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The New Threat Facing Active Fund Managers

Stock- and bond-picking funds will be pressured by private-market investments but have wiggle room

By Telis Demos Follow

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T. Rowe Price plans to team up with Goldman Sachs to sell private-market investments. PHOTO: BING GUAN/BLOOMBERG NEWS

Active stock pickers always seem to be running out of road—and now face the rise of private-market investments. For all the gloom though, they still have room to maneuver.

Funds that choose what stocks and bonds to buy and sell have come under increasing pressure from index funds. Not only are those "passive" options tough to beat these days, thanks to an ever-rising S&P 500, but they also typically carry lower fees than "active" ones.

One port in the storm for active managers of public investments has been target-date funds, which have emerged as enormously popular instruments used by many 401(k) savers. These funds shift allocations over time as the investor ages, which can lend itself to an active strategy. So there are widely used actively managed target-date funds, as well as funds that blend active and passive strategies.

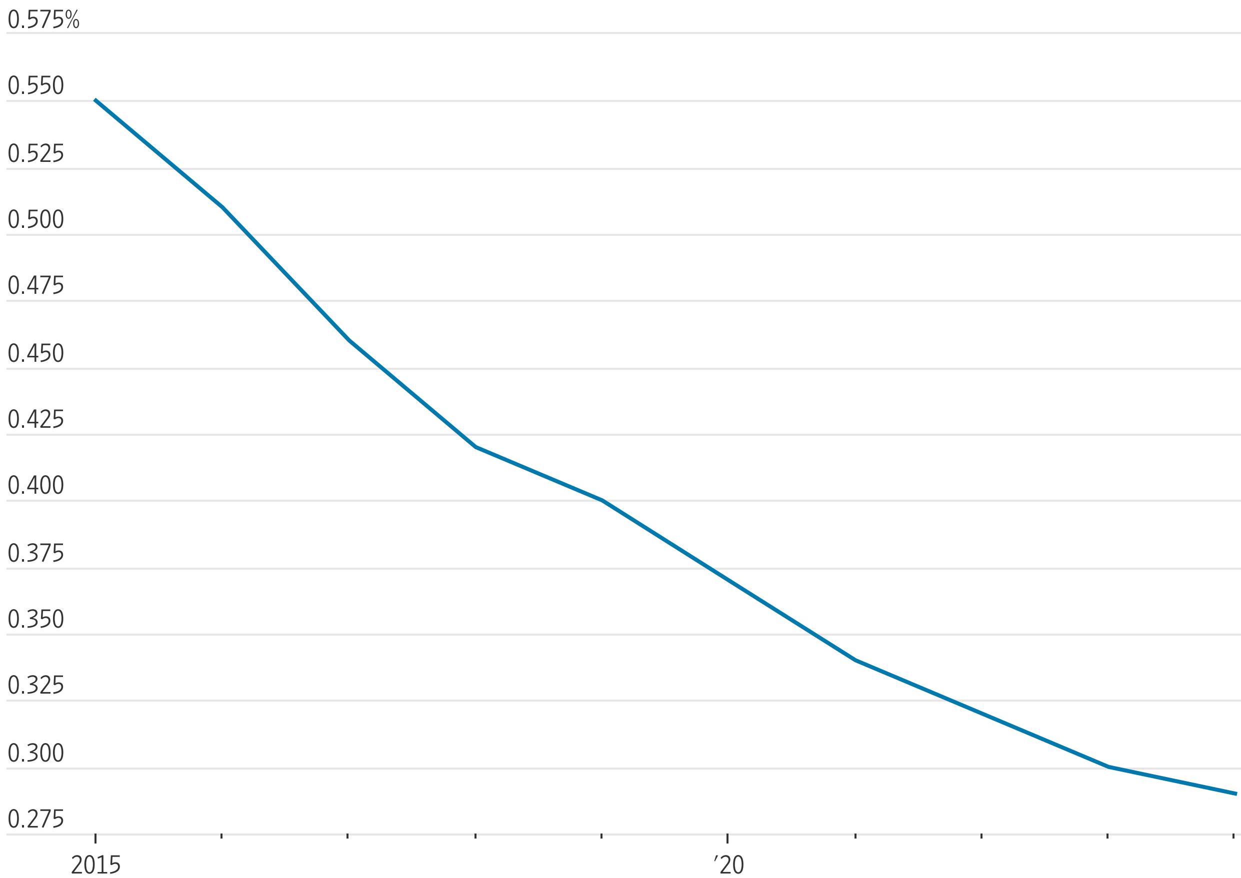
Now, managers of alternative assets are hoping to break into that corner of the market. Since 401(k) plans, and target-date funds in particular, are typically treated by investors as long-term, set-it-and-forget-it money, that can match up with the way private funds are typically managed. And a recent executive order from President Trump may make it easier for them to enter this market.

The outcome will be important for asset managers as varied as Apollo Global Management, Goldman Sachs, BlackRock, State Street, Blackstone, Vanguard and T. Rowe Price.

Already, the lines between the different types of managers are blurring. Goldman Sachs, for example, recently said it would invest $1 billion in T. Rowe Price. The two firms also said they would team up to sell private-markets investments.

But how active public managers ultimately fare may depend, to a large degree, on fees. These are important to the target-date market. Many plan sponsors, or companies that offer these products in 401(k) plans, have been focused on lowering costs, in part because of the threat of litigation if they don’t offer the cheapest options. Already, that has pushed some sponsors to seek out more passive options for target-date funds.

Asset-weighted net expense ratio for target-date mutual funds, at year-end



Source: Morningstar

Now, the challenge posed by private investments is that they can carry even higher fees than active funds. So if a lot of companies that sponsor retirement plans want them in their target-date options—and that remains a big "if"—they might have to find a way to pay for them and still keep their overall costs low.

According to data compiled by Morningstar, actively managed alternative-asset funds had an asset-weighted average fee of 1.51% last year. That was almost triple the overall average for active funds, at 0.59%—and more than 10 times the average passive-fund fee at 0.11%.

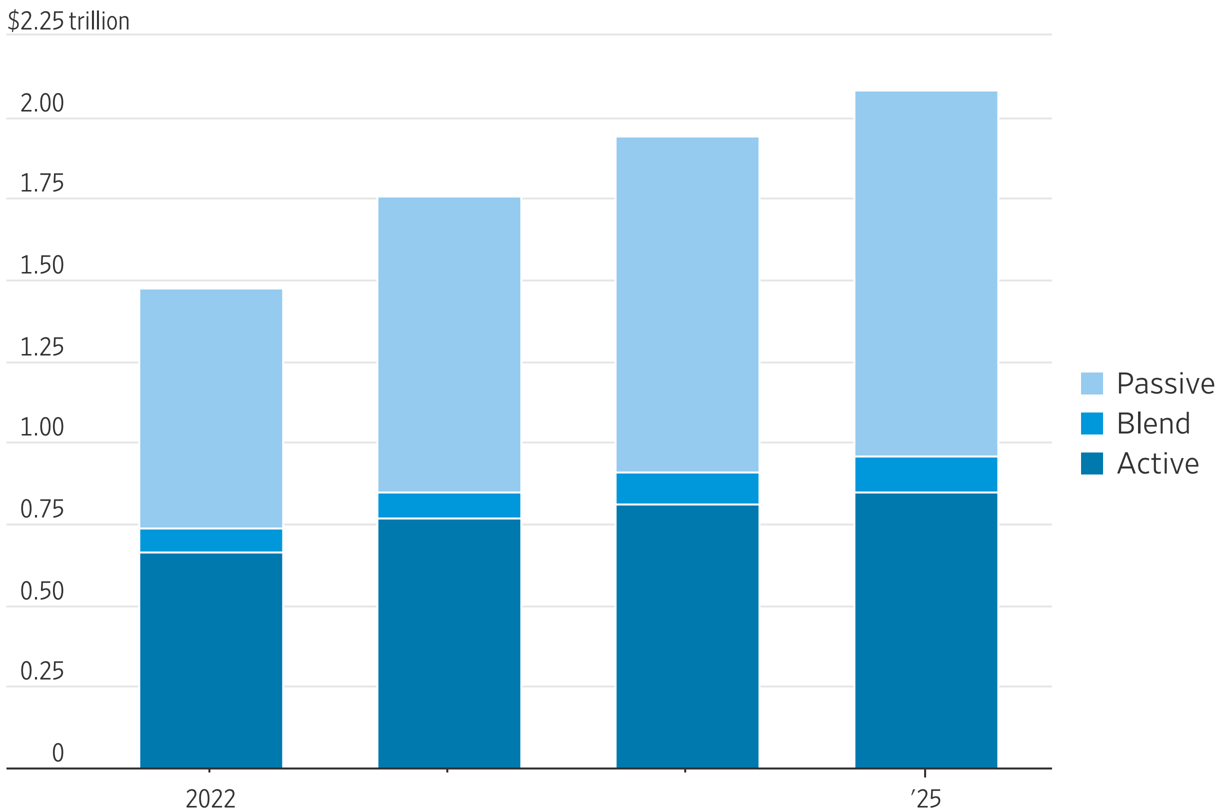
One risk is that plan sponsors adopt what TD Securities analyst Bill Katz calls a "barbell" approach. This would involve having relatively expensive private funds at one end and ultracheap index funds at the other, squeezing out active public funds.

Still, fees aren't everything. Returns matter, too. In recent years investors have focused on a narrower number of managers of private assets, indicating that a manager's track record matters a lot in that market. Active managers' own history with private assets could also help them be some of the first to introduce them to a plan sponsor.

Many longtime public stock funds have in recent years already incorporated so-called crossover investments, like tech startups that stay private well past their infancy. So they may already have a track record to tout.

Actively managed funds also have had a particular appeal for smaller 401(k) plan sponsors. This is because the fund managers often share revenue with the sponsors to offset expenses, says Janet Yang Rohr, director of multi-asset and alternative strategies for Morningstar.

Target-date mutual-fund assets by investment category



Note: Figures are for year-end except 2025, which is through June. Figures do not include collective investment trust assets.
Source: Morningstar

Meanwhile, the largest plan sponsors have more resources to do the diligence to pick active managers. They also may have broader relationships with those managers that lead to lower fees as they add more products, she adds.

Some private-asset managers may also have designs on offering more passive versions of those investments, akin to exchange-traded funds, with lower fees. BlackRock, for example, has acquired companies that could help it lead the ETF-ification of private markets. So a future fee mix might not be so unfriendly to maintaining a space for active public management.

The race for retirement assets is a long one, and the rules of the road aren't straightforward. It's too soon to count anyone out—even stock pickers.

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