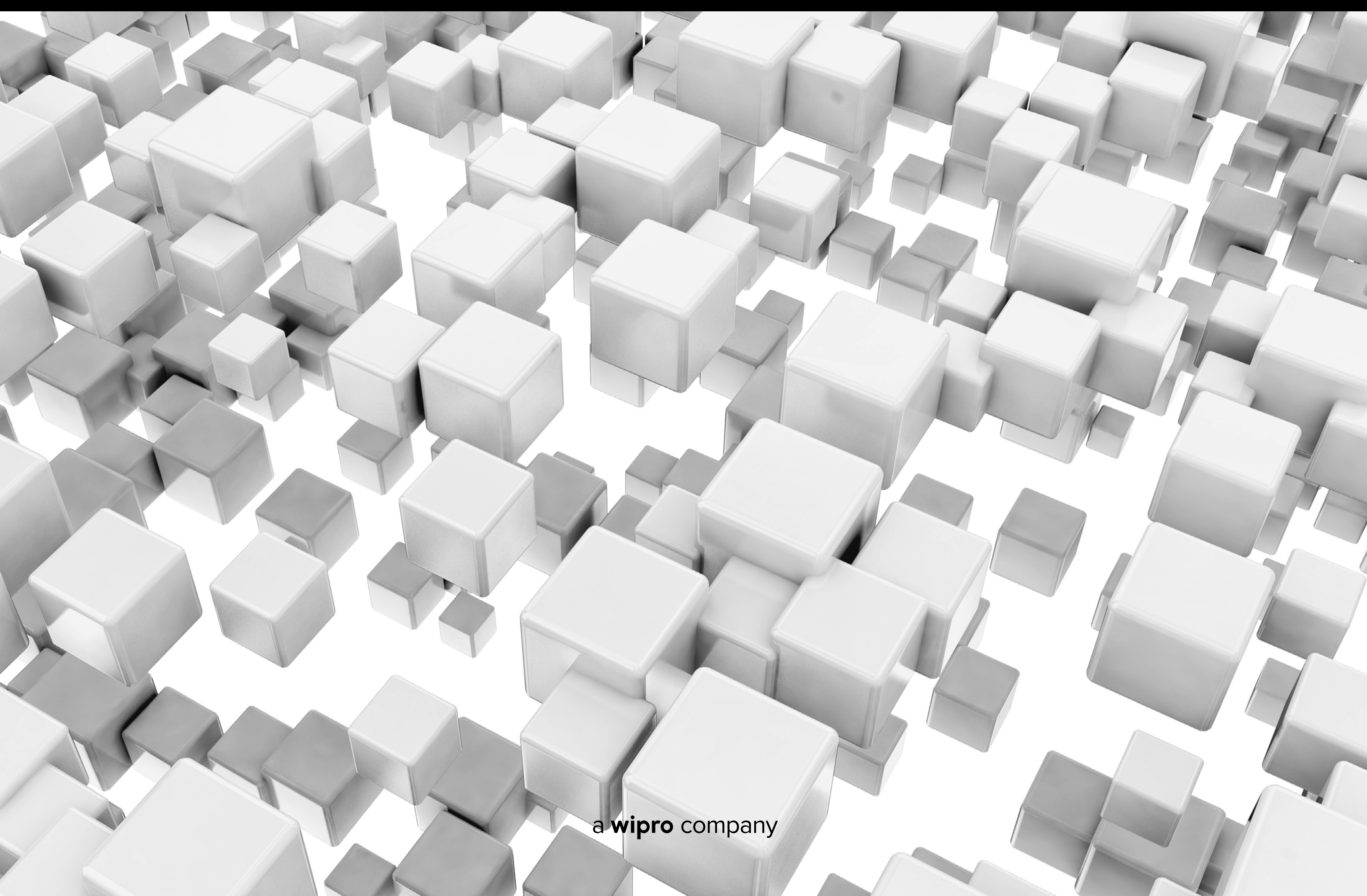
CAPCO

THE ONLY CONSTANT IS CHANGE

8 ASSET MANAGEMENT TRENDS FOR 2022



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INTRO

Asset management is experiencing a new-age transformation affecting consumers, technology, and business leaders. As a Head of Client Investment Strategy emphasized, “Against a backdrop of higher inflation, however persistent it proves to be, asset managers could struggle.” Capco identified eight trends below that asset managers will need to address in 2022 to diminish those potential setbacks:

DECLINE OF THE MUTUAL FUND

"Dual threats from product innovation and consumer demand are driving the mutual fund to no longer be at the forefront of asset management. And while these dinosaur funds will likely continue to exist, their place as the behemoth Tyrannosaur is certainly no more."

While other asset classes have seen massive inflows from both institutional and retail investors, the mutual fund industry has witnessed growth kindly described as anemic. In 2021 alone, Equity Mutual Funds experienced nearly $13 billion in outflows.[1]

Capco expects this trend to continue gaining steam, especially as the SEC's relaxed stance on ETF position disclosures gives mutual fund managers a viable exit strategy. Even this, however, may prove a mirage as the spectra of widespread direct indexing allows client-driven customization of common investment strategies.

It's not all bad news, though. Demand for SMAs has been growing steadily year over year, and fund complexes may find an opportunity to provide hyper-personalized solutions at scale.[2]

ALTERNATIVE INVESTMENTS – NOT SO ALTERNATIVE

"Clients are expressing an insatiable appetite for alternative investments and they're demanding menus. All that's left to be decided is which asset managers have the vision, strategy, and execution to take the orders."

Institutions have always expressed healthy demand for alternative investments, but as yields continue to be compressed and economic forecasts remains cloudy, Capco expects smaller, less subversive pools of institutional capital to increase their allocations to alts.

Large asset managers are in pole position to offer illiquid solutions to capital looking to make up ground against underfunded liabilities, uncertain revenue streams, and a lower-return environment. By combining capabilities around diligence, branding, and distribution, marquis asset management firms can increase AUM, wallet share, and market dominance.

Our experts consulted with a senior leader in asset management (Head of Client Investment Strategy) who stated, "Portfolios solely reliant on traditional asset classes could struggle to deliver client needs. The tendency of equities and bonds to underwhelm against a backdrop of rising prices, combined with full valuations across both asset classes, is a strong argument for an enhanced allocation to alternative investments."

Operational buildouts are necessary to provide a robust offering along these lines, but there is no reason to believe that the asset managers of 2022 and beyond will not see the value in expanding their product suite to give institutional investors more of what they're craving.

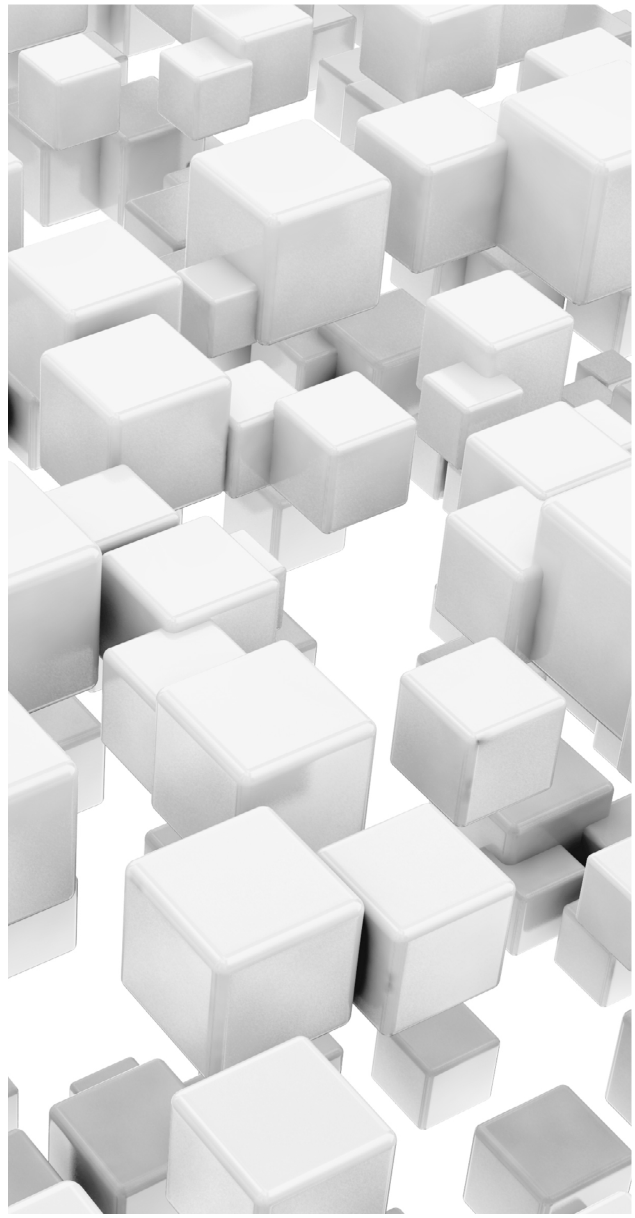
DIGITAL ASSETS – THE TIME IS NOW

"As institutional clients continue to crave digital assets, Asset Managers must pick up their game or they will find themselves on the losing end of one of the biggest battles this decade: The viability of cryptocurrencies."

Institutional consultants have waffled between "what is this," and "DANGER STAY AWAY!" on cryptocurrencies for years. Only recently have they come around to recommending institutional capital including various crypto assets into portfolios.

To this end, Capco expects asset managers servicing institutional clients to dedicate higher headcounts and more operating budget to developing and perfecting solutions around the custody and administration of digital assets. Fidelity, BNY, and US Bank, along with others, have already committed significant resources to making this happen, and given the game of catchup currently happening on the allocation front, there is still room in the market for more entrants to meaningfully compete. The CEO of Onramp Invest, a provider of crypto asset management technology states that now Asset Managers "are typically adding a 1% to 2% allocation. However, those who are more committed to the strategy may be as high as 3% to 5%."

After all, with its 60x return in the past five years, had large institutional capital and their consultants dedicated even a small portion of their portfolios to Bitcoin, their looming liability avalanches wouldn't look nearly so ominous.



ENVIRONMENTAL, SOCIAL, AND GOVERNANCE CONTINUING TO GAIN GROUND

"Environmental, Social, and Governance (ESG) reporting is imperative for public and private companies, and with the SEC likely to announce new climate risk disclosure rules, reporting standardization will not close the gap around the actual application and implementation of sustainability reporting. Meanwhile, ESG fund flows are greater than ever, 2021 totals as of Q3 surpassed all of 2020 totals; however, interest and queries have risen around ESG credentials, inciting fear in asset managers."

ESG disclosure and reporting has become imperative for companies, public and private. This past summer, the SEC provided insights into upcoming climate disclosure rules. For instance, there is likely to be a new climate risk disclosure rule in addition to mandatory climate disclosures. New disclosure rules will be helpful for companies to streamline and standardize ESG reporting, as the current sustainability reporting landscape is very complex with many different frameworks across the industry. At the same time, public funds, private equity firms, high-net-worth investors, and nonprofits are aggressively increasing ESG commitments. However, new regulations will not bridge the wide gap between the ESG goals that companies have outlined and the actual application and implementation of sustainability reporting.

Pure outperformance is the driver of ESG investments and commitments, and ESG will continue to be mainstream because it has shown outperformance in times of economic growth and economic dislocation. ESG fund flows by the end of Q3 2021 hit $54.7 billion, greater than the total 2020 ESG fund flows at $51.1 billion. Despite this obvious popularity, a phenomenon known as greenwashing has emerged in the industry. This refers to an increasing suspicion around ESG credentials claimed by asset managers.

CONSOLIDATION AND M&A ACTIVITY ARE SET TO CONTINUE

"The trend of consolidating, merging, or acquiring asset managers continues into 2022 for financial institutions looking to glamorize those all-important earnings calls."

This has been an active few years in the asset management M&A space, with a record number of high-profile players hungry for acquisitions. From Morgan Stanley's massive bidding war for Eaton Vance against JPMorgan in 2020 to middle-sized deals like Amundi's acquisition of Lyxor in April 2021, there appears to be no shortage of cash or appetite in sight.

There are a few reasons for the relentless demand for consolidation in the asset management industry depending on who you ask. For banks, low interest rates have forced them to seek out steady noninterest income. Asset management firms are a natural fit for banks since they don't consume much capital and have natural synergies with banks' wealth management arms. For asset managers, shifting priorities in their large institutional clients have forced them to seek out ways to provide a broader range of products across asset classes. Mix that with continuous fee pressure and a need for cost synergy, consolidation for scale inevitably becomes the most attractive solution.

Size isn't everything though – companies interested in acquiring an asset management firm should first and foremost look beyond scaling to reduce costs and focus on strategic niches, such as breaking into ESG product offerings or a particular geographic region. One senior research analyst notes that investors are more excited by deals with a strategic purpose than acquisitions just for scale alone. "The market had a collective yawn because [some companies] didn't make you think they were going to grow more, they were more focused on cost synergies."

ASSET MANAGEMENT FEE LIMBO

"How low can fees really go? Not as low as you think at some funds. Are higher fees worth the risk to start-up funds and smaller managers?"

Across the industry, fees are down, but not all managers are feeling the same pinch. When raising funding, asset managers face pressure to lower their management fees in order to attract the highly sought institutional investor assets. Due to this competition, smaller funds are being forced to cut their fees at higher rates than the mega-funds in the market. However, some smaller funds are still commanding higher fees due to higher fixed operational costs. Meanwhile, at the larger funds, managers can leverage technology across their business to realize economies of scale to minimize operational expenses.

Now, with these large and mega funds offering not only lower fees, but also prestige, impressive track records and potential, how are the smaller and start-up funds expected to attract large investments of institutional assets? As we head into 2022, we can expect to see fees continuing to decline across the industry, but will smaller, boutique firms be able to lower fees like their larger counterparts? If they're able to capitalize on automation, they may be able to. If not, they will rely on marketing and selling their long-term potential to investors that are constantly chasing that high return.

DIGITAL AND CLIENT EXPERIENCE ARE FINALLY FRONT & CENTER

"In today's market, clients' needs continue to evolve and so do their expectations for digital products and services. Asset managers must increase their digital spend to remain competitive. Times are changing and one thing is for certain: we are amid a revolution, not an evolution."

The Covid pandemic has served as an accelerator to digital transformation resulting in asset managers increasing their digital spend. Achieving growth is a top priority given the rise of low-cost passive investments ($21trillions in AUM/↑35% Y/Y)[3] and challenger banks (26,000 FinTech firms/↑21% Y/Y).[4]

Digital transformation is no longer a luxury, but a necessity as it enables asset managers to do more with less and frees them from their desks by having access to top-notch digital tools as well as providing digital solutions to investors in real time from home. Investing more on digital capabilities, particularly in client-facing systems, means firms will be further inclined to spend on people designing these new technologies.

There is a fundamental culture shift happening in investors' attitudes, behaviors, and expectations towards personalized digital interaction. Clients might not recognize some of these digital tools and technology, yet they still expect accessibility and ubiquitous platforms that are easy to use. Due to their hyper personalization expectations, clients are more capable and willing than ever to change firms in an instant.

Designing customized digital capabilities is crucial, but do not ignore the importance of client engagement. Client engagement is driven by delivering relevant and the right-sized communication. One of the strategies to increase client engagement is through responsible digital transformation. Asset managers are aware of this and in a recent survey of 100 buy-side firms with AUM of $10 billions-$100 billions, over half of the firms currently use the cloud for data management today and 28% plan to migrate data management to the cloud in the next 12-18 months.[5]

Savvy investors are more cognizant about how they invest their time and money. Only those asset managers who deliver personalized technology and relevant communications to their clients' needs will survive in a rapidly changing industry.

DATA FOR COMPETITIVE ADVANTAGE

“The industry is still building the data quality and governance foundations in order to harness the transformational power of data, but there is still a long way to go.”

Investment managers have fragmented legacy technology landscapes with disparate siloed platforms and inconsistent data. Progress is being made, and foundations are being laid in terms data quality, governance, lineage, and resiliency to ensure regulatory compliance, but there is still a long way to go before the true value of linking existing with new and emerging data sets to find alpha insights is achieved.

In 2022, we expect to see an increasing level of activity in cloud migration as well as API integration to generate efficiencies and simplification and keep up with the exponential growth in datasets that need to be onboarded, cleansed, and operational. In addition, we expect service providers to continue to innovate and have a significant role to play with an expanding range of services, new tech partnership, and access to unique data sets.

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ABOUT CAPCO

Capco, a Wipro company, is a global technology and management consultancy specializing in driving digital transformation in the financial services industry. With a growing client portfolio comprising of over 100 global organizations, Capco operates at the intersection of business and technology by combining innovative thinking with unrivalled industry knowledge to deliver end-to-end data-driven solutions and fast-track digital initiatives for banking and payments, capital markets, wealth and asset management, insurance, and the energy sector. Capco's cutting-edge ingenuity is brought to life through its Innovation Labs and award-winning Be Yourself At Work culture and diverse talent.

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