Allocationmetrics Limited

The Future of Investment Management

There are plenty of changes happening around us in asset management - the increased prominence of passive and ETFs (versus alpha or relative return products), convergence of active and alternatives, asset flows into multi-asset products, re-emergence of quantitative investing with the new label of smart beta, machine learning and big data, and an increased demand for total return products by individuals and institutions. But has anyone considered what is the unifying reason for all these changes and where is this going ?

Fact : the majority of risk and return of any portfolio comes from the allocation decision

Fact : the only investment objective of any asset owner (individuals and institutions) is a numerical absolute or inflation adjusted total return, with a constraint on risk allowed. It is not relative return, it is not to maximize return per unit risk, it is not alpha, it is not investment in an equities product or a fixed income product and it also isn't picking active managers or invest in passive ETFs.

Fact : the majority of investment products, investment professionals and investment managers are focused on manufacturing and selling relative return security selection products or passive products. Neither has the same objective as the investor. The active products don't care if the markets fall, and actually neither do the passive products. In both cases, the investor bears the loss and the investment manager goes unscathed.

So where do we go from here ?

Any firm which manufactures and sells investment products which are aligned with the objective of investors will devastate the existing asset management industry. And for that to happen, there needs to be shift in resources, research, processes and products which focus on the allocation decision. All the product changes we are witnessing today, are laying the groundwork for a superior implementation of the allocation decision.

It is It is not about active vs. passive, or beta vs. smart beta, all will continue to co-exist in the new world, it is about the actual alignment of the investment management industry with the needs of the investor. And that means -

- a greater emphasis on quantitative investing vs. fundamental investing (which is likely to be confined to non-index small caps, unlisted or private equity/debt).

- a minimum requirement for PMs / analysts to know programming to handle larger data sets, not just Excel

- a shift in resources to research asset allocation methodologies rather than individual index stocks

- development of portfolios, products, risk models, optimizers and analysis for a multi-asset world, not two single asset portfolios bolted together with a pin.

- distribution of financial services through the internet without the intermediation of segmented country regulation, financial advisors, brokers and distributors.

The asset management business has one of the highest ROEs of any industry, which is shared by the most closely held group of shareholders. It is absolutely ripe for disruption. Given the natural inertia of our industry to protect and defend an existing revenue base, business model and product structure, perhaps the next generation asset manager will be born here in the coffee shops of Silicon Valley, not on Wall Street.