

# AcF 304 Financial Markets

## Investment Management –Trends & Challenges



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# Investment Management vs Investment Banking

## Buy Side vs Sell Side

Where's the growth?

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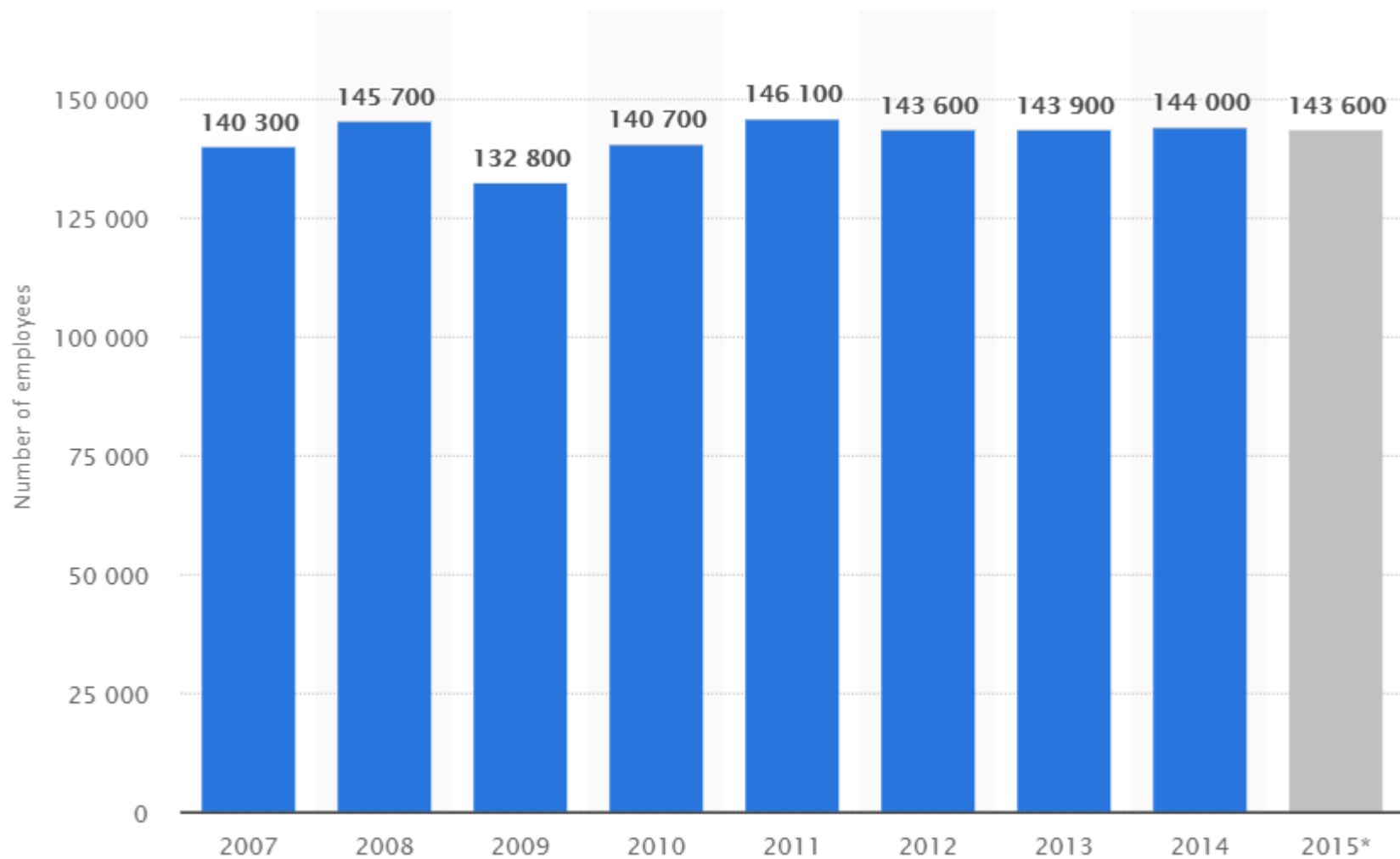
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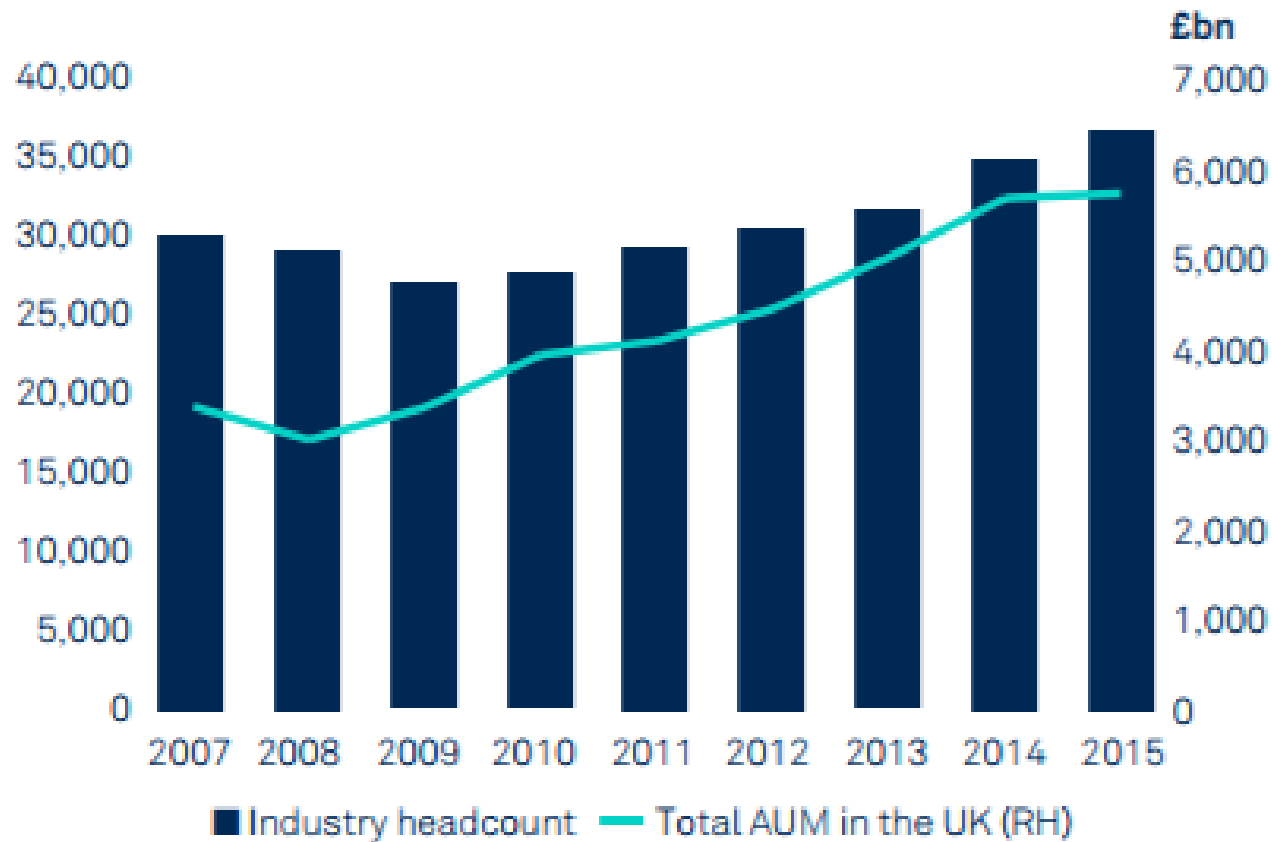
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## *Number of employees in the banking sector*

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## Asset Management Industry Headcount vs. AUM 2007-2015



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**TABLE 5: DISTRIBUTION OF STAFF BY ACTIVITY  
(DIRECT EMPLOYMENT)**

Activity	Percentage of total headcount
<b>Investment Management of which</b>	<b>24%</b>
Investment management (asset allocation and stock selection)	68%
Research, analysis	25%
Dealing	7%
<b>Operations and Fund Administration of which</b>	<b>18%</b>
Investment transaction processing, settlement, asset servicing	31%
Investment accounting, performance measurement, client reporting	32%
Other fund administration (incl. CIS transfer agency, ISA administration etc.)	37%
<b>Business Development and Client Services of which</b>	<b>18%</b>

Marketing, sales, business development	63%
Client services	37%
<b>Compliance, Legal and Audit of which</b>	<b>8%</b>
Compliance	39%
Risk	32%
Legal	22%
Internal audit	7%
<b>Corporate Finance and Corporate Administration of which</b>	<b>12%</b>
Corporate finance	43%
HR, training	26%
Other corporate administration	31%
<b>IT Systems</b>	<b>14%</b>
<b>Other Sector</b>	<b>6%</b>

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## PwC Asset Management

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- ➔ Assets under management expected to rise to \$145.4 trillion by 2025 from \$84.9 trillion in 2016
- ➔ *Assets under management in the SAAAME (South America, Asia, Africa and the Middle East) economies are set to grow faster than in the developed world*
- ➔ The sector is experiencing "transformational change" and firms must be ready to innovate in order to prosper
- ➔ Asset classes and investments are expected to diversify considerably and growth will be driven by the wealth of high-net-worth individuals

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## *Asset Management – They are not all Fund Managers or Analysts*

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	2011	2012	2013	2014	2015
Investment Management	27%	27%	27%	25%	25%
Operations and Fund Administration	21%	20%	19%	21%	20%
Business Development and Client Services	20%	20%	22%	21%	22%
Compliance, Legal and Audit	5%	5%	7%	7%	7%
Corporate Finance and Corporate Administration	11%	11%	10%	10%	11%
IT Systems	13%	13%	11%	12%	12%
Other Sector	3%	4%	4%	4%	4%

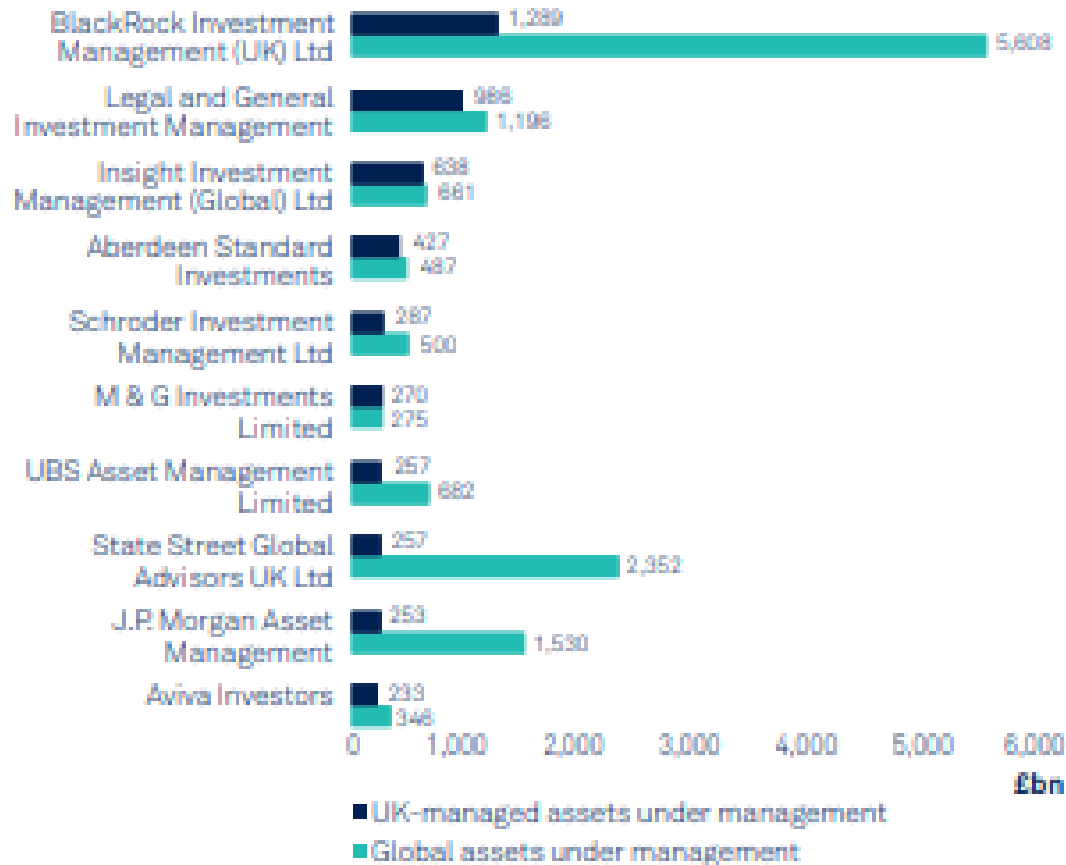
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## CHART 82: TOP TEN FIRMS BY UK-MANAGED AND GLOBAL ASSETS UNDER MANAGEMENT<sup>35</sup>



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# Active vs Passive Investment - Active

**What is active investing?** – Aim to outperform a specified index/benchmark = **Alpha**

**How?** – Individual investment styles and stock selection identifying attractive/unattractive stocks using Qualitative & Quantitative tools

## Benefits

- Investment Managers make informed decisions
- Active funds may significantly outperform the benchmark
- Flexible mandates allow movement in and out of stocks/markets
- Can provide downside protection in bear markets

## Drawbacks

- More costly to run so higher fees
- More concentrated with fewer securities
- Significant under-performance may occur
- Requires ability to select those active managers who can outperform

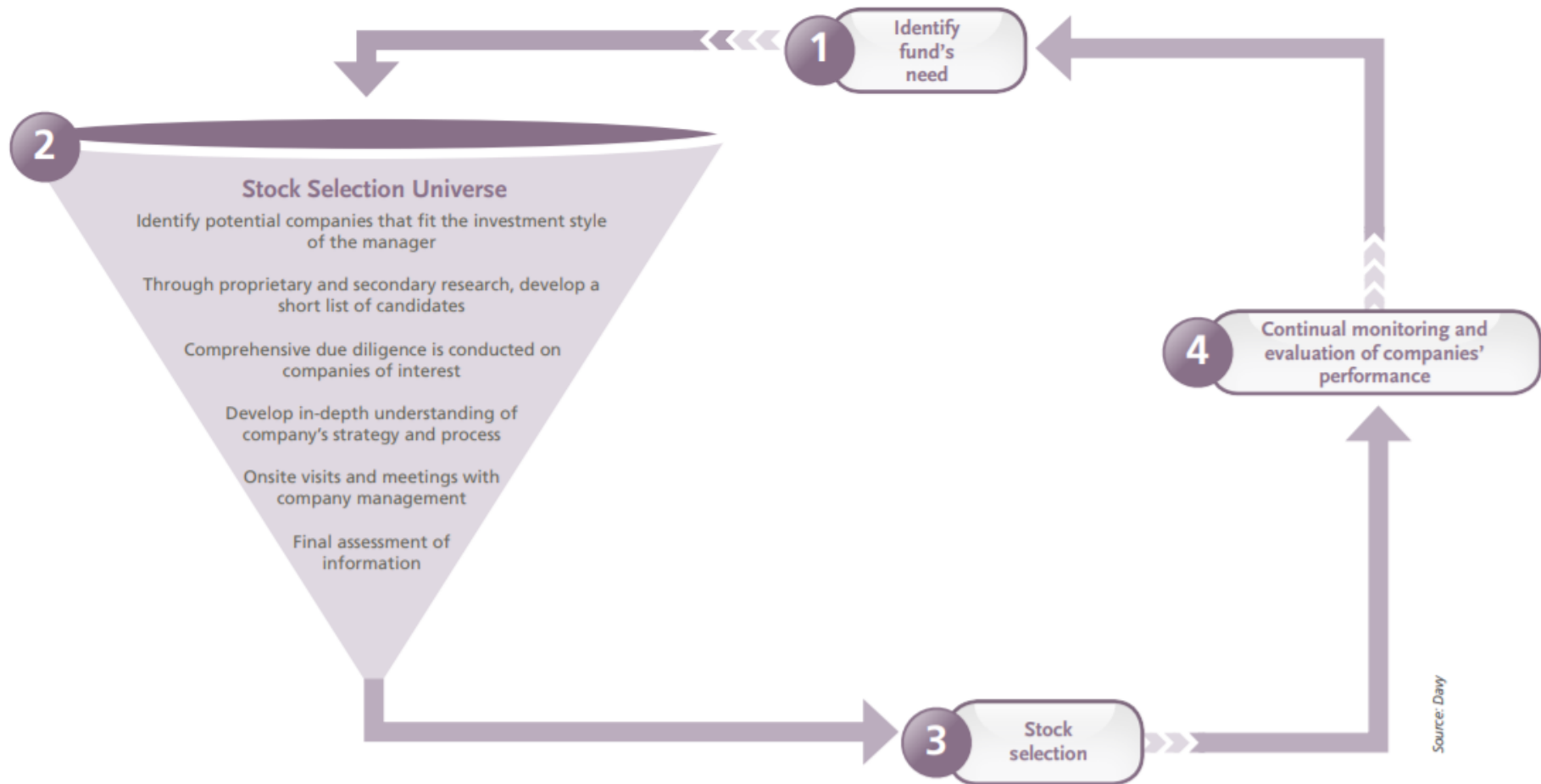
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# An Overview of an Active Manager's Investment Process



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# Active vs Passive Investment - Passive

**What is passive investing?** – Tracks a specific market or section of the market by replicating the underlying index – NO forecasting, stock picking or market selection

**How?** – Exchange Traded Funds (ETFs) or Index Managed Funds

## Benefits

- Lower cost due to lower associated resource requirements
- Removes emotional element of gaining exposure to the underlying market
- Investors can still influence their investment portfolio through asset allocation decisions rather than individual stock picking
- Gain broad access to market sentiment

## Drawbacks

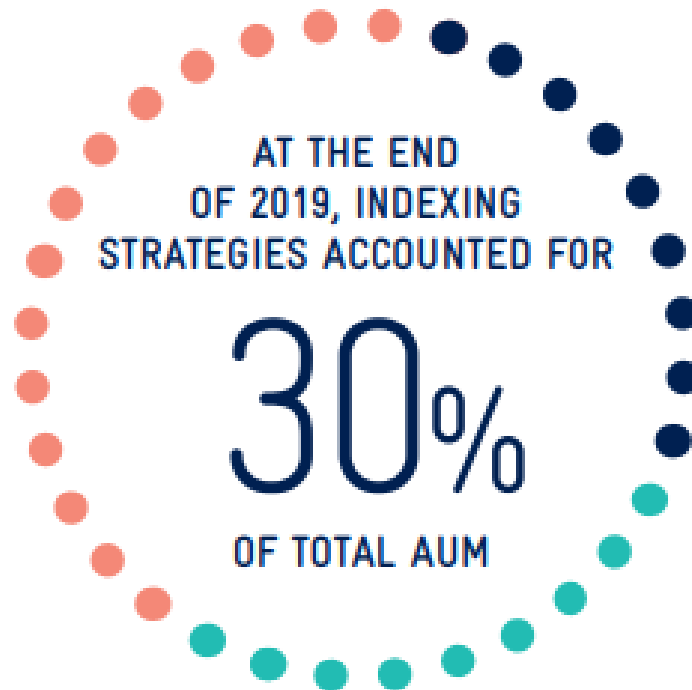
- No outperformance of underlying benchmark possible
- No control of individual asset exposures –hold same weighting as benchmark
- As most indices are market capitalisation weighted passive investments tend to increase exposure to stocks that are performing well and reduce exposures to those that aren't regardless of future outlook or valuation
- Difficult to gain exposure to illiquid asset classes e.g. hedge funds /private equity

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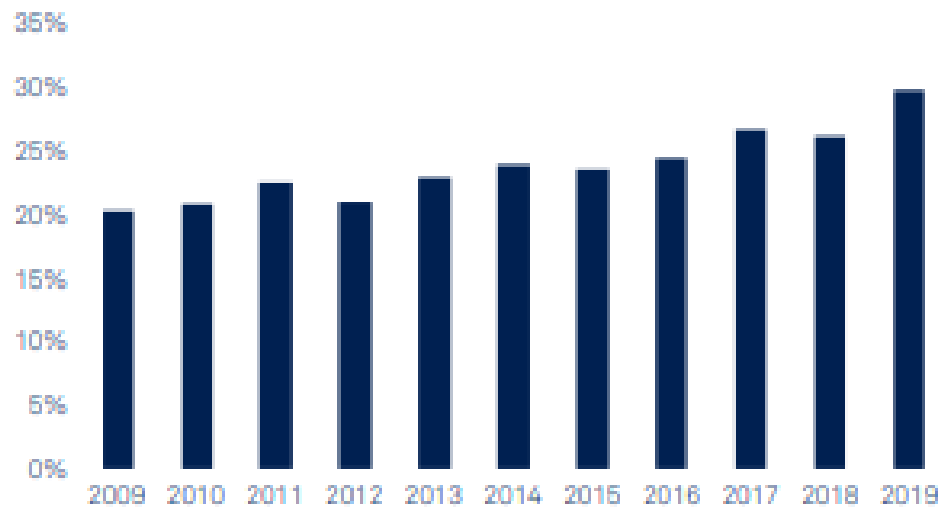


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**CHART 15: INDEXING STRATEGIES AS PROPORTION OF TOTAL UK ASSETS UNDER MANAGEMENT (2009-2019)**



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# Active vs Passive Investment – Two Key Points

- **Fees** – Passive products are on average four times cheaper than actively managed alternatives
- **Performance** – Active Managers have a history of **NOT** outperforming Passive Managers
- 2016 - The S&P 500 Price index returned 9.84%
- Just 19% of large-cap mutual fund managers achieved a return that exceeded their benchmark
- **Therefore, active managers are not justifying their higher fees hence the rise of passive investing**

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# The Pressure is on Active Investment Managers

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- ➡ Index-tracking funds have increased their share of assets in the US by \$2 Trillion since 2013
- ➡ Passive funds now account for a third of mutual fund assets up from a quarter 3 years ago
- ➡ *Passive Funds have grown 4 times faster than Active Funds since 2007 at \$6 Trillion*
- ➡ Passive Market Leaders: Blackrock, Vanguard & State Street

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# The Pressure is on Active Investment Managers

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- ➔ Schrodgers “Index-tracking funds are the dictionary definition of ‘dumb money’. They undertake no research. They do not care about the quality of a business or its management team or whether or not it has debt or whether or not it is cheap.”
- ➔ “We believe most long-term investors are better off relying on the capable hands of a trusted, and active, investment adviser.”
- ➔ They would say that !!! Schrodgers only runs active funds

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# How Are Active Managers Responding

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- ➔ Fidelity, Janus Capital, Franklin Templeton launched their own benchmark tracking products

**Develop investment strategies and offer funds that are difficult to replicate in a passive format e.g.**

- ➔ Infrastructure, property, private equity and direct lending
- ➔ Fixed Income /Asset Backed Securities
- ➔ Quantitative strategies, whereby active managers run highly diversified, computer-driven portfolios that invest in a large number of stocks
- ➔ Increase the Active component of the portfolio

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# Closet Index Funds

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- ➔ Supposedly “active” fund managers which “hug” or stay close to their benchmark index instead of actively managing their fund.

## Why is this an issue?

- ➔ Misleading – investors thought buying an actively managed fund
- ➔ Investors could have put their money in a dedicated index tracker at a fraction of the cost
- ➔ overcharges investors via relatively high Active management fees compared to low Passive management fees.

*The attraction for the Fund Manager – charge higher active management fees whilst paying for the resource cost of running a passive fund!*

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# Investing in Stocks: ETFs

Exchange Traded Funds are a recent innovation to help keep transaction costs down while offering diversification.

- Represent a basket of securities
- Traded on a major exchange. They are listed and trade as individual stocks on a stock exchange.
- Index to a specific portfolio (e.g., the S&P 500), so management fees are low (although commissions still apply)
- Exact content of basket is known, so valuation is certain
- ETFs represent Passive Investment
- ETFs have seen explosive growth over the last decade with global assets under management increasing 19% each year on average.

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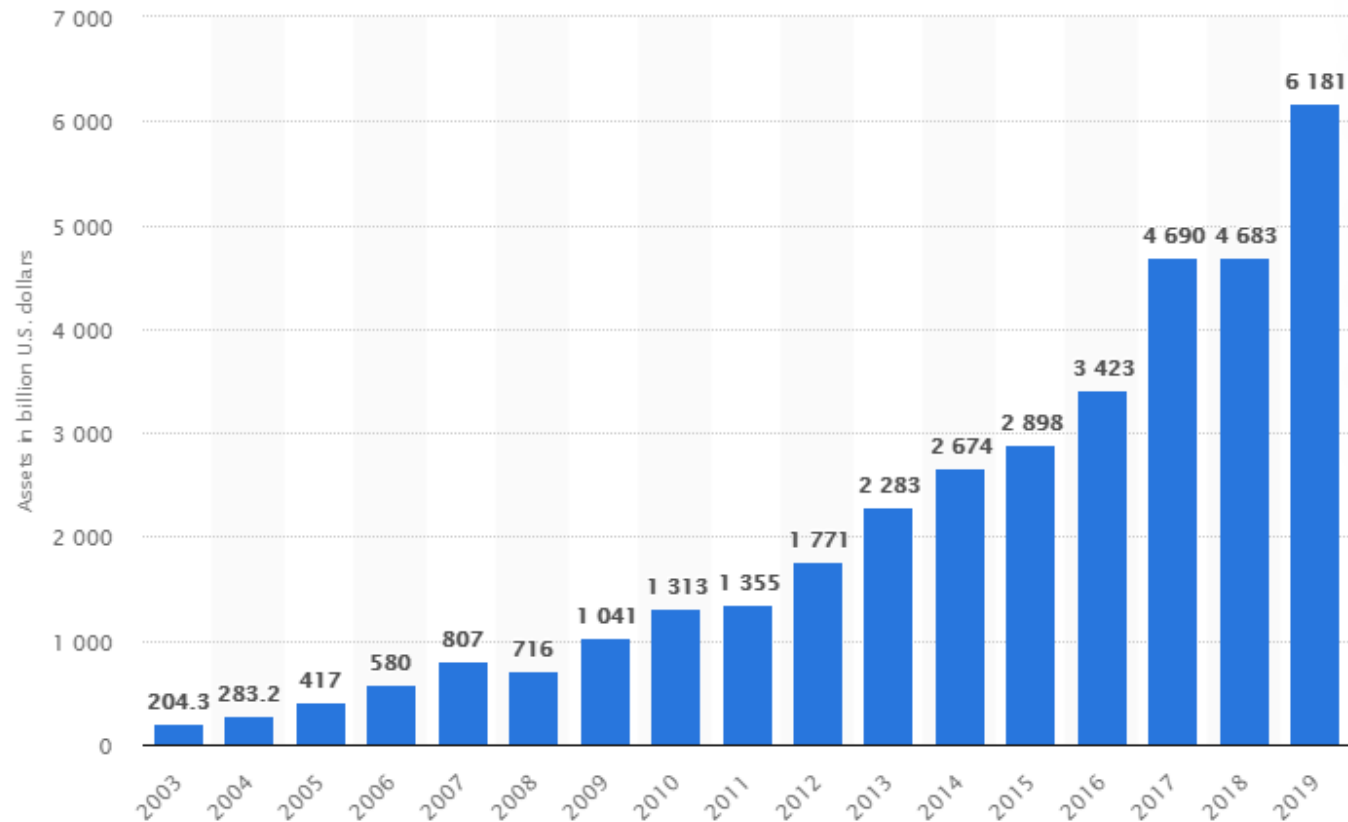


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# The Growth of Exchange Traded Funds

## Development of assets of global Exchange Traded Funds (ETFs)

(in billion U.S. dollars)



# ETFs

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- ➔ ETF is a wrapper that contains a basket of stocks, bonds or derivatives
- ➔ An ETF S&P 500 you are investing in the underlying securities
- ➔ Bought and sold the same way as stocks (unlike Mutual Funds which trade once a day)
- ➔ Authorized Participants create and redeem the baskets of securities keeping ETF prices aligned with market value of underlying assets

*e.g. When rising demand causes ETF prices to rise higher than the value of the ETF holdings the role of the AP is to buy the underlying securities, exchange them for ETF shares, and sell those shares into the market*

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# Asset Management Fees

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## Pressure from UK Regulators on Fees

- ➡ Too high
- ➡ Not clear how the fees breakdown
- ➡ No link with performance (unlike Hedge Funds)

FT Monday March 5<sup>th</sup> 2018

### ***Mercer proposes fees shake-up***

*“Asset Managers should pay investors to run their portfolios and provide performance guarantees instead of earning fees regardless of returns delivered”*

*“Growing numbers of investors and regulators believe the current system prioritises profits for asset managers over their clients interests”*

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# Regulation: complex and costly

## *More Sell Side but Buy Side too!*

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### Sell Side – US 2010 Dodd Frank Act

- Limiting the activities of investment banks e.g. proprietary trading

### Sell Side – Basel 3

- Banks to meet strict capital ratios

### Sell Side & Buy Side – MiFID 2

1.7 Million paragraphs of regulation!

- Price Transparency
- Research ‘Unbundling’

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# FinTech – Robo Advisors

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**Deutsche Bank launches 'robo adviser' for equities investors**

**Fidelity plans new 'robo-adviser' to manage money for clients online**

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Stocks & shares  
Lifetime ISA

General investment  
account

Personal pension

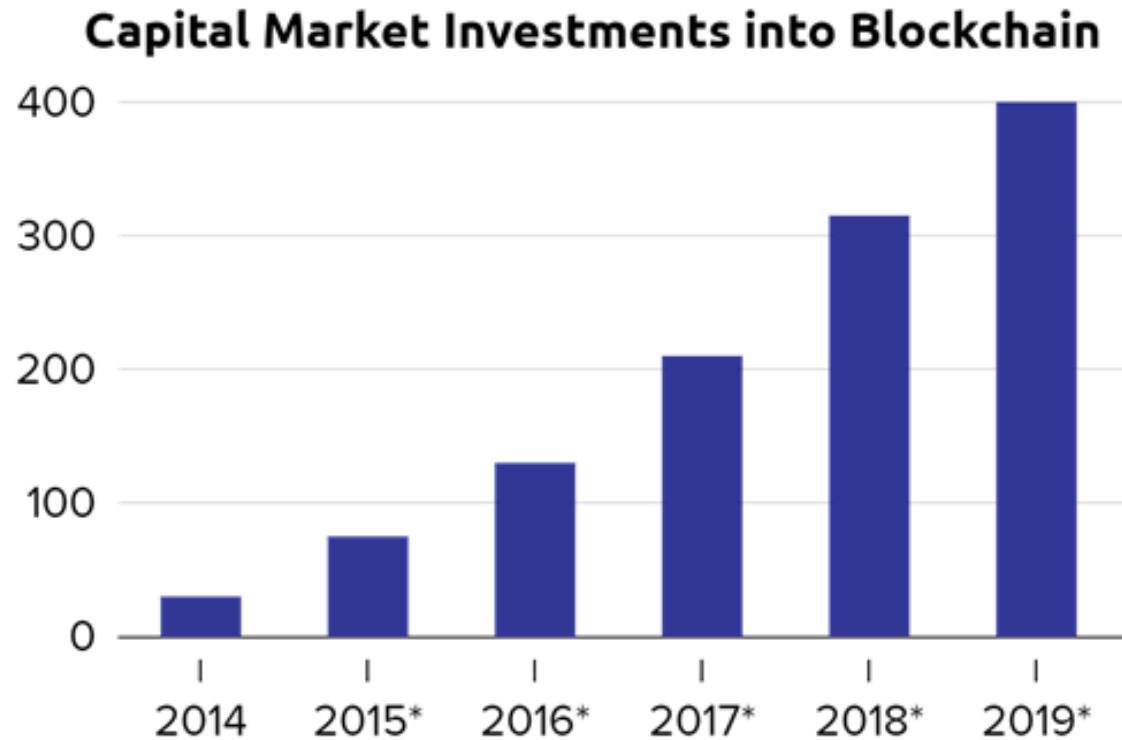
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# FinTech – Blockchain

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# Investment Management Trends so far...

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- ➔ Growth of Investment Management
- ➔ Active vs Passive Investment
- ➔ 'Closet' Index Funds
- ➔ Exchange Traded Funds
- ➔ Fees
- ➔ Regulation
- ➔ FinTech – Robo Advisors & Blockchain

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