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ADAPTING TO AN EVOLVING WORLD: THE ASSET MANAGEMENT AGENDA - 2019

When historians look back at 2018, "eventful" and "frenetic" will likely be common descriptions. Be it politically, economically, socially or technologically, the last twelve months have been full of upheaval, creating a challenging landscape for asset managers and the financial services sector more generally.

In such a complex environment, it is vital that investment industry businesses are cognisant of both the world around them and what is coming up on the horizon, as events will inevitably shape the views and requirements of their end customers. The media plays a crucial role in this context; not just shaping sentiment towards current events, but also in identifying those issues likely to be at the forefront of underlying clients' minds and which therefore need to be a priority for asset managers.

It is this premise that forms the basis of JPES Partners' fifth Asset Management Agenda report, where we have conducted comprehensive research across global English-speaking media titles (including national and international press, specialist trade publications and newswires) to identify those themes trending upwards in the media and therefore likely to drive agendas in 2019. In parallel, we have also sought the views of leading journalists to gain a clear sense of what topics they expect to be most prominent in the year ahead.

KEY FINDINGS

- **Active quant** strategies have become increasingly popular and have recorded strong inflows over the last year, but will face further scrutiny over their ability to deliver in different, and more challenging, market environments
- Demand for **Environmental, Social and Governance (ESG)** solutions continues apace, but asset managers will have to clearly demonstrate their ability to meet such criteria in the face of more sophisticated ways of measuring ESG impact and greater scrutiny from a more socially-conscious audience
- **Technology** is creating new opportunities and efficiencies for asset managers but could also leave the industry open to disruption as new entrants seek to gain market share
- Recent sell-offs have heightened concerns over **growing market risk**, with it becoming increasingly likely that asset managers will have to deal with new and more volatile paradigms as questions arise about when the longest running bull market in history will come to an end
- Populist sentiment and nationalism have made for a highly uncertain **geopolitical environment**, with asset managers having to plan at both an investment and business level for the fallout arising from events, most notably **Brexit**

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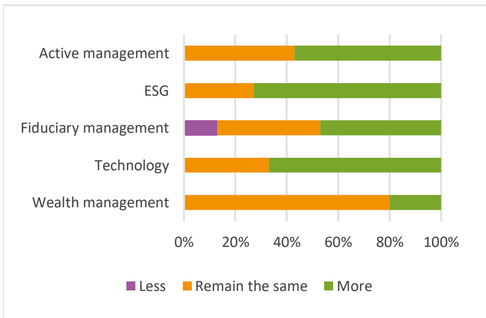
Journalist expectations for 2018



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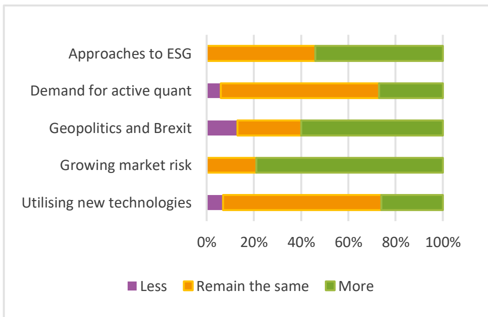
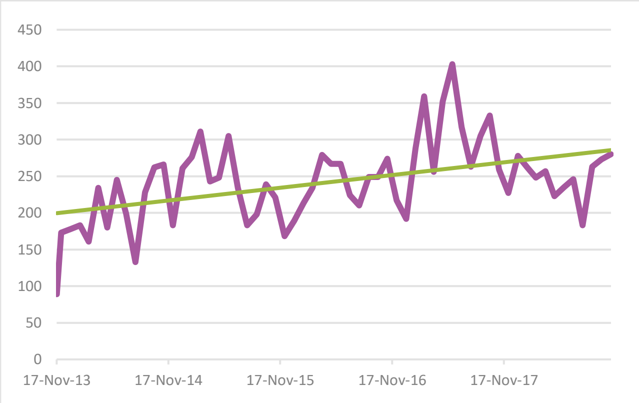


The demand for active quant

Despite being a relatively new theme to drive asset management news agendas, there can be no denying that active quant has experienced a surge in popularity in the last year.



Media coverage of issues relating to active quant, Nov 2013 – Nov 2018
(Source: Factiva)

Part of this popularity relates to the acceptance of sophisticated strategies such as smart beta and factor investing by investors[1]; indeed, factor-based strategies were the only segment of the EMEA institutional asset management equity universe to record inflows in 2017[2]. It is also reflected in the rapid growth in the space due to the proliferation of new products, including most notably from fundamental managers using extensive screening mechanisms to create new, lower cost offerings to diversify their product ranges and aid business development.

Such is the momentum behind these approaches that some commentators have gone so far as to claim that "the next frontier in investing is quantamental stock picking."[3]

But, while there is substantial momentum behind active quant, this is not to say that the space is immune from criticism or challenges in the future. Questions have been raised over the transparency of active quant strategies, with industry surveys highlighting institutional concerns about how returns are generated and the extent to which such managers can be accurately measured[4].

More pertinent however is the extent to which rules-based active quant strategies are equipped to manage changing market environments, particularly as we come to the end of the longest bull market run in history. Some have suggested that quantitative, rules-based strategies may even exacerbate challenging market conditions and create asset bubbles due to an inability to respond to more dynamic environments[5].

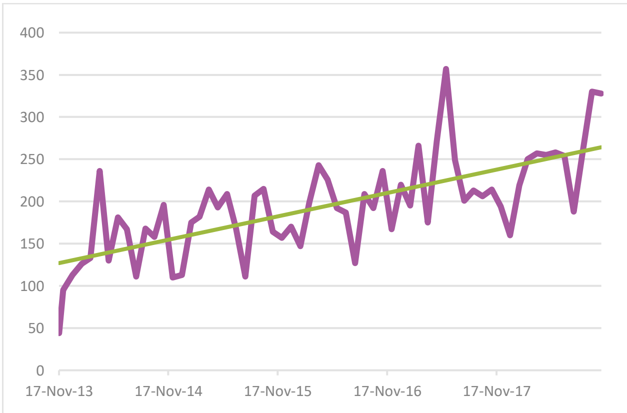
On this basis, while there remains real momentum behind active quant, the future is not quite as rosy as it might initially appear. Managers would therefore do well to proactively consider these issues now in advance of inevitable future scrutiny.

Approaching and evaluating ESG

That ESG is set to continue to dominate news agendas in 2019 should come as little surprise. It is a theme that is everywhere and now permeates all aspects of the investment industry. It is no longer a "nice to have" option; it is mainstream within the investment industry and now expected as a core part of asset managers' business practices, be this at a corporate or domestic level.

Certainly, the industry and regulators have appeared to say all the right things. Managers themselves are increasingly seeking to position themselves as responsible fiduciaries and stewards of clients' assets, putting pressure on investee companies to positively contribute to society[6]. Regulators have also made significant efforts, with rules published by the UK Department of Work & Pensions (DWP) to force both defined benefit and defined contribution pension funds to openly state policies on ESG factors such as climate change[7].

On one hand, these efforts have been positively received by investors, certainly if asset flows are anything to go by. Earlier this year, Morningstar noted that mutual funds that invest based on ESG criteria have passed $1tn, a 60% increase in just six years[8]. But at the same time, ways of measuring ESG efforts and impact have become more sophisticated, allowing greater scrutiny from an increasingly socially-conscious audience wanting to ensure managers are truly living up to their credentials and claims, and not simply using ESG as a marketing gimmick.



Media coverage of issues relating to ESG, Nov 2013 – Nov 2018
(Source: Factiva)

A survey by Lane Clarke & Peacock earlier this year is a case in point, with the consultancy finding just 8% of the 120 asset managers surveyed achieved top scores on consideration of ESG issues[9]. On this basis, while developments in ESG will continue apace, asset managers must be aware of an increasing cynicism among investment audiences. Simply talking up their ESG credentials is no longer enough; managers now have to demonstrate their adherence to best practice ESG criteria at a granular level, as well as their ability to utilise these factors to consistently deliver both outperformance and downside protection.

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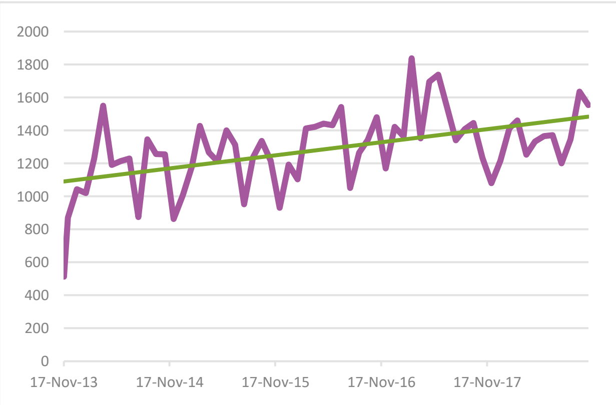
Utilising new technologies in asset management

The use of technology continues to be a major theme driving asset management news agendas, both from a positive and negative standpoint.

Taking a more critical viewpoint, the speed at which new technologies have developed is inevitably going to have more pronounced repercussions on an industry that historically has proved slow to adopt new practices and, as such, is already behind the curve in the use of such capabilities compared to other financial services sectors. This attitude would certainly explain the amount of investment made into investment solutions in recent times, with Accenture data showing that fintech investment increased by 18% over just a one-year period[10].



Media coverage of issues relating to technology, Nov 2013 – Nov 2018
(Source: Factiva)

Also of inevitable concern to asset managers will be the potential for disruption within the industry by new entrants, be these specialist fintech providers or larger players (such as Google, Amazon and Facebook) seeking to diversify their businesses and seeing the investment, pensions and savings arena as an attractive area of growth. A PwC survey would indicate this to be the biggest concern for existing providers, with 60% of those surveyed fearful of losing at least part of their business to fintech companies[11].

Despite these headwinds, there is also much for the asset management industry and its clients to be optimistic about when it comes to new technologies. The ability to use technology to enhance existing practices, generate efficiencies, improve reporting and engagement and, ultimately, ensure the consistent delivery of improved results to customers is significant. We are already beginning to see some elements of this incorporated into investment practices, with technologies being used to access "big data" to make more informed, nuanced investment decisions.

It would also be naïve to suggest that machines are simply going to take over the investment world. Our own audit of end investment audiences clearly shows that asset management remains a "people business" and that even in this era of enhanced technology, personal relationships matter more than almost anything else[12]. On this basis, the challenge for asset managers and financial services is simply to catch up with technology, with a recent study by Intertrust showing that just 33% of financial services are employing disruptive technologies such as artificial intelligence (AI)[13]. In such a fast-moving sector, such a trend is clearly unsustainable and will need to change.

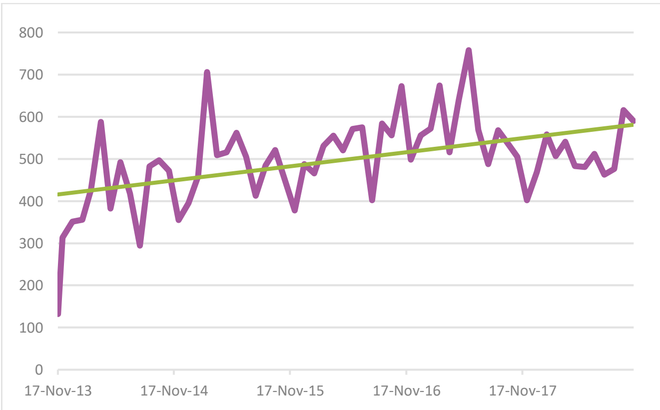
The impact of growing market risk

The importance of growing market risk as a theme influencing asset management news agendas cannot be overstated, and is likely to prove one of the biggest areas of focus for the media in 2019.

In many ways the significance of market risk has only been strengthened by recent events, with autumn sell-offs heightening the sense of change within markets. Increased volatility has now become a more regular feature of the stock market, with US-China trade tensions continuing to remain top of mind, and tech stocks in particular driving the momentum of markets.

Add into this a slowdown in the global economy and the continuing transition of central banks away from quantitative easing, leaving media commentators increasingly expectant of greater risk and uncertainty in the foreseeable future[14].

This type of environment inevitably increases the need for asset managers to deliver results in an investment context, be these returns and / or downside protection. On a longer-term view, this could lead to significant business pressures on those who fail to do so, with the potential for a further wave of consolidation within the industry as businesses seek to protect themselves with increased size on account of greater demands from clients, pressure on costs and rising fees[15].



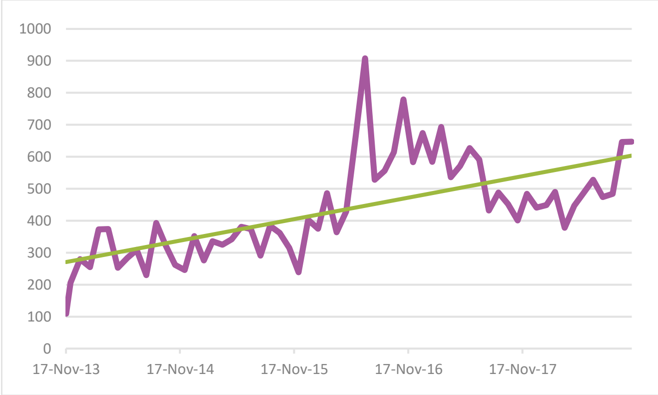
Media coverage of issues relating to market risk, Nov 2013 – Nov 2018
(Source: Factiva)

Yet, opportunities may well arise as a result of the changing market environment, with managers able to demonstrate their skill and ability to deliver meaningful returns by exploiting market inefficiencies, volatility and changing valuations[16]. Proactive communication with end audiences will be crucial to business success however, with managers needing to clearly and frequently explain positioning and its effects to clients.

Geopolitics and Brexit

Despite a significant amount of fatigue among journalists (and indeed the wider world), there is simply no way to ignore the geopolitical climate and Brexit in particular.

In the short to medium term, the latter is particularly worrying with the lack of certainty on the terms of the UK's exit from the European Union having a profound impact and creating huge headaches for asset managers and financial services companies. As noted in a KPMG report, Brexit is potentially the "single biggest impact in cross-border financial services in a generation"[16]. From an asset management standpoint, it threatens to affect all aspects of business – the ability to distribute products, the location of offices and personnel, responding to inevitable changes in regulation, back office systems and processes – all before the implications for assets and global markets are even considered.



Media coverage of issues relating to geopolitics and Brexit, Nov 2013 – Nov 2018 (Source: Factiva)

The lack of clarity over Brexit terms and the scope of a final deal and its implications have inevitably (and understandably) left asset managers cautious about doing "too much, too soon"; indeed it has only been in the last six months that managers have begun to proactively address the most pressing issues arising from Brexit, having lost patience with the ineffectiveness of politicians to agree a way forward and provide even a vaguely smooth exit from the EU[17].

Remarkably, the chaos of Brexit is such that events elsewhere in the world (that would usually be some cause for concern) look fairly mild by comparison. Donald Trump continues to dominate the airwaves at a global level, though his ability to dictate and to disrupt more conventional thinking may be substantially reined in as a result of shifts in the US political landscape and the Republicans losing control of the House of Representatives. Populism and nationalist sentiment remain unabashed, as reflected most recently by far-right elections in Brazil. More recently we have also seen substantial upheaval in Europe with riots in France and the future changing of the political guard in Germany, which could substantially alter political dynamics on the continent in due time.

Ultimately though, at least in the immediate term, everything would appear to come back to Brexit. And with little sign of any conclusion on the horizon, asset managers can really only plan for eventualities as best they can and then hunker down like everyone else to ride out the storm.

Summary

Without question, 2018 has been a year of substantial upheaval, not only for asset managers, but for financial services and the wider world.

In many ways though, it would not be accurate to say that it has been a year of substantial change; of the five topics our analysis has identified as being those most likely to drive news agendas in the coming year, two (ESG and technology) are themes that appeared in last year's study, while a third (geopolitics) is a returning theme, albeit in a different guise as the impact of Trump is replaced by the impact of Brexit.

Indeed, even those topics appearing for the first time – active quant, growing market risk – are arguably not so much "new" as opposed to evolving themes, reflecting the next iteration of sophisticated investment strategies and the prospective end of the current market cycle respectively.

Regardless, we can say with some confidence that asset managers will face substantial pressures in 2019 in what will likely prove to be a difficult environment. Yet, and as we have noted earlier in this paper, alongside the potential challenges there will inevitably be opportunities for asset managers to demonstrate their skills and abilities through the delivery of both meaningful returns and, just as importantly, downside protection in an increasingly volatile ecosystem. Those likely to be most successful in the coming year will inevitably be those who embrace the challenges ahead and proactively communicate their successes to target audiences.

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