Link to Article on website

Leading fund gatekeepers discuss the options for 2018

Hubbis assembled an erudite team of product gatekeepers and fund selectors in Singapore for a discussion on a wide range of issues affecting their institutions in the foreseeable future, as well as reviewing some key investment themes for the year ahead.

AMG hubbis

THE DISCUSSION WAS HOSTED BY HUBBIS, in association with Affiliated Managers Group (AMG), a global asset management company with equity investments in boutique asset management firms around the world.

The discussion participants were senior product gatekeepers and fund selectors from leading international and regional private banks, as well as representatives from multi-family offices.

Hugh Cutler, Executive Vice President and Head of Global Distribution, represented AMG and welcomed the group of experts. He briefly introduced AMG, highlighting the group's history and some of the unique features of both the holding company AMG and its affiliated specialist boutiques which manage, in aggregate, USD836 billion in assets across over 550 investment products. [See profile 'AMG: Shining a Light for Boutique Asset Managers'].

The key discussion themes for the roundtable included the investment landscape in 2018 and beyond; the value of alternative investments; the pressures on firms' revenues and profitability from global regulatory reform, compliance, technology, fee compression and competition.

Also central to the discussion was how product 'manufacturers' and fund selectors partner with each other and whether private banks' dominant tendency to use the same big-name fund providers might evolve to incorporate a more significant focus on boutique and specialist managers. This portion of the discussion focused on the primary selection factors for wealth management gatekeepers in Asia.

Are decisions to select the leading name asset managers driven by scale considerations, leverage in fee retrocession arrangements or other deals, or because larger managers offer better service and returns?

If boutique asset managers gain greater traction with banks, how will their partnerships compare with those of larger managers?

With the global regulatory environment tightening, the wealth industry must be extremely careful about retrocessions and be diligent in providing clients with fee transparency and fee justification, with all of

these factors imposing greater compliance, revenue and profit pressures on the firms.

As digitisation demands greater financial, and human, investment, resources can become increasingly strained just as competition from non-traditional sources - FinTech, RegTech, Big Tech, gains momentum.

The lively debate also touched on investment themes and products around which participants have seen strong client dialogue in year-ahead discussions and expect to be most relevant at this stage in the investment cycle. With the developed world's fixed income and equity markets on a virtually non-stop upward track since the worst of the global financial crisis receded, do wealth management firms now advise that investors tread with greater caution, further diversify by incorporating a higher allocation to alternative investments and/ or adopt more active hedging strategies? These are all vital issues that at the start of 2018 wealth providers are assessing and based on which they are positioning their firms for the future challenges in providing wealth solutions to their HNW clients in Asia.

All eyes on rising volatility in 2018

The discussion took place on January 30, shortly before the global equity market volatility that began on February 1.

... as the bull markets had run long and hard for the past nine years, and as volatility was negligible in 2017, people should expect greater volatility in 2018.

While the experts assembled at the Hubbis roundtable had diverse views on many of the discussion topics of the day, there was a greater consensus regarding the state of the markets.

The general view was that as the bull markets had run long and hard for the past nine years, and as volatility was negligible in 2017, investors and clients should expect higher volatility in 2018.

"Looking at the year ahead we see a similar narrative as at the start of 2017," said one expert. "[If] we rewound the clock 12 months ago to where we talked about where our surprises might be, we advised that clients should position for increased volatility. I think we really are in the very late stages of this market, and volatility seems to be very gradually ticking up now."

Another panellist said: "I am really thinking about how to play the 'end of the bull' market because it must come to an end at some point. Almost a decade in an extended upward trend and it is probably starting to get a bit long in the tooth."

The AMG Team (left to right): Hugh Cutler (Executive Vice President, Head of Global Distribution), Indo Kang (Managing Director, Co-Head of Asian Distribution), Xing Yu Toh (Manager, Asian Distribution), James Sim (Managing Director, Co-Head of Asian Distribution)

A tail? With salt, or sugar?

But on the other hand, doomsayers have been muted in recent years. "We must also consider how to play that last leg up," said one attendee. "What is the best way to do that? Then secondly, how do you make sure that your portfolio is resilient so that you can see through that last piece?"

Another added: "The two things that we are really focusing on in our conversations with clients are, one, is there much further, or any distance at all, to go before the bull market ends. But, two, as nobody could have afforded to be out of the markets in recent years and it has held up time and again, and valuations are not dramatically stretched in every leading market, even today, so how do you play that now?

One expert explained that their biggest priority recently has been "to really try to get clients to take our strategic and tactical asset allocations to heart".

Why? Because, as he explained, looking at where asset prices were [in late January], he had been seeing plenty of head-nodding in client meetings while talking about being truly diversified and following tactical and strategic asset allocation. "But," he noted, "all too often when one looks at their books and their current expectations, they are still chasing returns."

Diversification in play

He further explained that diversification is a sensible play especially given the market's recent history.

"I always say that being diversified is like having an umbrella. It is too late to reach for alternatives when the market has sold off. It is already raining, you are outside, you are already wet. The point is to have the umbrella in your portfolio so that when these drops start coming, you are all ready to deploy it."

On the other hand, one panellist explained how his mission over the past year had been to shift some clients from a fixed income focus to more risk-oriented investments, based on the widespread positive market conditions.

"The clients were very happy," he said, "and are quite positive about the prospects for equity markets or risk in general for this year as well. Fixed income, especially with heavy leveraging, did very well, but with rising rates, there is much less juice in this, so we see people redeeming quite a bit of their fixed income portfolios and moving more to equity/multi-asset."

I always say that being diversified is like having an umbrella. It is too late to reach for alternatives when the market has sold off. It is already raining, you are outside, you are already wet.

Looking at alternatives

Another private bank representative reported that his firm had seen rising activity on the alternative investment side and he anticipated expansion of that trend.

"There was certainly a renewed interest in private equity, and I should also say private markets generally," he observed.

"That ranged from mezzanine debt to fintech to buyouts, both Asian and the US. We also saw renewed interest in what I would refer to as 'managed' real estate. We saw quite a bit of success with some of the more prominent quant managers, particularly those dealing with artificial intelligence (AI)."

Yet another perspective was given by one wealth adviser.

"We have been assessing where asset prices are today and the underlying global economic and geopolitical conditions - and our client conversations and engagements are certainly around taking some money off the table and diversifying, both within fixed income, where it is going to be increasingly difficult on the credit side, and equities, due to valuations that are at such a level as to be vulnerable to market reassessment or weakening economic and profits fundamentals. Accordingly, we are recommending allocating increasingly to alternative investments and having some very engaging conversations."

To hedge (funds), or not?

A banker explained that their private banking business is now skewed towards ultra-high-net-worth clients (UHNW) who are now also looking for more sophisticated products.

"The one vehicle that we put together last year which we believe was a differentiated

value proposition to clients was an actively managed portfolio of very high conviction hedge fund managers," he said.

"We were working with a leading fund name in creating that product, these were managers that we hand-selected," he continued.

"We did our own due diligence in conjunction with their own investment team. We do have a seat on the investment committee which is something unusual; they generally do not open the door to that role."

He added a further perspective: "A lot of HNW and UHNW banking clients have had poor experiences investing in hedge funds. Usually, clients will ask us to pick the best hedge fund solution for them. Our solution was to create a vehicle that gave them enough diversity through a portfolio of funds."

But another expert said he warns HNW clients to be wary of the hedge funds in whatever guise. He gave a brief historical perspective, recalling the start of the hedge fund boom in the late 1990s/early 2000s.

"At the outset, those hedge funds were happy to raise maybe USD100 million, then suddenly within a year or two, it was USD500 million and so on and so forth. But could their strategies work as well when they were so much bigger? No, and the proof is to look at hedge fund performance on an aggregate basis from those days to now, and you will see a lot of disappointment in this alternative space."

A lot of HNW and UHNW banking clients have had poor experiences investing in hedge funds.

One panellist noted that Warren Buffet is often to be heard "bashing hedge funds as his 'go-to' playbook". But he said there is a lot of expertise in the hedge funds, and they have played a key role in the markets in the past 15-20 years. "Don't forget about the fact that his [Buffet's] CIO is an ex-hedge fund guy, and the number two lieutenant on the investment side is an ex-hedge fund guy".

Independence days ahead?

Asset allocation and the advisory role is always at the forefront of wealth providers' thinking, as it is key to their revenues as well as their clients' financial security. It is also how firms, big and small, differentiate themselves from their rivals.

One representative from a global bank argued that the views coming from their CIO and the sheer weight of their investment in analysts and research differentiate them greatly from other firms. "We differentiate ourselves via advice and the portfolio approach. And we tend to work with the big brand name funds, as the clients

AMG hubbis

expect this association of our global brand with other well-recognised, global names."

Being independent, countered another expert at the roundtable discussion, means his firm has the advantage of really taking the best products on the market.

"Too often the big banks are encouraged, almost forced, to see the products they consider as most profitable, or where they can obtain the best retrocessions, instead of selling the optimal products to the clients, based on their deep understanding of those clients.

Also, where we do not have the capabilities, we partner up, as an example, we did a private debt fund with a small manager and it added significant additional performance to our clients. That's where we can add value. It's nearly impossible for a big private bank to operate in this way, as they need scale and can only offer a big fund."

Some questioned the corporate pressures on staff in global investment firms, especially those which are captive within larger financial institutions.

A panellist commented: "It is ultimately about the alignment of interest. If you are on the bank's payroll, your loyalty is to the bank. I think it is important to be mindful of the fact that these are very large institutions. The larger they get they also become more bureaucratic. I was in a global bank CIO investment committee and I can tell you, hands on heart; they are always behind the curve."

It is ultimately about the alignment of interest. If you are on the bank's payroll, your loyalty is to the bank.

Quality, not quantity

One banker wondered, "Does the world really need 37,000 managers to manage the pool of global assets? Probably not. It is not the quantity that matters, it is the quality that does."

Another bank representative gave a balanced perspective that size does give some power in the market, but on occasions, it acts against performance.

"To asset managers in certain asset classes or certain strategies scale is your friend," he observed. "If you are running, for example, an SME 500 index fund and you have USD200 billion to play with, you can do it a lot cheaper than if you have just USD1 billion. But if you are running an active strategy where you are actually trying to take advantage of liquidity and dislocation, then scale is your enemy. And as you get into small-cap equities, for example,

would you buy a small-cap equity fund with USD30 billion in assets? Or an emerging market equity fund that had USD50 billion? Unless it was passive, I probably suggest you would not do so. So, in this case, scale is also your enemy."

Another commented that a lot of the managers "get too big for their own good, and then they cease to give you alpha".

He said they then start to become beta generators, which can be helpful as a diversifier and might stabilise the portfolio.

"But is it truly adding a lot of value? I am sometimes honestly not sure, as size is often a double-edged sword."

Regulatory environment: challenges for all market participants

A representative from one global institution highlighted how new regulations around the globe are such a massive challenge for everyone. The big players, who have their global brand to protect, are ever more fearful of lawsuits from outside and from within and therefore have to be ever more careful about their advice and the audit trail to that advice and the subsequent actions taken.

"A key priority, perhaps the biggest challenge, is to equally work with our compliance and risk partners who prescribe the ways with which we can engage with our clients correctly," he explained. "What comes out in the big banks is a process that is sometimes not feasible, despite the best efforts from the platform partners to come up with their best product, or the research department to come up with exemplary research."

There are many new, or recent, regulations, but none more pervasive than the EU's ambitious regulatory reforms and especially the revamped version of the Markets in Financial Instruments Directive, or MiFID II, which are being rolled as of January 3.

The aim of the design is to offer greater protection for investors and inject more transparency in all asset classes: from equities to fixed income, exchange-traded funds and foreign exchange.

The new rules cover virtually

The big players, who have their global brand to protect, are ever more fearful of lawsuits from outside and from within and therefore have to be ever more careful about their advice and the audit trail to that advice and the subsequent actions taken.

AMG hubbis

all aspects of trading within the EU. They reach across the financial services industry, from banks to institutional investors, exchanges, brokers, hedge funds and high-frequency traders.

They also cover European institutions operating outside the EU borders, as well as EU clients serviced by any firm, European or other, outside those borders.

And, of course, the rules cover any product or derivative linked ultimately back to a listing in the EU. In other words, the rules are extraordinarily pervasive throughout the global financial industry, therefore having a deep impact on wealth management in Asia. There was a consensus at the discussion that the industry is not yet prepared for these new rules.

One expert noted: “Regulation is forcing the fiduciary duty that we have as we present investment products to our clients even more to the forefront of all the discussions we have and decisions that we make. The way the regulators have forced us to engage with clients is perhaps where the biggest challenge is today.”

Fees require ideas and bravery

Another banker conceded that the industry has not been so successful in pushing Discretionary Portfolio Management (DPM) and advice. “In my view, I wish we might have more success in what we believe in, earning fees for advice, for discretionary, strategic asset allocation by the bank. But generally, we are not successful in making our clients do what we believe is the right thing. How many clients really follow the strategic asset allocation of the bank?”

The regulatory and compliance angles clearly add further anxiety to making strong advisory or product calls, creating a fear factor that can all too often result in banks avoiding making any strong recommendations at all, favouring a careful approach and working with their big brand name partners so that they are more immune from a backlash if things go awry.

And that is where smaller and less ‘corporate’ can pay off.

“The nice thing from where I sit,” said one representative from a boutique firm, “is that we do not have to make any trade-offs, the only thing we do is decide what the clients need, what are they comfortable with owning, and whether we should educate them to own some things that they have not had before.”

The client first approach - a long-only, active view

At the end of the day, the client, their financial security and their returns are what the wealth industry is all about.

“I truly believe that whatever the short-term situation, in the end it is long-only strategies that benefit the clients. Any investor in the world can go long in the market, all he needs is an internet connection. They do not need to pay any extraordinary fees to big brand name banks or asset managers for that. Where true value comes in is if you have actively managed true alpha-generating managers on a risk-adjusted basis, that still add value in portfolios.” ■

The views and opinions expressed herein are those of their respective speakers, and do not necessarily reflect the views of either AMG or Hubbis.

AMG

Shining a light for boutique asset managers

Affiliated Managers Group (AMG) has a unique perspective on the world of asset management. Founded 25 years ago, it is a partner to some of the most highly-regarded boutique investment firms around the world, today holding stakes in 39 independent specialist firms.

WITH APPROXIMATELY 75 PERCENT OF AMG'S USD836 BILLION in assets managed across a broad array of global and emerging markets equity and alternative strategies, the firm's strategic focus, according to the documentation it produces, is very much on areas where there are meaningful opportunities to generate alpha, and where AMG sees secular investor demand trends. Across its Affiliates' offerings, AMG has a wide range of specialized, high-conviction global equity strategies, and claims to have one of the world's most diverse ranges of liquid and illiquid alternative strategies, spanning private equity, infrastructure, energy, credit, global macro, multi-strategy, relative value, managed futures, and long/short equities.

Boutiques – beating the odds

AMG produced a whitepaper in 2015 called "The Boutique Premium," utilising Mercer's Global Investment Manager Database to provide empirical evidence of long-term value added by boutique investment firms in its proprietary study.

"In brief," explained Hugh Cutler, EVP & Head of Global Distribution at AMG, "through that research, we found that boutiques did, in fact, outperform their non-boutique peers over a twenty-year period. Moreover, this out-performance was most pronounced in less efficient markets such as the emerging market and smaller capitalisation equities. But it was also evident in the efficient markets and large-cap sectors."

The MercerInsight global database was the primary source utilised for the return data in AMG's analysis, which incorporated more than 1,200 individual investment management firms around the world and nearly 5,000 institutional equity strategies comprising approximately USD7 trillion in AUM.

"We analysed rolling one-year returns for the trailing 20-year period ending 31 December 2014 across 11 different investment product categories," Cutler said.

Cutler has 20 years of sales and distribution leadership experience in the investment management industry across a broad range of strategies, client types, and geographies from previous senior business development roles at firms like Och-Ziff Capital Management Group LLC, Legal &

Hugh Cutler
AMG

General Investment Management, and Barclays Global Investors.

Consistent outperformance

"While the debate over the value of active investment management has intensified in recent years," Cutler commented, "the outperformance of boutique managers has been overlooked. In fact, investing exclusively with boutiques would have created 11% greater wealth over the past two decades."

Boutiques also generated substantial net excess returns versus indices.

"Core boutique characteristics position them to generate consistent outperformance," Cutler stated. "Sophisticated investors around the world are increasingly recognising the ability of focused boutique active investment managers to outperform both non-boutique peers and indices."

Liberation by investment

AMG typically owns between 40 to 60 percent of the economics in its Affiliates. Cutler highlighted several core characteristics of these firms, and boutiques in general, that have helped them consistently outperform in return-seeking asset classes (active equities and alternatives). "Principals at the firms in which we invest have significant direct equity ownership, ensuring alignment of interests with the client and a long-term perspective on returns and the business. The presence of a multi-generational management team, fully engaged in the business, ensures continuity. An entrepreneurial culture with partnership orientation attracts the talented investor."

Tightly aligned with the client

"With these stakes, the management partners alongside us are running the business so they have very strong alignment with the clients," he said. "We believe that people that are focused on generating outstanding investment results and aligned with their clients should do better than managers who are perhaps more focused on keeping their job within a multi-stream bank or other large financial institution."

AMG prides itself on providing a 'boutique-plus' environment.

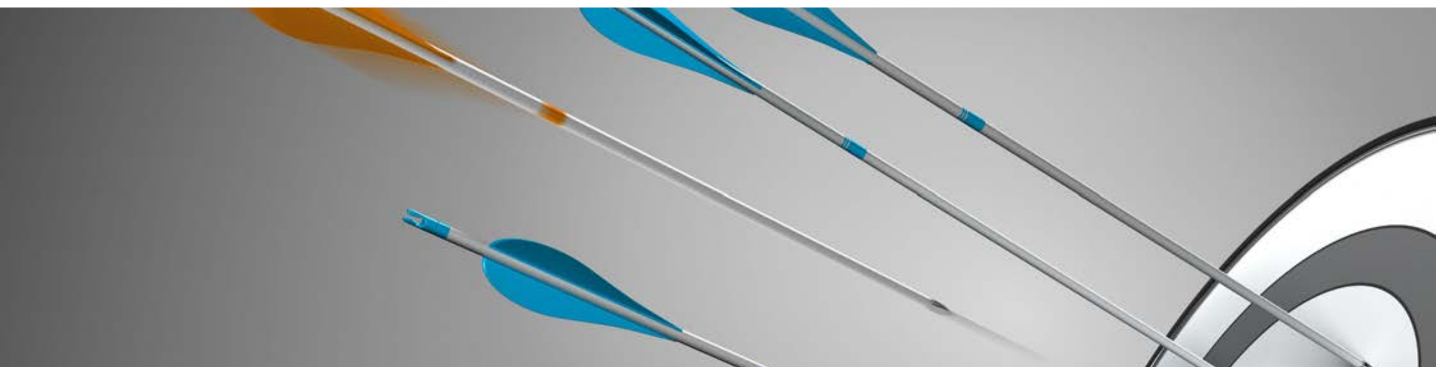
Cutler elucidated: "We take a very long-term view to investing in our Affiliates, and we provide ongoing strategic support to their businesses, for example helping them design a succession plan to transition from the founders to the next generation, helping them to enhance the growth of their businesses through strategic capabilities in areas where scale is really a benefit, including marketing and distribution, and providing help with legal and compliance."

The teams that run the 39 boutique asset management firms are incentivised by having substantial retained equity ownership in their own businesses, along with investment and operational independence - and in that way, they retain their distinct and entrepreneurial cultures and are incented to go out and hunt for the excess returns.

High-quality, high-conviction active

Cutler concluded, "AMG's core strategy of partnering with the highest-quality boutique investment firms worldwide is based on a profound belief in the competitive advantage created by the boutique business model. While our proprietary study, 'The Boutique Premium,' offers industry-wide evidence of the value created by boutique investment firms, AMG's track record of successful partnerships over the past 25 years, wherein we have supported the succession and transition of multiple generations of management partners at many Affiliates as they have continued to generate excellent results for clients and further build on their outstanding reputations as leaders in their respective disciplines, also speaks for itself."

For more information on AMG or its proprietary research, please visit www.amg.com ■



AMG hubbis