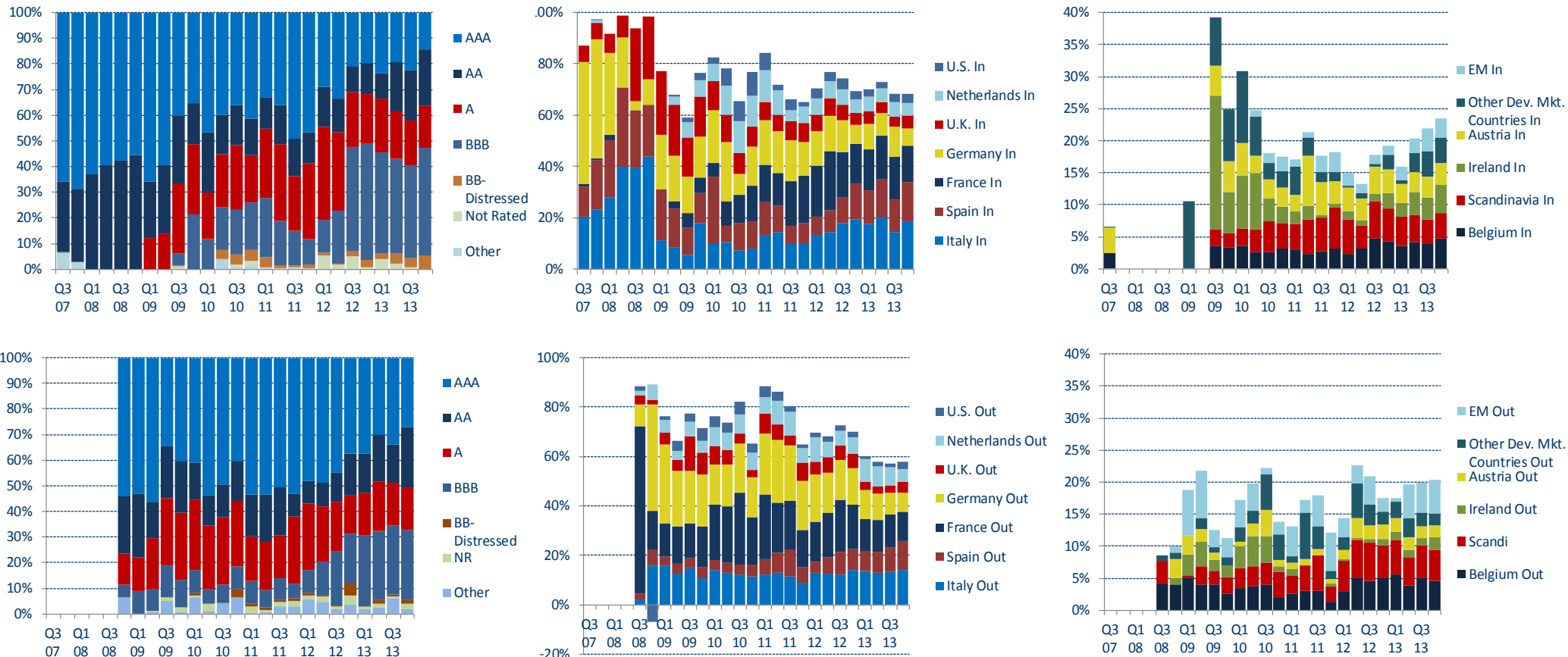
The most notable preferences for European investors was to allocate to strategies which have been more proactive in reallocating their portfolio exposure down the quality spectrum. Not only in the form of more BBB-holdings, but particularly in the dramatic reduction in AAA exposure.

While the overall EFI-CA universe exposure trends have been to increase exposure outside of core Eurozone countries, Europe-domiciled investors have actually preferred funds which have found attractive yields within the core nations. Nearly 70% of European asset gainers median exposure is inside Europe's largest countries versus 58% for asset losers.

Further illustrating the preference to accept risk in their "own backyard", European investors opted to allocate to funds which, while having increased emerging market exposure, have kept a median exposure level to EM only half that of median levels for asset losers.

We note that asset gainers have a history of supplying more thorough information to eVestment.

Figure 12: Median portfolio exposures by quality and country since Q3 2007 for asset gainers (top) and asset losers (bottom)

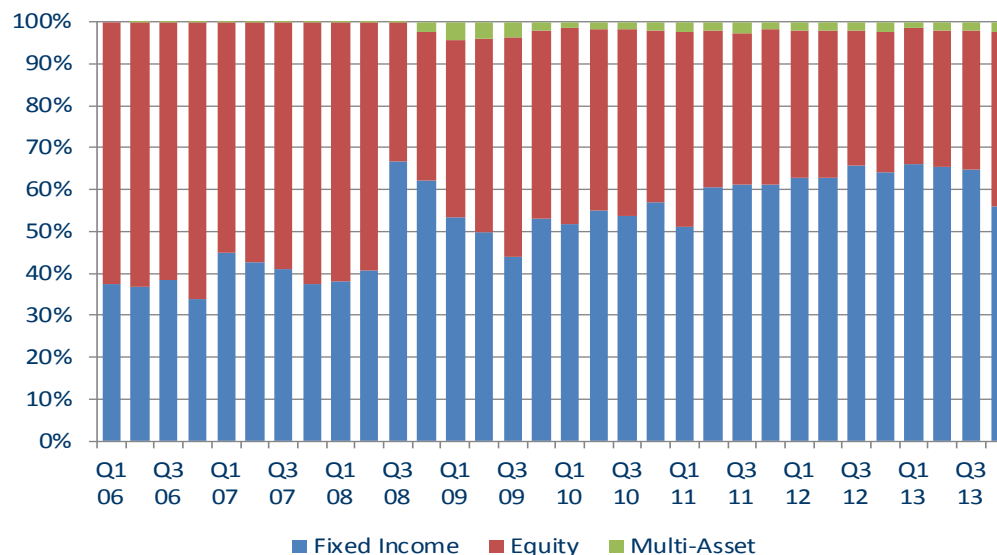


Summary & Outlook:

Over 60% of all of Europe-domiciled institutional allocations went into fixed income strategies in 2013 and the majority of those assets went into relatively higher yielding segments of fixed income markets. After a sharp rise and reversion surrounding the financial crisis, fixed income exposure has become increasingly importance to Europe-domiciled investors. However, there were indications of a reversal in Q4 2013 with equity now comprising its largest percentage share of assets since Q1 2011.

eVestment, along with Casey Quirk, recently release an institutional investor/consultant survey ([link to survey results](#)) which indicated that European investors expect their allocations to fixed income strategies to decline when comparing 2014 to expected 2016 allocations, to the benefit of both equities and alternatives. These expected allocation shifts, along with 2013 preferences across the fixed income spectrum, indicate European institutional investors' desire for higher returns is expected to continue beyond the near-term. Given the aforementioned change in Q4 2013, visible in *Figure 13*, it appears this shift may have already begun. It will be of interest to note if the recent increase in tensions to the East has any meaningful impact on these future allocation expectations.

Figure 13: Change in Euro-domiciled allocations by major asset class from Q1 2006 through Q4 2013



Managers operating fixed income strategies competing for Europe-domiciled institutional clients should be aware of what appears to be a calculated increase in risk appetite in the form of current preferences for medium-grade and high-yield securities and expected future allocations towards equities and alternatives.

COMPANY DESCRIPTION

eVestment provides a flexible suite of easy-to-use, cloud-based solutions to help global investors and their consultants select investment managers, enable asset managers to successfully market their funds worldwide and assist clients to identify and capitalize on global investment trends.

With the largest, most comprehensive global database of traditional and alternative strategies, delivered through leading-edge technology and backed by fantastic client service, eVestment helps its clients be more strategic, efficient and informed.

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