Cerulli Special Quantitative Update

Japan 2012

New Opportunities In Shifting Institutional And Retail Risk Appetites

CERULLI ASSOCIATES
Global Analytics

Overview

The risk tolerance of Japan's retail and institutional investors is becoming increasingly nuanced, ranging from highly risk-tolerant to highly risk-averse. Cerulli Associates' most recent Japan research explains the forces shaping this development, the opportunities it presents to various types of asset managers, the most appropriate channels and products for reaching various investor types, and the commercial realities of serving Asia's largest fund market.

Retail-focused topics include marketsizing, retail investor behavior, product trends, regulatory developments, tax structures, fees and profitability, and channel analysis.

Institutional-focused topics include defined contribution and defined benefit pension funds, asset allocation, and most effective ways for global asset managers to access institutional assets.

Key Reasons to Buy This Report:

- Insightful coverage of both retail and institutional markets in a single strategic sourcebook
- Expertise gleaned from 14 years of dedicated coverage
- Addressability analysis of the potential for retail mutual fund penetration to expand beyond its current level of 4.2%
- Opportunities presented by Japanese institutions' asset allocation shifts
- Realistic view of the opportunities and challenges in both retail and institutional markets
- Success requirements for locally domiciled and cross-border funds
- Unexplored retail distribution channels
- Considerations for building successful partnerships

Answer These and Other Critical Questions:

1. How accessible are Japanese retail and institutional assets to global asset managers?
2. How do different distribution channels affect product decisions?
3. What products to Japanese investors want most?

95 pages, 54 exhibits

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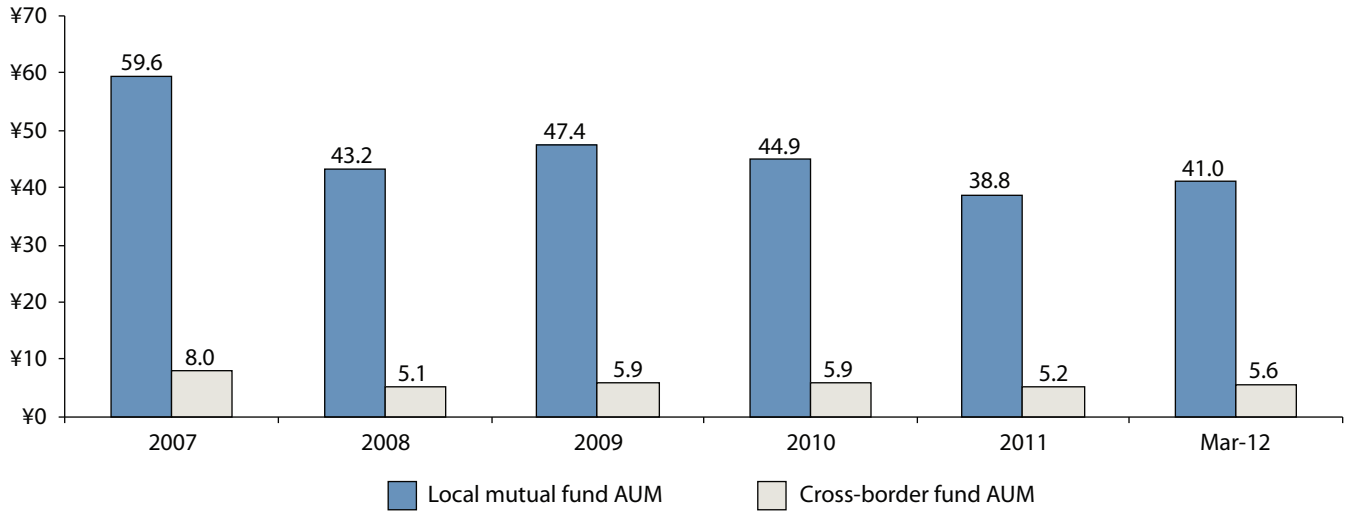
EXHIBIT 5.02

Japanese Mutual Fund Assets Under Management by Domicile, 2007–March 2012 (¥ trillions)

Sources: Investment Trusts Association, Japan Securities Dealers Association, Cerulli Associates



- Japan's **total retail mutual fund assets under management (AUM)**, including both local and foreign domiciles, **increased by 5.8% to ¥46.6 trillion between December 2011 and March 2012. The gain, however, represents a recovery from a low base in the year-ago period, and was largely driven by a stronger yen and turmoil in foreign markets**.

- The market's actual size is larger than what is presented in this exhibit as assets of **funds of funds (FoFs) are not included here. The AUM of FoFs stood at ¥22.2 trillion in March 2012**, and the segment has shown consistent growth since 2008 (see **Chapter 4: Subadvisory Mandates and Funds of Funds** for details); however, please note **that most of FoFs' recent growth was due to REIT funds**, notably those investing into U.S. REITs. For example, 95.2% of net inflows into FoFs in Japan in May 2012 were into REITs, and only a handful of products drew significant assets.

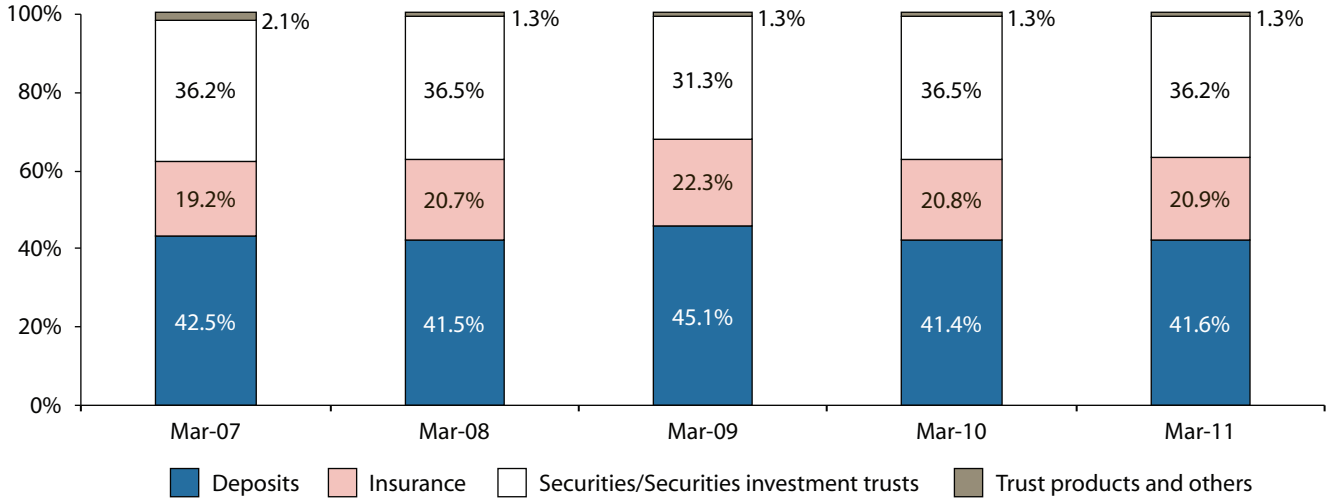
- Cross-border funds represent a small part of the market due to limited distribution—only a few banks are willing to distribute such funds. Moreover, **locally domiciled funds have increasingly diverse investment approaches, enough to satisfy Japanese investors' appetite for foreign exposure**. Cross-border fund assets suffered an 11.0% slump between 2010 and 2011, but grew by 7.3% between end-2011 and March 2012.

Key Implication: The rapid appreciation of the Japanese yen after the March 11, 2011, earthquake and tsunami, as well as global market volatility, had an adverse impact on Japan's mutual fund assets because half of these assets are managed in foreign currencies. The situation is compounded by Japanese retail investors' short investment horizons, causing even higher churn during times of market volatility. Until Japanese investors use mutual funds for long-term asset accumulation, the industry's fortunes will be affected by capital market events.

EXHIBIT 8.05

Japanese DC Plan Assets Under Management by Major Investment Vehicle, March 2007–March 2011

Sources: Rating & Investment Information, Cerulli Associates



- Due to a tendency to be risk-averse and having little financial literacy, Japanese DC subscribers' choice of investment products is conservative. **About two-thirds of their assets are allocated to principal-guaranteed products**. Their conservatism is unlikely to change in the immediate future.

- Switching among products is allowed, but **more than 90% of DC subscribers have made no changes in the asset allocations they decided upon when they started on their DC plans**, according to PAs. The most common reason cited is their lack of interest in DC. As employees of large firms feel assured that DB plans cover most of their pension needs and consider DC as only a fraction of their retirement plans, they do not want to spend too much time thinking about DC. Meanwhile, those in smaller firms have neither the time to think about DC as they engage in their busy daily schedules nor the financial literacy to learn more about DC. In short, **DC typically does not enter most subscribers' minds**.

Key Implication: Considering that Japan's mutual fund penetration rate is around 3% of total household financial assets, DC's 36.2% allocation to securities products might indicate a silver lining. But that would be false hope. DC is a very small market and half of the securities products are passively managed. Furthermore, management fees are very low, generally half of retail fees. As such, fund managers who think of entering the market should seriously consider whether DC is a commercially viable opportunity.

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