Asset management industry: Stable following economic recovery

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EXECUTIVE SUMMARY

The performance of asset management (AM) industry depends heavily on the performance of the assets it manages. In nominal terms, most of the managed assets are derived from the capital market, given its liquidity. Therefore, it is natural that the industry performance correlates highly with the performance metrics of capital markets, especially with proxies, such as stock composite and the government bond indexes.

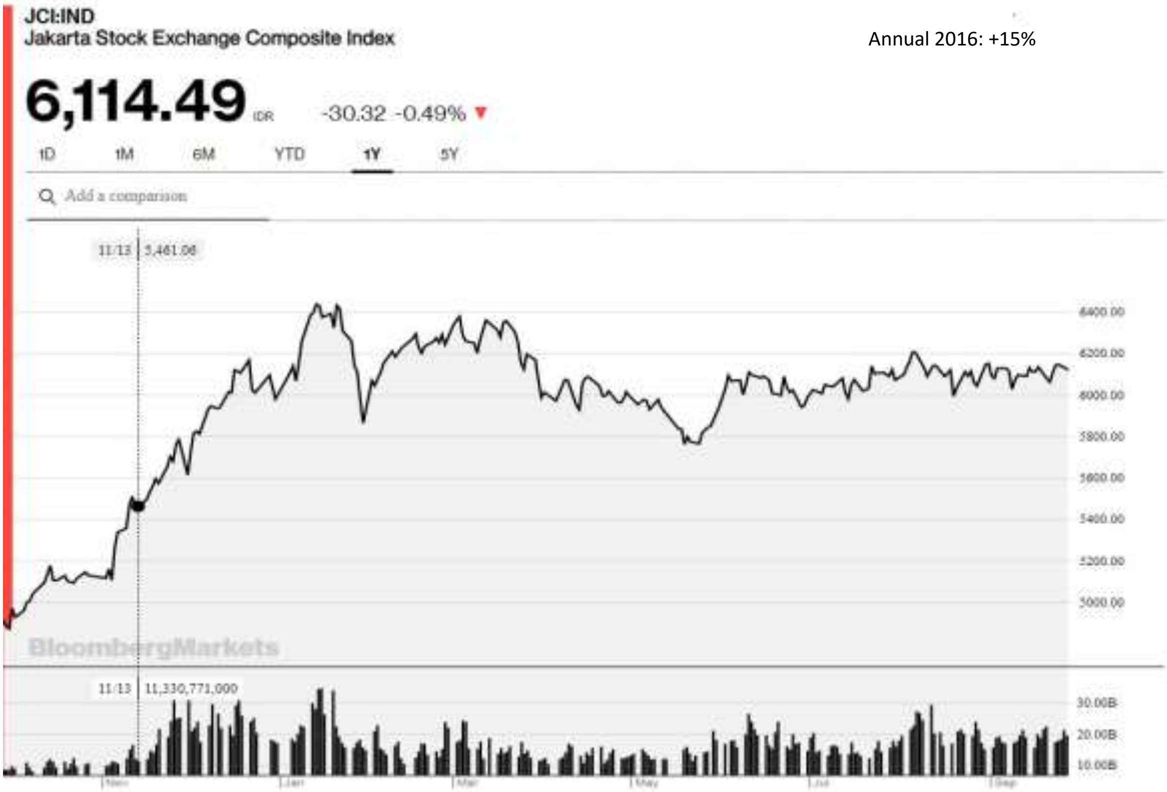
Furthermore, the performance of the capital market is determined by market sentiment, which is the synthesis of macroeconomic conditions, based on domestic as well as global perceptions, and from the microeconomic conditions, such as the performance of each issuer of capital market instruments.

We view that the industry's outlook will be stable bolstered by the sustained trend of the economic recovery, despite slackening somewhat. The overall limited business opportunity during this pandemic has driven many corporations to hold major expansion; instead, they place their liquidity in investments that tend to yield higher than time deposits amid the prevailing low interest rate. An asset management company (AMC) offers a wide range of investment classes with their respective risks and serve as a one-stop solution for corporations' needs in placing idle funds. From the rating perspective, we view these various factors, including meeting the corporations' primary needs and offering diverse products with varying degrees of risk, return, and tenor, especially in terms of business stability and growth prospects. On the other hand, we also see that the industry might not be foolproof, since the underlying assets may fluctuate along with macroeconomic conditions and market sentiments. As the industry's profitability and going concern hinge on fees based on assets under its management, the investors' sentiment is also crucial. A number of cases, such as those related to Jiwasraya and Asabri, had tainted the reputation of the industry, dragging some of the well-known AMCs. The tendency for the industry to be concentrated on big players is also a challenge in itself. We look at these factors as the potential impediments for this industry, and if there is any indication that these factors will persist, it will affect our view on the industry's prospect.

Recent Performance in Underlying Assets

After the outbreak of the Covid-19 pandemic in 2020, capital market performance has recovered, but stability has not been in place. In 2021, the capital market showed a significant improvement over the previous year, with the Jakarta Composite Index (JCI) growing 24.7% year-on-year (YoY), following a correction of 29.5% in the previous year. Currently, the government bonds index also recorded a gain of 10.4% YoY.

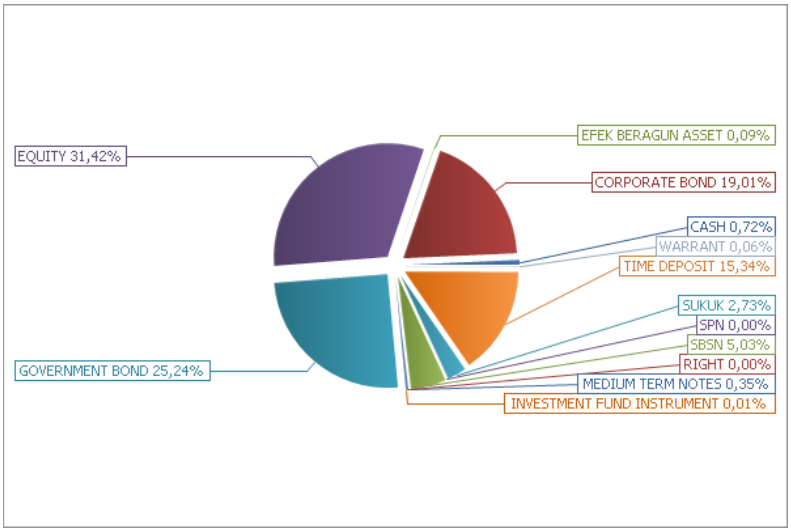
Jakarta Composite Index (JCI)



Source: Bloomberg

Supported by the strengthening of the capital market, the assets managed in the industry grew 21.1% to around Rp542.5 trillion. Specifically, the largest managed assets are held by the stock mutual fund industry, amounting to Rp169.0 trillion or equal to 31.4% of the total assets under management of the industry in August 2021. Accordingly, the stock market volatility is positively related to the performance of the industry, as seen from the net asset value as well as the total assets under management. On the other hand, the size of the managed assets of the industry of Rp542.5 trillion (equivalent to US$38.2 billion), whereas the Rp169.0 trillion (equivalent to US$11.9 billion) of it being in stock mutual fund, is quite small compared to the market capitalization of the Indonesia Stock Exchange in the range of Rp7,054 trillion or equal to US$486 billion; hence, there is room for growth potential for the industry. Government bonds rank second in terms of size of asset class amounting to Rp135.8 trillion, accounting for 25.2% of the total managed fund. Investors in pursuit of high yields, but expecting their principal of their investment intact, drive the demand of this mutual fund class. The third position of the asset class is occupied by corporate bonds, with a total of Rp102.3 trillion or 19.0% of the total managed funds.

Placement of Mutual Fund Assets in August 2021



Placement of funds (Rp tn)

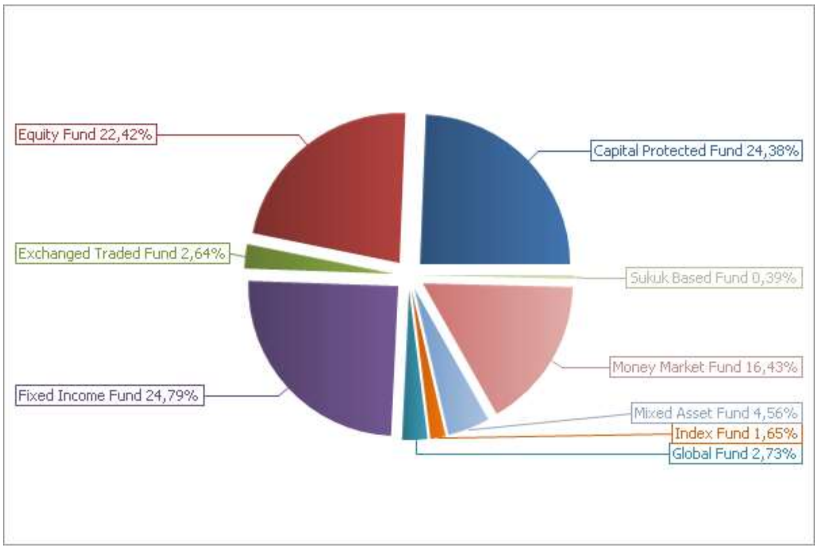
Stock	169.0
Goverment bonds	135.8
Corporate bonds	102.3
Warrant	0.3
MTN	1.9
Time deposit	82.5
SBSN	27.1
SPN	0.0
Sukuk	14.7
Cash	3.9

Source: OJK

Mutual Fund by Product Classes

In the industry, AMCs generally have four basic product classes, namely: stock mutual funds, fixed income funds, mixed mutual funds, and money market mutual funds, as well as the sharia versions of those products. A shift took place in the composition when the fixed income fund moved to the top position at 27.5% and equity fund at the second with 23.5% of the total AM industry. There was a period when the capital protected fund overtook the stock mutual fund at the end of September 2019, as the stock index was affected by the negative sentiment surrounding the Jiwasraya case. Currently, however, as the investors see the prospect of economic recovery, the equity fund has reclaimed its edge over the capital protected fund. Since at the same time the general investors also hedged their position by putting on fixed income fund, this fixed income fund became the leading type of fund since the end of April 2021.

Graph of Mutual Funds Market Share by Type in August 2021



Source: OJK

When JCI grew 17.3% annually by the end of August 2021, equity funds simultaneously recorded a 17.8% gain. We view that after the market came under severe pressure, it has recovered across the board. We see that the market drop at the beginning and during the pandemic has sent shockwaves to all stocks in all sectors indiscriminately, including blue-chip stocks or stocks from defensive sectors. During the depression, investors tended to load up on the equity funds with these blue-chip and defensive stocks, seeing them at the rare deep discount relative to their intrinsic value. Hence, when the market recovered, with these stocks leading the recovery, the rate of recovery on both JCI and equity funds have been in alignment with each other.

The investors' view of risks during and after the pandemic has also significantly shaped the new normal composition of the mutual fund industry. The jitter has not all subsided as the investors tended to load up on fixed income mutual funds.

If we look at the government bond index's performance of around 10.4%, the net asset value of fixed income mutual funds grew by 24.1%, also supported by the gain in the corporate bonds during this prevailing low interest rate. Money market mutual funds also perform very well during these risky times with the year-on-year growth of 33.6%. Looking at its characteristics, money market mutual funds serve as a substitute for the savings account, with the components generally consisting of deposits and short-term debt instruments (including commercial paper), a close substitute of liquidity tool rather than an investment. This specific role contributes to the relatively flat growth of the money market mutual funds but remains stable and relatively insensitive to the economic cycle.

Concentration on Big Players

On the industrial landscape, the AM industry shares a typical characteristic of the financial industry, consisting of many players but controlled by only a few big ones. The number of AMCs in Indonesia is 87, but based on the value of the managed funds, the top ten AM companies command more than 60% of the total managed funds (62.6% in August 2021). The big players are generally dominated by foreign companies and local companies affiliated with a large group. In the future, we expect this trend to remain, given those companies' size of capital and the support of the extensive business network, generally accompanied by a presence of a captive market.

Top 10 Investment Managers Company

Aug-21			
Rank	**Fund Manager**	**Total in Rp**	**Market Share**
1	Manulife Aset Manajemen Indonesia, PT	60,267,484,566,819.50	11.11%
2	Bahana TCW Investment Management, PT	43,565,182,981,729.30	8.03%
3	Mandiri Manajemen Investasi, PT	41,768,927,222,527.00	7.70%
4	Batavia Prosperindo Aset Manajemen, PT	40,686,551,600,128.00	7.50%
5	Schroder Investment Management Indonesia, PT	33,738,399,090,573.80	6.22%
6	Danareksa Investment Management, PT	28,615,450,996,386.10	5.27%
7	Trimegah Asset Management, PT	25,193,249,131,067.40	4.64%
8	Ashmore Asset Management Indonesia, PT	23,722,166,257,534.80	4.37%
9	BNI Asset Management, PT	21,440,424,527,392.60	3.95%
10	Sinarmas Asset Management, PT	20,680,436,774,593.80	3.81%

Source: OJK (processed)

PEFINDO's View on Industry's Prospect

Following the gradual economic recovery up to the present, PEFINDO sees that the prospect of the AM industry will be stable in 2021. The recommencement of several infrastructure projects should bolster the pace of the recovery, albeit less pronounced than before.

The AM industry is also one of the industries positively affected by the prevailing low interest rates in prime banks' time deposit, whereby mutual funds is one of the alternative placements. It is also one of the reasons why the money market mutual fund has performed satisfactorily since last year. The sectoral government policy also plays a pivotal role since it will affect the industry performance in the sector concerned. This sectoral performance will determine the share price of the issuer; hence, to a certain extent determining the performance of mutual funds and the dynamics of its managed assets. The industry caters favorably to corporations in general that seek temporary placement of their excess funds, while waiting for the appropriate time or condition for expansion. Several index-tracking funds, for instance, recorded over 10% return year to date, while the money market, the safest type of funds, recorded more than 5.5% return year-on-year.

The pace of economic growth, however, has slackened following the emergence of new variants of the Covid-19 virus, resulting in the resurgence of positive cases in various regions, prompting the government to intensify the vaccination program. The ongoing legal proceedings of high-profile cases have also tainted the industry; thereby, possibly changing the way the companies approach the institutional government-related entities, some of which are the prime clients and the main contributors to those AMC's portfolio. We view some positive factors as remaining to outweigh the negative ones in the near to medium term since several sectors have sustained the pandemic and adapted favorably to the new normal situation, such as pharmaceuticals, housing and landed property, banking, and telecommunications.

PEFINDO's Rating Methodology

PEFINDO looks at several aspects to define risks in the industry. First, by looking at the structure of income. The fee is the primary income of the industry, consisting of some assortments, ranging from subscription fees, redemption fees, and management fees. The rise and fall of stock indices do not affect the bottom line of this industry directly. But if the stock market weakens, the holders of the funds tend to hold the purchase of additional units or, under extreme conditions, will trigger the redemption of mutual funds. Accordingly, the size of assets under management will be stagnant or shrinking. In terms of income stability, the management fee is the most important since it is recurring and more stable as it is calculated from the managed fund. It also strengthens the industry stability as fees are more asset-based than transactional-based*.* In case of a decrease in assets under management, the management fee*s* will be reduced. Therefore, the amount of assets under management and cost structure are very important determinants for the business and profitability of MI companies. In addition, as is the case with other industries, PEFINDO sees diversification as one of the essential risk mitigation factors. Diversification in product offering, types of clients, and marketing channels will enable MI companies to position themselves better in dealing with business volatility. It is even more crucial given the industry's dependence on the performance of the capital market, which tends to fluctuate, particularly for capital markets in an emerging country like Indonesia. Capital is also another pivotal factor, especially for the newly established MI companies to support the expansion measures, such as launching new products, attracting quality investment managers, and improving its IT infrastructure.

In conducting the rating, PEFINDO is guided by a specific rating methodology for the AM sector, including analyses of the risk profile of business and financial aspects. Concerning the business aspect, the assessment includes business position, diversification, cost structure, management, infrastructure, and strategy. Regarding the financial aspect, it covers four main areas: risk management, capital structure, profitability, liquidity, and financial flexibility. Aside from these factors, based on the methodology of parent support, PEFINDO also considers a possible notch-up in rating if there is evidence and potential support from the parent company. The point is to determine the capacity and commitment of the parent in providing support. Qualitative elements are also considered in assigning ratings to companies in the industry since the rating is a forward-looking assessment, and these qualitative elements will have the likelihood to drive the company to achieve its projections. These projections are first gauged by the past achievements or financial track record to verify whether a gap exist and, if so, whether it is reasonable.

Use of Rating

The AM industry is quite different from corporations or financial institutions in general because AMCs are by regulation prohibited to incur borrowing. In general, the absence of debt obligations does ease the financial burden on a company, including an AMC, and it contributes positively to the ratings obtained. It does not, however, by itself mean that an AMC will automatically earn a high ranking. PEFINDO also pays attention to other aspects, including business, which PEFINDO views to remain quite volatile, in line with the capital market conditions in general. In addition, while there is no risk of debt repayment, it is vulnerable to the risk of redemption, equally affecting the liquidity aspect, as well as reputation risks, possibly directly impacting the growth of assets under management, subsequently undermining its business position and profitability.

In sum, although the rating of an MI is not obligatory in this industry, it can showcase its business standing when it needs to collaborate with institutional customers such as banking.