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Innovative income funds fuel investors' appetite in Taiwan

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Income-based investment products remain in demand across the globe, underpinned mainly by the low interest rate backdrop and shifting demographics. Given these trends are here to stay, asset managers with innovative solutions that meet investors' needs stand to benefit greatly.

Taiwan serves as a case in point. Income themes have been gaining popularity in recent years with fixed income products seeing a strong demand from local institutional investors. The skew towards income is not surprising given the country's demographic profile. By 2026, Taiwan is expected to become a hyper-aged society which by the World Health Organisation's definition occurs when more than 20% of the population is aged 65 years or above[1].See Fig. 1.

Fig 1: Time trend of aging population

Country	Population Aged 65 and Above (% of Total)			
	7%	10%	14%	20%
Japan	1970	1984	1994	2005
Taiwan	1993	2006	2018	2026
South Korea	1999	2007	2017	2026
Singapore	1999	2012	2018	2026
China	2000	2016	2025	2035
Germany	1932	1951	1971	2008
France	1864	1943	1990	2019
Canada	1945	1984	2010	2024
United Kingdom	1929	1946	1975	2026
United States	1942	1972	2013	2029

Source: World Population Prospects: The 2017 Revision, United Nations (2017).

Source: [1]Population Projections for (Taiwan): 2016–2061 published by the National Development Council. World Health Organisation defines an aging society as one where more than 7% of the population is aged 65 years or above and an aged society as one in which this age group accounts for more than 14% of the total population.

Fig 2: Assets under management (AUM in TWD bn) and market share (in %) by asset classes

Asset Class	2018		2019		2020 (YTD)	
	AUM	Mkt Share	AUM	Mkt Share	AUM	Mkt Share
Equity	2,339	40.6%	2,097	27.4%	2,232	28.7%
Fixed Income	1,894	32.9%	3,850	50.3%	3,720	47.8%
Mixed Assets	805	14.0%	881	11.5%	822	10.5%
Others	719	12.5%	824	10.8%	1,014	13.0%
Total	5,757	100%	7,652	100%	7,788	100%

Source: SITCA, Taiwan as at the end of Oct 2020. “Others” include money market and alternatives.

Regardless of how comprehensive or adequate a country’s retirement and pension systems are, this statistic will continue to fuel demand for income to support the future financial needs of Taiwan’s hyper-aged population. Growing concerns over insufficient retirement savings have led many Taiwanese investors to try to build a pool of accumulated savings on their own. Mutual funds have typically been their go-to product with bond funds seeing the most inflows. See Fig. 2.

THE MORE THE MERRIER CATCHES THE REGULATOR’S EYE

Within the fixed income mutual fund space, Taiwanese investors can choose from several products ranging from the traditional bond funds and target-date funds (TDFs) to fixed-maturity products (FMPs) and bond exchange-traded funds (ETFs).

TDFs’ ability to pay out regular income and the attractive yields lifted their popularity after 2016 when bond yields dived on the back of economic worries. Moreover, by investing in a portfolio of bonds that mature at the same time, the overall portfolio risk can be relatively lower.

Meanwhile bond ETFs gained popularity after tighter regulations put constraints on the Formosa bond issuance market from 2018. Moreover, the growth of the bond ETF market has been fueled by demand from Taiwanese life insurers. New regulations on accounting standards meant the life insurers were no longer able to directly invest in investment grade cash bonds. As such they were forced to invest in ETFs and onshore funds in their portfolios.

The huge inflows into FMPs and bond ETFs prompted Taiwan’s financial regulator to tighten rules on such offerings to avoid the risk posed by any massive outflow of capital from an overly concentrated market. In 2019, Taiwan’s regulator, the Financial Supervisory Commission banned domestic fund managers from launching three bond ETFs or TDFs consecutively.

RESPONSIBLE INNOVATIVE SOLUTIONS WILL STAND OUT

Against this backdrop, asset managers who want to be major players in this market will have to structure new products that meet both investors’ and regulators’ requirements. These new products, however, need not be invented from scratch. A mix of longstanding investment strategies can also create an innovative solution. In line with this, we introduced a new strategy that combines both the existing target-date and fixed-maturity investment strategies.

Traditionally, most of the TDFs are Fund of Funds which implies that a bond fund would form the main component in an investment portfolio. Bond

Fig. 3. Key differences in product features

Features/Products	New TDF	Traditional TDF	FMP	Multi Asset
Target date	Yes	Yes	Yes	No
Fixed maturity	Yes	No	Yes	No
Decreasing bond risk	Yes	No	Yes	No
Enhanced equity	Yes	Yes	No	Yes
Decreasing equity risk	Yes	Yes	No equity	No

Source: Eastspring Taiwan, Dec 2020.

funds are typically index driven and have a fixed duration. Should a bond fund, within a TDF that is maturing in 2 to 3 years, have a fixed duration of 8 years, the issue of an over exposure to duration risk arises. Hence the new TDF strategy incorporates the fixed-maturity feature into the TDF to match the duration risk.

This new feature makes this TDF quite different from the traditional TDFs, FMPs and Multi Asset strategies. See Fig. 3. The new TDF aims to offer a broader and a more conservative solution that generates long-term, sustainable and steady income, whilst offering a return of the principal as well as the payment of interest.

TAIWAN HAS MUCH TO OFFER ASSET MANAGERS

Taiwan's wealth management industry still has a high growth potential. The country's GDP per capital has been steadily rising and over the last 10 years grown by 36%; the International Monetary Fund has projected this number to average USD 26, 910 in 2020. The country also boasts a high savings rate.

According to Market Research.com, high net worth (HNW) and affluent population accounted for just over a quarter of its adult population in 2018. Yet this segment held more than 80% of the country's total onshore liquid assets. Moreover, HNW Taiwanese typically hold most of their wealth in assets such as equities, mutual funds, and bonds. This trend is expected to continue, and we expect Taiwan's mutual funds' market to hit a funds under management size of TWD 8 trillion next year, and most likely reach USD 10 trillion within 5 years.

Most Taiwanese investors also prefer to invest and actively manage money overseas rather than retain it in the home market. In a nutshell, Taiwan is a sweet spot for asset managers that are nimble and innovative.

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