How Investment Management Firms Can Prepare For Them

Surprise!

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Executive Summary

I have 7 predictions that each have a better than even chance of occurring in 2014. Each would also be a unexpected surprise to many experts in the asset management industry. The greatest opportunities and risks for firms are surprises that disrupt existing trends. This executive report discusses these predictions and suggests how an investment management firm can prepare for these surprises.

1. *There will be at least one blockbuster deal* – firms can now to participate in M&A, either as a prospective buyer or seller.
2. *Unmanaged money, such as insured bank deposits or directly held government securities, will increasingly be directed back towards investment managers, boosting organic revenue growth*. Firms can prepare for clients who will be moving money away from, or to, their firm.
3. *International growth by U.S. firms will slow*. There are lessons that have been learned from past expansion, and cautions to pay attention to.
4. *Lift-outs of investment teams will accelerate*. Firms could re-consider the effectiveness of their retention skills for their own investment teams, and prepare to be an attractive partner for teams to consider.
5. *Hedge fund fad will fade* – how will you respond if you currently offer hedge funds, or how can you benefit from a shift away from hedge funds if you are a hopeful long – only manager?
6. *Solution fad will fade* – if your firm offers solutions, how will you respond? If you are a product – oriented firm, how can you benefit?
7. *More compliance blow-ups* – are you vulnerable to rogues, do you recognize conflicts of interest, and are you building trust and revenues from clients?

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Introduction

I have 7 predictions that each have a better than even chance of occurring in 2014. Each would also be a unexpected surprise to many experts in the asset management industry. The greatest opportunities and risks for firms are surprises that disrupt existing trends. This executive report discusses these predictions and suggests how an investment management firm can prepare for these surprises.

To recap the 7 surprises:

- At least one blockbuster deal will occur
- Unmanaged money will come back, boosting revenues
- International growth will slow
- Lift-outs will accelerate
- Hedge fund fad fades
- Solution fad fades
- More compliance blow-ups

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1. Blockbuster Deals

It's been a few years since we've had a game changing acquisition in the asset management business. With higher stock prices for public firms and cheap financing available, buyers are likely to pounce. Once the first blockbuster is announced, more will follow. Here are some issues to consider if your firm is a potential participant in a transaction.

Are You a Potential Seller?

- Will all stakeholders (e.g. owners, shareholders, clients) be supportive of a transaction?
- Does your firm offer popular products that are selling well, coupled with strong investment performance?
- Does your firm have a robust succession plan?
- Does your firm offer unique distribution strengths, investment talent?

Are You a Potential Buyer?

- The 3 biggest risks of an acquisition are a major and unforeseen compliance issue, a downturn in relative performance or a shift in client preferences away from the products, or an acquirer attempting to "fix" investment or sales shortfalls which may compound the problem.
- How attractive is your firm to sellers? Your culture, willingness to offer autonomy, patience with investment results, reputation, type of organization, and track record of previous acquisitions will be scrutinized.
- Will you treasure sales and investment talent? Will key employees stay – for how long?
- Will you bring new distribution to the acquired firm?
- Will you offer additional capital to the acquired firm – for succession, further fold –in acquisitions, future incentive payments?
- Look beyond current momentum in sales and investment performance.

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2. Unmanaged Money Returns________

The Great Recession frightened many investors, and they retreated into insured deposits and US government securities. A multiyear rally in stocks and paltry interest rates, will spark flows back into managed investments in 2014, boosting organic revenue growth.

Will Investors Be Moving Assets Away From Your Firm?

- Were you a beneficiary of the shift towards safety in recent years?
- Investors are beginning to recognize that they are eroding their capital, and are unable to meet their current obligations with low yielding assets.
- Rising interest rates, and the rally in stock markets is finally starting to catch the attention of clients.
- Do you have other higher risk and return products that you can offer to your clients?

Will Your Firm's Products Appeal to Investors?

- Look for customers from the pool of those who used to use you to manage their assets.
- Consider soliciting clients who are now turning away from treasuries, bank accounts, and who are missing exposure to higher risk – higher return mandates.

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3. Slowing International Growth

Are You Expanding?

- Investment management is not a highly globalized industry.
- Other markets offer superior growth, demographics, and new pools of institutional capital.
- There is a strong preference for U.S. managers elsewhere.
- Build your own brand first, and don't rely on others to do it for you through joint ventures and distribution arrangements which you will come to regret in the future.
- First impressions matter. Don't enter markets with too small of a commitment.
- Stick initially to the largest markets, especially those with influential intermediaries who can leverage your brand.

Are You Reconsidering International Expansion?

- International markets have fast-changing and uncoordinated regulation, and taxation.
- Some markets have shrunk in recent years. Economic growth in others has not led to growth in managed assets, as investing in domestic infrastructure has been the priority.
- Reliance on 3rd party distribution is undependable and delays brand – building.
- Issues include staffing, compliance, product complexity.
- Some surveys suggest that profitability is higher for managers who refrain from significant international expansion.

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4. Lift – Outs Accelerate

Will You Hold Onto Your Current Investment Teams?

- The need to have both manufacturing and distribution in the same firm is over.
- Frustrated portfolio management teams can readily set up their own shop, or be housed in a more amenable firm that interferes less, offers better distribution and/or capital.
- The need for firms to grow larger to attract more client asset flows, means that lift-outs will increase in number
- Review incentive structure, expense limitations, marketing and admin support, relations with others in the firm, relations with clients, competitive demand for team.

Are You Looking to Lift – Out Investment Teams?

- Target vulnerable firms that don't respect, support or help investment talent to distribute their product.

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5. Hedge Funds Growth Slows________

How Can You Defend Your Hedge Funds?

- Large hedge funds are garnering the bulk of asset flows.
- Public funds in particular, may worry about the impact of hedge funds on social issues – e.g. employment, ESG.
- A politically motivated attack on hedge fund manager compensation may undermine the incentives for offering or managing hedge funds.
- Increasing concerns about the collective – and often identical - views of hedge fund managers and their strategies on capital markets.

Are You a Long – Only Manager?

- The only free lunch in the capital markets is diversification, and diversification is the main argument left standing to support additional investment in hedge funds.
- Clients and their advisors may become more adept at deconstructing returns, and unpacking the factors that contribute to performance. They may choose to replicate hedge fund returns using alpha generating long only managers. They could then supplement these managers with a variety of short, or leveraged strategies.
- Long – short strategies are popular and a clear first step for long – only managers.
- Liquid alts, and in the future active ETFs, also offer cheaper ways for clients to access more exotic hedge fund strategies.

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6. Solutions Growth Slows

Solutions include absolute return, target date, global asset allocation, and outsourced CIO, amongst other products and strategies. Investment performance doesn't always make up for the added costs of these solutions. Customers will once again recognize that solutions are expensive, and that investment returns are dependent on investment skill - which is in short supply - and not just packaging. Solutions represent easy answers for clients who are unable or unwilling to carefully consider the relationship of return and risk, the true cost of solutions, that the demand for asset allocation expertise out-strips supply.

Before there were packaged solutions, we had balanced funds. Today's solutions offer more diversification than was offered in balanced funds, which is a step forward. But the idea that lower correlation via diversification alone, will provide a superior result, is mistaken.

Do You Have Solutions?

- Every solution costs investors more.
- Someone is responsible for asset allocation and manager selection. The key is who has these responsibilities, what is their track record, and how much is it costing the client.
- Clients are becoming more discerning about fees, performance and want customization.
- Your products will sustain your firm in the long run.

How Can You Respond to the Backlash Against Solutions?

- Unbundle solutions.
- Partner with other firms to create cheaper solutions.

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7. Compliance Blow- ups_______

There is a lack of public trust in money managers. Regulators have a broader mandate to consider the "culture of compliance" and "tone at the top", and they move more quickly to bring in enforcement. This means that the threat of major blow-ups is increasing, and threatening the survival of some firms.

Defend Your Firm

- Focus on integrity - do what you say you do. Are exceptions the rule?
- Culture - identify, escalate and address issues.
- Watch out for rogue behaviors.
- Monitor the actions taken in remote offices.
- Monitor 3 rd parties. Remain vigilant about the commitment of outsourcers to the relationship. Firms that provide outsourcing services have their own strategic plans, and for economic reasons, they may choose to allocate resources away from certain services or clients. If you are entrusting some of your work to others, you have to be wary of changes in their willingness to support your firm and your clients.
- Intermediaries and distributors should also be monitored for their attitudes toward compliance.

Take Advantage of Culture

- Clients prefer advisors who appear more worthy of trust – such as larger firms.
- *Identify, and adhere to best practices in professional and business conduct* – there is both regulatory and professional guidance that can inform your firm.
- *Use your partners to leverage their reputation* to enhance your own.
- Be an outspoken *advocate* for higher standards in the industry.
- Create an economic incentive – more assets, revenues, profits – for measuring and enhancing trust, to sustain everyone's involvement in trust building activities within firms over time.

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Conclusion

I have offered 7 predictions that each have a better than even chance of occurring in 2014, any one of which would come as an unexpected surprise to many experts in the asset management industry. The greatest opportunities and risks for firms are surprises that disrupt existing trends. Preparing the firm to either defend against, or take advantage of these surprises should be on the leadership agenda for most firms.

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Authors Bio

Russell Campbell is the CEO of Your Second Opinion, LLC, a management consulting firm offering expert advice to leaders of investment management firms. He writes a weekly subscription newsletter for leaders, and also works one-on-one and with leadership teams on critical issues.

Russell has led 5 investment groups in his career. Prior to establishing his own firm, Russell was the CEO of The Marco Consulting Group, one of the largest institutional investment consulting firms, with a significant CIO outsourcing business. Previously, he was the EVP of AMCORE Bank, and led the Wealth Management Group which was one of the 60 largest bank wealth managers in the U.S.. Russell was the President and CEO of ABN AMRO Asset Management Holdings, Inc., which managed $75 billion in assets, and was the U.S. investment management affiliate of ABN AMRO Bank. Russell was promoted to this position after having been the CEO of ABN AMRO Asset Management Canada, Inc. He was previously a Vice – President and Partner of Beutel Goodman, Inc., one of Canada's largest investment counseling firms. His first leadership position was as Vice – President, Bank of Nova Scotia, where he led the investment management of the Bank's own pension fund, and a family office portfolio.

Earlier in his career, he worked as a pension investment consultant, in institutional equity sales and managed a portfolio of precious metals.

Russell has an MBA in Investment Finance and Marketing from York University, and he has a BA in Industrial Relations from McGill University. He also attended the Advanced Management Program at INSEAD in France.

He has earned the Chartered Financial Analyst designation, and has attended both the Financial Analyst's Seminar and the Investment Management Workshop. Russell has also acquired the Certified Financial Planner ™ certification. He previously held Series 7 and 24.

Russell has been a director of several for-profit and not for profit boards, and he is a member of numerous non-profit, civic and industry organizations.

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