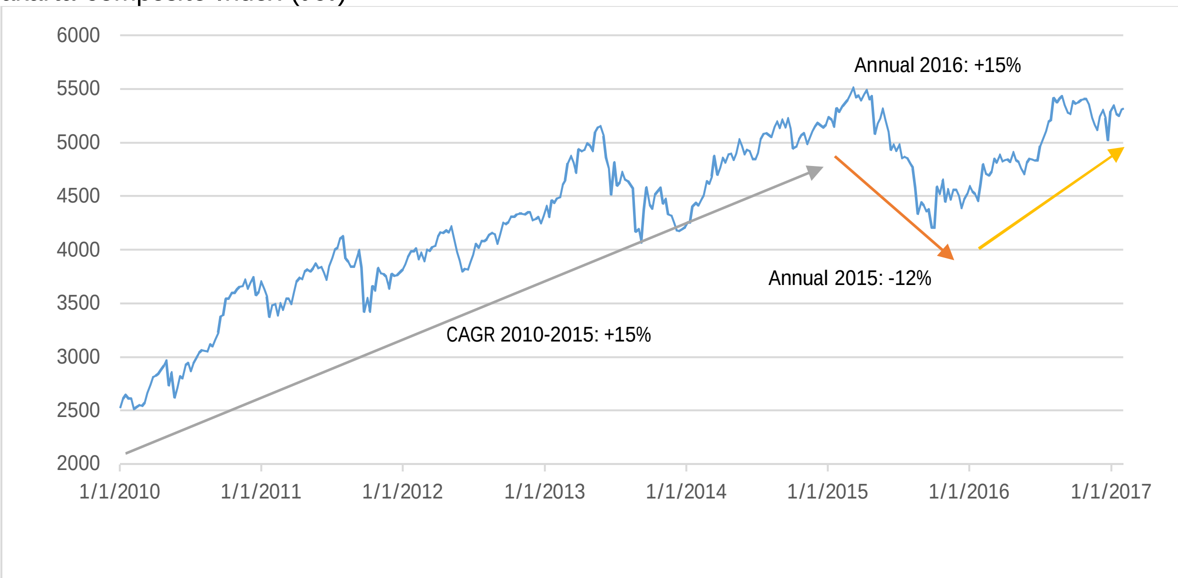
Asset Management Industry In Rating Perspective

Analyst: Kreshna Dwinanta Armand

The performance of the asset management industry depends heavily on the performance of the assets it manages. In nominal terms, the majority of the managed assets is derived from the capital market, given its liquidity. Therefore, it is natural that the industry performance is highly correlated with the performance metrics of capital markets, especially with proxies such as stock composite index and the government bond index. Furthermore, the performance of the capital market is determined by market sentiment, which is the synthesis of macroeconomic conditions, seen from the domestic as well as the global point of view, and from the microeconomic situation, i.e. the performance of each issuer of capital market instruments. After the drop in commodity prices, capital market performance has not yet shown stability. But amid the soft economy, both globally and domestically, the performance of the capital market in 2016 showed a significant improvement over the previous year, in which Jakarta Composite Index (JCI) is capable of driving a 15% *year-on-year* (YoY) growth, compared to the previous year which saw a 12% correction. The government bonds index is also able to post a gain 10% of year on year (YoY) in 2016 compared to 4% YoY in the previous year.

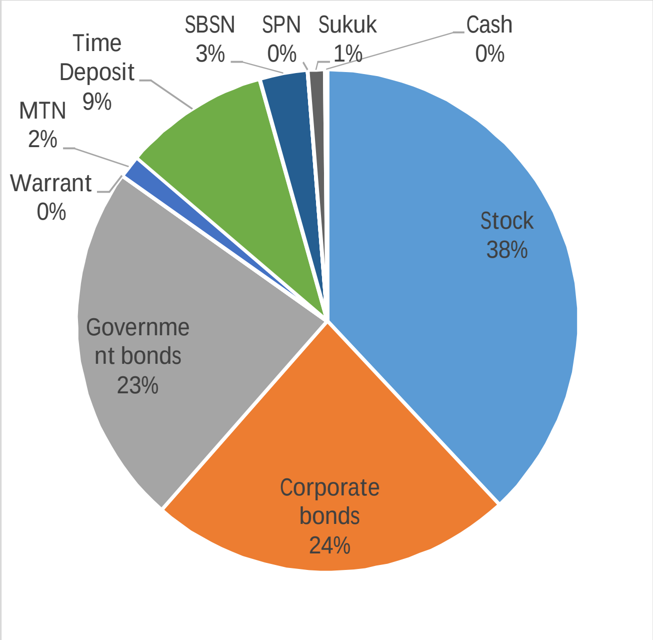
Jakarta Composite Index (JCI)



Source: Bloomberg

Supported by the strengthening in the capital market, the assets managed in the industry also grew 27% to around Rp330 trillion. Specifically, the composition of the largest managed assets is still held by the stock mutual fund industry, which in 2016 was recorded at Rp118 trillion (including sharia) or equal to 36% of the total assets under management of the industry. Thus, it is reasonable that the stock market volatility has always had an impact on 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 is still quite small compared to the market capitalization of the Indonesia Stock Exchange which is in the range of Rp5,800 trillion or equivalent to US $ 447 billion, so there is still a growth potential for the industry. For the record, the market capitalization of the Indonesia Stock Exchange has outperformed the capitalization of Thai stock exchange (US $ 425 billion), the Philippines (US $ 199 billion), Malaysia (US $ 250 billion), and Singapore (US $ 302 billion). Protected mutual funds are at number two in the largest managed assets with Rp88 trillion or equal to 27% of total managed fund. Investors who still pursue high yield but do not want the principal amount of their investment eroded drive the demand of this mutual fund class. The third position of managed assets is occupied by fixed income mutual funds with total managed funds of Rp63 trillion or 19% of total managed funds.

Placement of Mutual Fund Assets in 2016

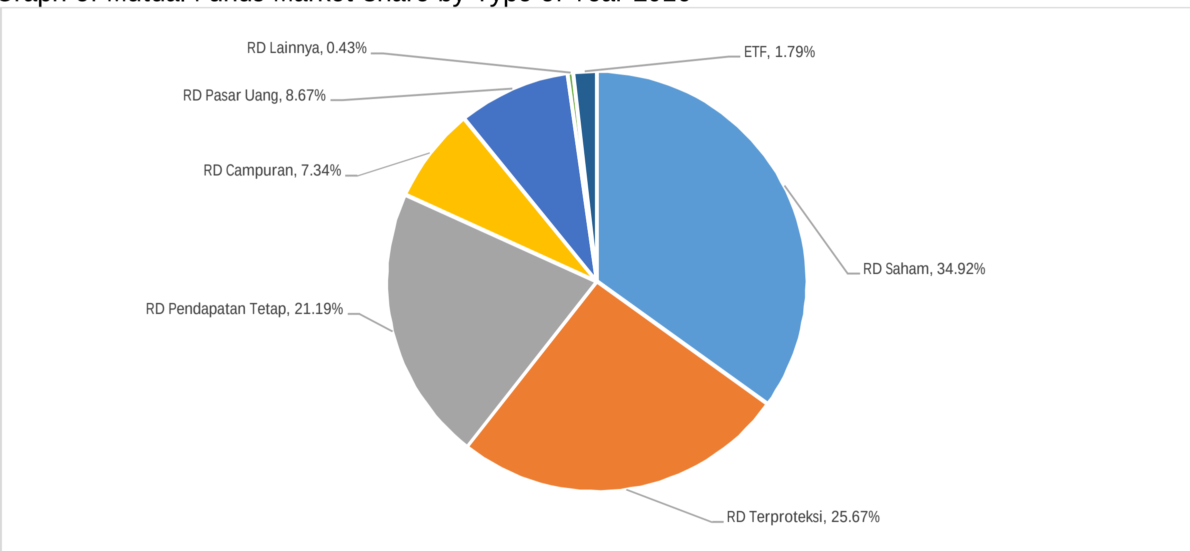


Placement of funds (IDR trilion)	
Stock	126.25
Corporate Bonds	77.83
Government bonds	77.44
Warrant	0.03
MTN	4.82
Time deposit	31.23
SBSN	10.23
SPN	0.00
Sukuk	3.59
Cash	0.59

Source: http://aria.bapepam.go.id

In the industry, mutual fund companies generally have four basic product classes, namely stock mutual funds, fixed income funds, mixed mutual funds, and money market mutual funds, as well as sharia versions of those products. The stock mutual fund (and its sharia variant), as in the table below, holds 35% of the total MI industry. Followed by protected mutual funds (and its shariah variant) of 26% and fixed income mutual funds (and its shariah variant) of 21%.

Graph of Mutual Funds Market Share by Type of Year 2016



Source: http://aria.bapepam.go.id

PEFINDO sees a slight anomaly on the performance of mutual fund shares, as when JCI 2016 grew 15%, equity funds recorded only 7-8% gain, with a wide gap between best performing mutual funds in which the net asset value (NAV) grew 50%, against the worst performer which NAV shrank by 59%. According to PEFINDO, this is plausible given that there are several mutual funds with an investment focus on stocks in sectors with dimming performance in 2016 or small cap stocks with large beta. These type of mutual funds would have a pressure in its performance during less stable economic backdrop as in 2016. On the other hand, equity funds with a focus on blue chip stocks or stocks of a more defensive sectors were capable of providing good returns. Considerable growth is seen in fixed income mutual funds, where if we look at the government bond index's performance of around 10%, the growth of net asset value of fixed income mutual funds was posted at 8%, with the best fixed income mutual fund posted a net asset value increase of 20% and the worst at -9%. Balanced mutual funds were able to perform somewhere in the middle, up about 9% with the best balanced mutual fund up 30% and the worst resembling stock mutual funds at -50%. But if we look at the larger perspective, balanced mutual funds have more limited upside potential with similar downside potential compared to equity funds. However balanced funds have the better perception in terms of safety due to the factor that they have a placement in fixed income instruments. Money market mutual funds have the smallest average NAV increase of only 5%, with the best accounting for an 8% rise and the worst being -1%. Looking at its characteristics, money market mutual funds act as a substitute for savings account, where the components generally consist of deposits and short-term debt instruments (including commercial paper), making it more like a liquidity tool rather than an investment. This specific role that made growth in money market mutual funds relatively flat but remains stable and relatively immune to the economic cycle. In addition, there is also an Exchange Traded Fund (ETF) as a new product variant. This ETF is a form of a mutual fund-traded instrument traded on the stock market and in the future it can be a competition for mutual fund investments and the conventional MI industry. But its size for now is still relatively small and still need some time for ETF to gain larger market share.

On the industrial landscape, the mutual fund industry has a typical characteristic of the financial industry, where there are many players but controlled by only a few big ones. The number of mutual fund companies in Indonesia is 85, but based on the value of the managed funds, the top ten MIs dominate more than 65% of total managed funds. Big players are generally dominated by foreign companies and local companies affiliated with a large group, and in the future, we expect this trend to remain, due to the level capital support being provided and also the availability of business network that is more extensive for these companies, which generally accompanied by the presence of captive market.

Top 10 Investment Managers Company

No.	NAB - Rp triliun	FY2016	%pangsa	9M2016	%pangsa	2015	%pangsa	2014	%pangsa
1	Schroeder	46,0	13,9%	45,1	14,2%	48,3	17,7%	41,2	17,1%
2	Mandiri MI	31,2	9,4%	28,7	9,1%	22,0	8,1%	20,4	8,5%
3	Bahana TCW	29,2	8,8%	27,6	8,7%	21,4	7,9%	16,9	7,0%
4	Batavia Prosperindo	27,9	8,4%	27,8	8,8%	19,7	7,2%	12,5	5,2%
5	BNP Paribas	17,6	5,3%	19,2	6,1%	21,7	8,0%	28,8	11,9%
6	Manulife	13,5	4,1%	13,4	4,2%	10,7	4,0%	12,9	5,3%
7	BNI Asset Mgmnt	15,5	4,7%	13,6	4,3%	10,6	3,9%	6,1	2,5%
8	Danareksa	14,3	4,3%	12,2	3,8%	8,9	3,3%	8,3	3,4%
9	Panin Asset Management	9,2	2,8%	10,0	3,2%	10,9	4,0%	11,6	4,8%
10	Sinarmas	12,0	3,6%	10,7	3,4%	7,1	2,6%	6,5	2,7%
	TOP 10 % terhadap industri		65,4%		65,7%		66,7%		68,4%

Source: aria.bapepam.go.id

PEFINDO sees the prospect of asset management industry in 2017 as stable, where growth will remain limited but there are several supporting factors for the industry to survive and grow. Despite the looming macroeconomic uncertainty, there are several positive drivers such as gross domestic product that is expected to recover to slightly above 5%, the levels of interest rates and inflation that remains under control and commodity prices that looked to bottom out in end of last year and started to rebound. In the real sector, several infrastructure projects that begin to commence can also potentially serve as a growth driver. PEFINDO also see there are two factors that can be an additional support for the growth, namely the requirement to invest in government securities of 20% for non-bank financial industry, and the second is the impact of *tax amnesty.*

The requirement to place investments in government securities that are allowed through mutual fund, positively impacts the demand of fixed income funds that contain government securities. In addition, the tax benefits from the placement in mutual funds compared with direct placement in the government bond also add to the attractiveness of investors to invest in mutual funds through asset management companies. Asset management industry is also one of the industry positively affected by the inflow of tax amnesty funds, where mutual funds is one of alternative placements. In addition, the positive sentiment in the early application of the tax amnesty was also able to push the stock index reached its highest point in 2016 at 5,470 level, providing the year with a good growth and giving support to the increase in industry's net asset value. Sectoral government policy will also be very important because it will affect the industry performance in the sector concerned. This sectoral performance will then affect the share price of the issuer, thus affecting the performance of mutual funds and the dynamics of its managed assets.

PEFINDO looks at several aspects that define the risks in the industry. First, by looking at the structure of income. Fee is the main source of income of the asset management business. There are several types of fees, ranging from subscription fees, redemption fees and management fees. Thus in fact, rise and fall of stock market will not affect the bottom line of this industry directly. But if the stock market weakens, the holders of the mutual funds tend to hold the purchase of additional units or in extreme conditions will actually trigger the redemption. Consequently, size of assets under management will be stagnant or shrinking. In terms of the stability of income, management fee is the most important fee because it is recurring and more stable due to lower volatility of the size of managed fund. It also makes the industry more stable because of the bulk of the income is asset-based rather than transaction-based. If the assets under management erodes, management fee will be reduced. Therefore, the size of assets under management and cost structure are very important for the business and profitability of asset management companies.

Just like with any other industries, PEFINDO sees diversification factor as one of the important risk mitigation factors. Diversification, both in the product offered or in types of clients or marketing channels, can provide a better position for asset management companies to deal with business volatility. It is even more crucial considering that the industry is dependent on the performance of the capital markets which tend to fluctuate, particularly for capital markets in emerging country like Indonesia. Capitalization is also another important factor, especially for asset management companies that just recently started their business. Strong capital can support the expansion measures such as new products launch, attracting quality investment managers, and also improving the quality of supporting systems such as IT infrastructure.

In conducting the rating, PEFINDO is guided by a particular rating methodology for the asset management sector. In it, an analysis of the risk profile of business and the financial aspects will be performed. From the business point of view, several aspects are being assessed, which include business position, diversification, cost structure, and management, along with infrastructure and the business strategy going forward. From the financial perspective, there are four main items: risk management, capital structure, profitability, and liquidity and financial flexibility. Aside from these things, based on the methodology of parent support, PEFINDO also considers a rating notch-up if there is an evidence of or a potential support from the parent company. The point is to determine the level of capability and the willingness of the parent in providing support. Qualitative elements are also considered in assigning ratings to companies in this industry. The essence of the rating exercise is to have a forward-looking assessment so the rationale is these qualitative elements will enable the company to achieve its projections. But on the other hand, these projection has to be compared with existing achievement or track record, to verify whether there is a significant deviation that makes the projection less sensible.
This asset management industry is quite different from corporations or financial institutions in general, because asset management companies are not allowed to borrow. In general, the absence of debt does ease the financial burden and can have a positive impact on the rating. However, this does not mean that asset management companies will directly get a better rating because of this. PEFINDO also looks at other aspects, such as business aspect of the industry which according to PEFINDO is inherently volatile due to its tie with capital market. In addition, the absence of debt repayment risk is being traded with the risk large scale redemption which can significantly affect the liquidity, as well as reputation risk that can lead to a direct impact on the growth of assets under management, which ultimately affects the company's business position and its profitability.

Although rating is not obligatory in asset management of mutual fund industry, but it remains a useful tool for investors that will serve as a reference in investing in mutual funds. The reason is that investors need to understand the risk profile of their investment instruments, not only in terms of risk of having its net asset value decreased, but also from the overall risk perspective. The assessment will complement the consideration of the return on investment that has been considered a key determinant of investment decisions. For asset management companies themselves, PEFINDO rating can be particularly useful for business needs, where the company can use the rating to gain partnership or to sell its products to institutional customers such as banking.

It should be also understood that the asset management company rating is different from mutual fund rating. For mutual fund rating, PEFINDO has its own product that specifically assesses the credit risk of a fixed income funds or money market funds based on the analysis of the underlying assets of the said mutual fund.