The unmourned death of the sellside analyst

A former stalwart of Wall Street and the City has been felled by regulators and robots

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Spare a thought, friends, for Julian Bonusworthy. North of 40, he works for a respectable if second-tier global bank with towering offices in London. He is an equity analyst, advising fund manager clients what to buy and sell. His base salary is £350,000 and in a good year he takes a big performance award at year-end. His twins are in private school, the Land Rover is paid for and his £4m house is not.

Julian is about to get sacked. It is not that his performance has declined. He still churns out mountains of reports and works the phones. His problem is that, whether he knows it yet or not, he is as obsolete as a buggy-whip salesman.

Perhaps few tears will be shed for spreadsheet jockeys in braces and crisp white shirts — even those that are not, like Julian, imaginary. But his story has implications for the finance industry, and for cities such as London.

Who killed Julian's career? Regulators and robots. Start with the former. Under Europe's Mifid II rules, which came into effect this week, fund managers may not pay for analysts' research with "soft dollar" trading commissions. Once, analysts would take meetings with managers and send them research. In return, the clients would buy and sell shares through the trading desk at the analysts' bank. The traders and the analysts would then split the trading commissions.

Mifid II treats this as a potential conflict of interest. If a bank pays for trading services, but not on the basis of efficient trade execution, trades risk becoming a currency for exchanging favours, rather than enriching investors. Research will now have to be paid for with hard money. And because the market is global, Mifid is transforming how research is paid for worldwide.

The result is a much more unforgiving market. Before, blocks of client money came in, but who exactly earned that money was vague. Banks inferred the value of analysts from surveys of client opinion. This sheltering ambiguity was kind to the analyst community, and it proliferated.

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There are, according to Bloomberg, 43 analysts who publish research on Apple (35 say buy the stock). Are fund managers' research budgets large enough to pay 43 big salaries for 43 not-terribly-different views on Apple? Conceivably. Apple has a market value of almost a trillion dollars. Big bets can be made on it. But consider

Redrow, a £2.5bn UK housebuilder covered by 15 analysts (a mere two-thirds of whom rate it a buy). That is industrial overcapacity, and it will not survive exposure to market forces. In hard conversations with clients, banks are already finding that their research is worth much less than they thought.

It is true that reports and ratings are not how analysts produce the most value to the banks. That comes when banks sponsor an initial public offering or other capital raising. In such cases, analysts are brought over the "Chinese wall" separating research and investment banking. They perform due diligence, establish a valuation and speak with potential investors. Raising capital is a high-margin business, so banks with strong capital markets businesses will keep analysts on payroll even if they sell little research. And the most highly rated analysts will be able to pull their own weight in client revenue — either from their perch at a bank or by opening a research boutique.

Neither factor is much help to poor Julian. His bank's capital markets business is a perpetual also-ran to market leaders such as Goldman Sachs and Morgan Stanley. And if the strongest banks subsidise client research, that depresses the price Julian's bank can charge.

Then come the robots. Quantitative and passive strategies — where computers place most of the orders — now account for 60 per cent of US trading volume, twice the level of a decade ago, according to JPMorgan. The passives and the quants have limited use for Julian's work. His reports on company fundamentals are, increasingly, a niche product. He, and many like him, are going to struggle to justify their salaries.

After the crisis, regulatory pressure led Julian's employer to pay him more in fixed salary and less in bonus. That's helped him in the past few lean years. But to his boss, it makes him a bigger fixed cost. The writing is on the wall.

If Mifid II makes investment banks leaner, that is ultimately a good thing, for the banks' investors and for the economy. Banks' cost-to-income ratios are persistently bloated. A lot of smart, well-paid people were doing not-very-productive work. Better they should do something else. Of course, Mifid will create costs, too; compliance departments will grow ever bigger. But the net effect could be positive.

The transition will be painful, though. Fat finance salaries keep property prices up and restaurants full in the global trading hubs. Julian's house will go on the market, and his kids will switch to state schools. But in time Julian — and London — seem likely to get over it. It was a gruelling job, with long hours and lots of travel, producing little of lasting value beyond a paycheck. Julian may be a happier person, and his city a happier place, after he moves on.

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