March 2022

The Future is Now:
Five Waves Reconfiguring Asset Management

Five secular transformations are reconfiguring the asset management industry–putting to bed the truisms and received wisdom that have guided business decisions.

1. **Individual Investors Dominate:** innovation (and economics) will come from firms serving individual investors. By 2030 retail channels will account for 67% of global assets under management, up from 45% in 2014.

2. **Returns Redefined:** non-financial “alpha” such as ESG/Impact, purchasing power stability or retirement income certainty supersede peer rankings and benchmark-relative returns as managers’ and clients’ primary investment objective.

3. **Expanded Investment Toolkit:** new tools blur the distinction between private and public asset classes, and digital assets expand the investable risk spectrum.

4. **AI Tipping Point:** advances in data science and processing power arrive at the “front office,” reshaping the distribution and investment functions.

5. **Globalization Goes Local:** capital markets, investor preferences, and the industry’s business infrastructure fragment along local lines, reversing a multi-decade trend of globalization.

Authorship

Daniel Celeghin
Managing Partner
daniel.celeghin@indefi.com

Co-Authors

Richard Bruyère
Managing Partner
richard.bruyere@indefi.com

Ryan Carr
Engagement Manager
ryan.carr@indefi.com

Jonathan Doolan
Managing Partner
jonathan.doolan@indefi.com

About Indefi

We are strategy consultants dedicated to serving the asset and wealth management industry globally. We partner with business leaders and owners on growth strategy, market entry, product development and enhancement, sustainability strategy, organizational design and incentives, and acquisition support. We are an independent partnership founded in 2007, based in New York and Paris. We are a UNPRI signatory.

Introduction: This time is different

The asset management industry faces five waves of change, the likes of which it hasn't seen before. Each of these waves forces leaders to rethink core aspects of the industry's business model that were, until now, truisms we could all count on:

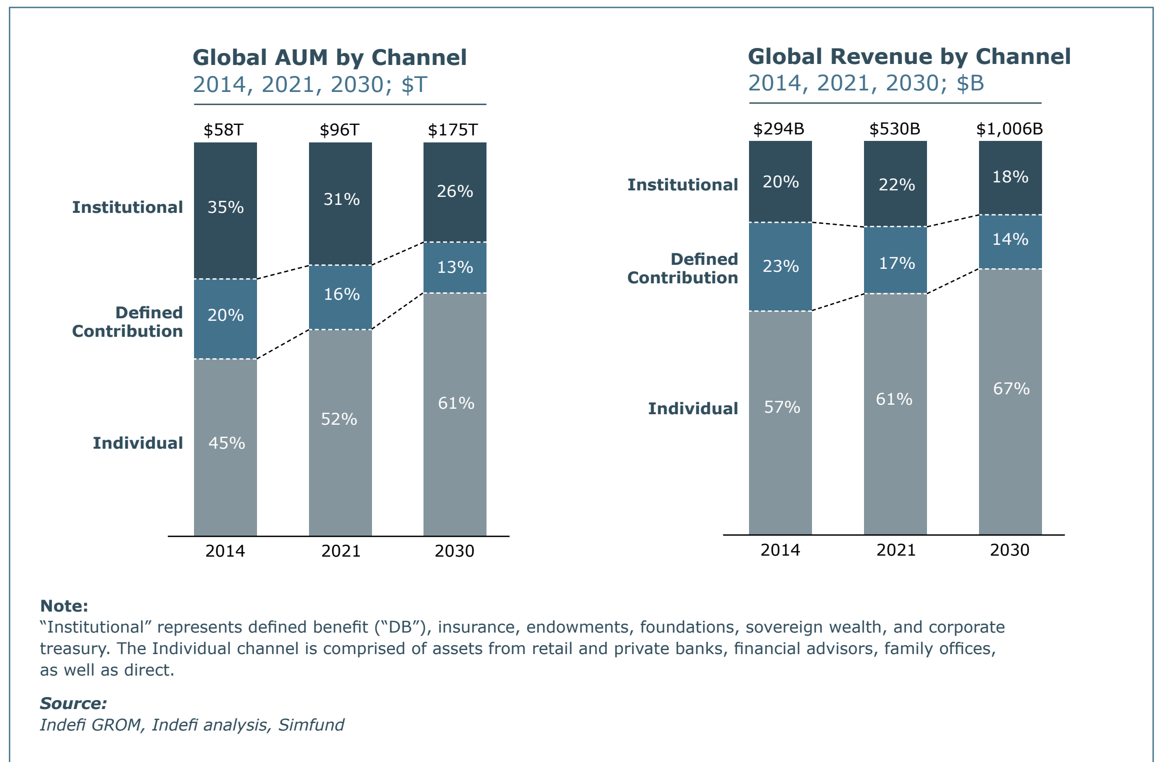
- **Globalization:** steadily integrating capital markets, converging regulations and investor expectations, and increasing demand for global products and strategies—*not so anymore*.
- **Institutional leadership:** investment innovation and best-practices came from serving the world's largest institutional investors, and eventually those innovations would trickle down to retail—*think again*.
- **Focus on returns:** even fundamental building blocks such as the purpose of investing, what constitutes risk assets, and the ultimate objective of the investment process itself—*not so clear anymore*.

In this brief paper we outline each of the five waves hitting our industry and conclude with a short framework for business leaders to assess their firm's readiness to "ride each wave" (and avoid getting overrun). By outlining five provocative thumbnail sketches of each challenge our aim is for industry leaders to question how they go about their business.

1. Individual Investors Dominate

Institutional investors, notably defined benefit pensions, served as the engine powering the growth and development of today's investment management industry. This has long ceased to be the case: the fees generated from legacy institutional channels (DB pensions, endowments and foundations, sovereigns, and insurance general account) now account for less than 18% of global industry revenues. In the largest market for asset management, the US, this trend is even more pronounced: back in 2000, legacy institutions accounted for over 40% of US fee revenue. By 2021 this was 25%, with continued erosion of share to individual/retail channels expected.

Global AUM and Global Revenue by Channel, 2014, 2021, 2030



Note:
"Institutional" represents defined benefit ("DB"), insurance, endowments, foundations, sovereign wealth, and corporate treasury. The Individual channel is comprised of assets from retail and private banks, financial advisors, family offices, as well as direct.

Source:
Indefi GROM, Indefi analysis, Simfund

"An industry driven by individual investors has a different value chain, with the balance of power tilting decisively towards distribution."

Policy and demographics are behind this shift. We expect it to pick up steam as the major emerging markets, notably China, are overwhelmingly dominated by retail investors: so there is no emerging market-based "institutional" cohort to make up for the decline in American and European DB pension assets outsourced to asset managers.

The implications for asset managers are profound: an industry driven by individual investors has a different value-chain than an institutional industry, with the balance of power tilting decisively towards distribution. Institutional investors enabled low barriers to entry by supporting boutique formation: high-quality investment teams were able to reach scale without costly distribution or mass-market brands. It remains to be seen if the individual channels develop ways to "seed" new teams and strategies.

The Individual-Oriented Future

The Shift Towards Individuals

	Legacy (Institutional)	Future (Individual)
Products	• Specialized components • Classification: asset class and investment style (inputs) • Differentiation: subtle • Standardized • Commingled vehicles	• Multi-use components • Classification: risk/return and liquidity profile (outputs) • Differentiation: stark • Customized • SMAs
Client Engagement	• Product-centric (features, inputs) • Technical • Industry jargon • Standardized, data-rich reporting • Similar across managers • In-person	• Client outcome • Personal • Layman's language • Reporting reflects end-client use • Unique to each manager • Multi-medium, mostly virtual
Distribution Talent	• Focus: know the product (features) • Similar backgrounds (within industry) • Process-oriented: can seamlessly work for other AM firms • Investment knowledge is prized ("PM-like")	• Focus: help client make the best use of the product (applications) • Varied backgrounds • Client-oriented: can seamlessly work as an advisor or at a platform • High EQ is prized

Perhaps the most profound change is the industry's tempo will become retail: the source of innovation, managers' focus, even language, will all be oriented around how to better serve the individual. Historically standards were set at the institutional level and worked their way "down" to retail. This pyramid is in the process of inverting itself, with institutional following, not leading. ETFs have been an early example of this, with initial retail adoption followed by adoption at scale by institutions globally.

In this environment managers need to reassess who their real competition is: not the fund house next door, but rather any potential destination for individuals' excess savings: bank deposit products, insurance, robo-type platforms, direct-lending platforms, and digital assets are all vying for the same dollar.

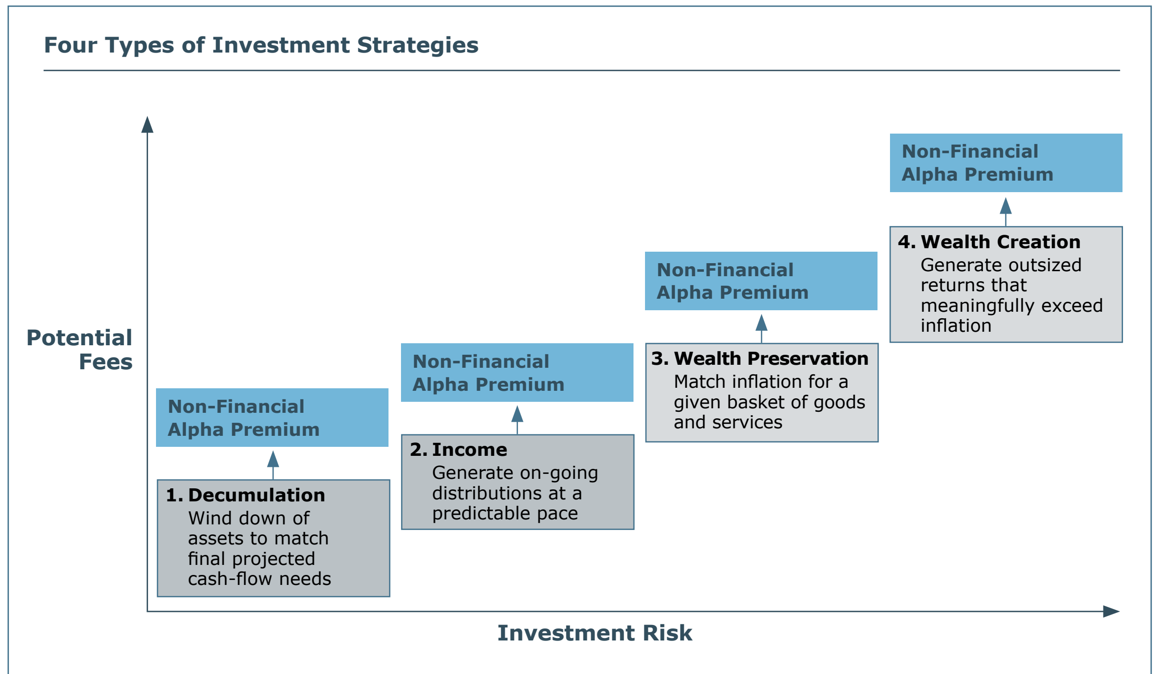
2. Returns Redefined

"Life was easier when maximizing returns was the sole investment objective."

Returns used to be simply defined: beating the relevant style-box benchmark. Over time this definition was augmented to include achieving a high peer rank, over multiple timeframes, and doing so without taking "too much" risk, usually defined by such notions as monthly return volatility, or tracking error relative to a benchmark. This statistical construct is at odds with the ultimate purpose of the industry, which is to meet investors' financial objectives with the greatest certainty.

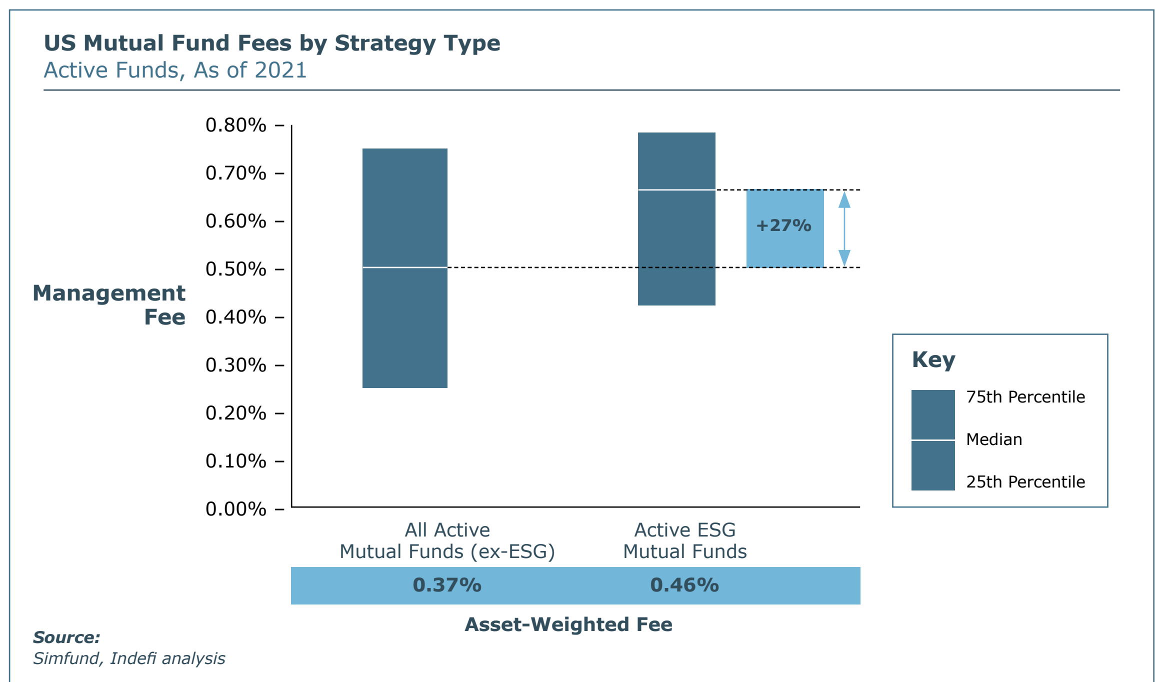
Legacy financial measures of return won't go away, but on their own no longer suffice. A focus on outcomes, likely measured over a longer timeframe than one year, is a better fit. At their core, all investment strategies fall into one of four categories (see chart above): managers should tailor strategy design, target setting, and communications around these distinct outcomes.

ESG as a Form of Non-Financial Alpha



Going beyond financials returns, investors (and policymakers) have embraced non-financial "alpha", clearly seen in the explosive growth of ESG and sustainability. We define non-financial alpha as **quantifiable portfolio attributes valued by investors (or imposed by regulators) that do not contribute to near-term outperformance**. Managers should take a step back and acknowledge the substantial change this wave represents. Life was easier when maximizing excess returns was the sole investment objective. Defining additional (non-financial) objectives and calibrating the right balance between potential erosion of short-term returns versus the degree of impact desired takes work, and the investors themselves have not yet demonstrated where they draw the line.

Non-Financial Alpha Lends New Life to Traditional Strategies



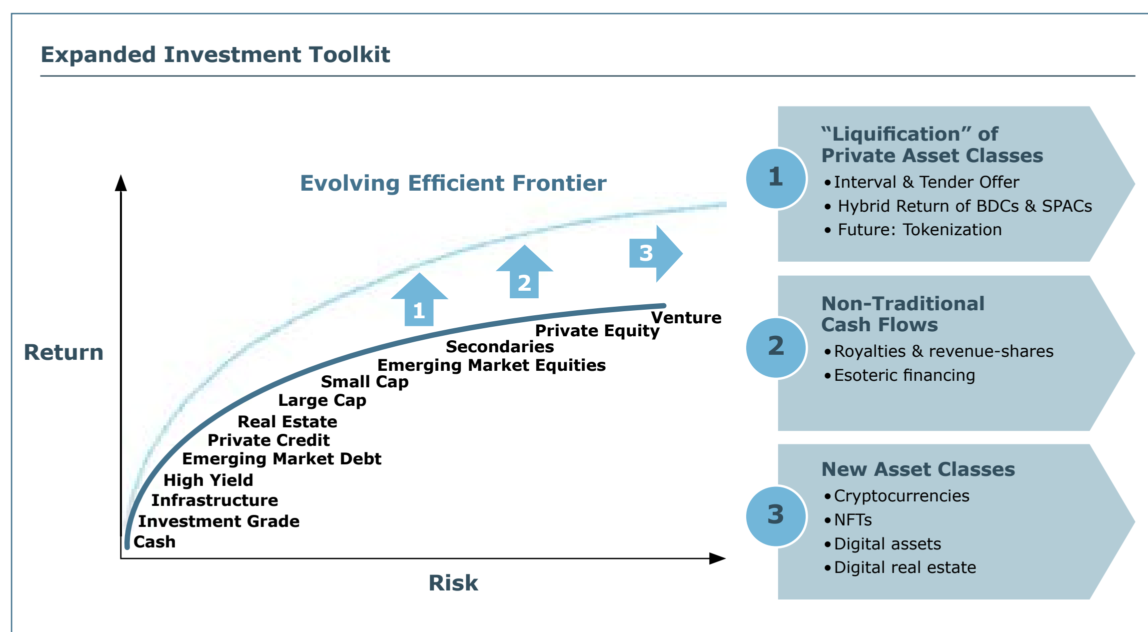
For otherwise commoditized strategies, non-financial alpha spells survival: examining active US mutual funds reporting to Simfund as of year-end 2021, funds classified as "sustainable" commanded on average 24% higher fees than comparable active US mutual funds lacking this classification. There is a compelling commercial case for managers to meaningfully incorporate ESG into their current investment strategies and products, focusing product differentiation along this sustainability dimension.

In Australia, and in Europe (as illustrated by the new SFDR classification and taxonomy) we would go a step further and state that ESG has become the norm. In those markets, failing to include sustainability in investment decisions is now a form of negligence. Contrast this with mainland China: managers with ambitions in China should pay close attention to potential conflicts with their ESG activities in Europe—something we explore in Wave 5, Globalization Goes Local.

Beyond ESG, it remains to be seen whether other forms of non-financial alpha emerge, for example, strategies looking to change a region's trajectory (e.g. US opportunity zone funds), national endeavors (climate change infrastructure), or other affinity-based groupings.

3. Expanded Investment Toolkit

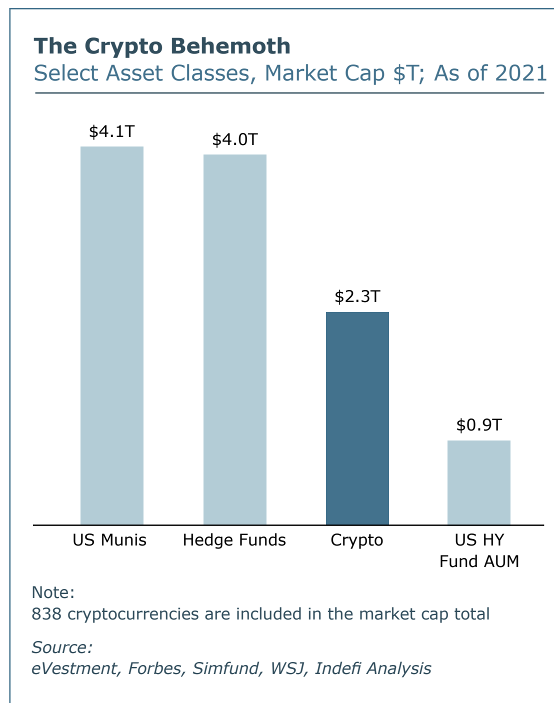
A New Efficient Frontier?



In contrast to most other forms of financial intermediation, investment management sells a promise (we hope to deliver performance X), not an outcome (an insurance policy paying out Y). Managers should improve their odds by expanding their investment toolkit: rethinking private asset classes, incorporating new(er) asset types, and rethinking tokenization.

The steady rise of alternatives, especially private alternatives, has been well-documented. However, private alternatives in their current packaging have largely been the purview of institutional investors. Friendlier packaging (including interval funds, tender-offer funds, BDCs, SPACs, ELTIFs, LTAFs, etc.) already exists. The bigger innovation is to use this packaging for investment strategies designed specifically to own both private and public assets, which would lead to a revolution in the multi-asset space, and fuel innovation for decumulation products.

The Rise of Crypto



Second, could digital assets represent an extension of the risk spectrum beyond equities? This newer world encompasses so-called crypto currencies, non-fungible tokens (NFTs), and virtual assets (such as Metaverse real estate). Crypto is the most developed, or at least largest, of these three, and it has become too large to simply ignore: the total market capitalization of crypto now exceeds the total value of US high yield bonds outstanding. Crypto's volatility and retail ownership have resulted in a trading environment where legacy investment strategies and heuristics (long ago exhausted in public equities) have a high information ratio. So far, this feature has been capitalized by institutions trading proprietary capital, but some early hedge funds are showing the way asset managers could also profit.

"…could digital assets represent an extension of the risk spectrum beyond equities?"

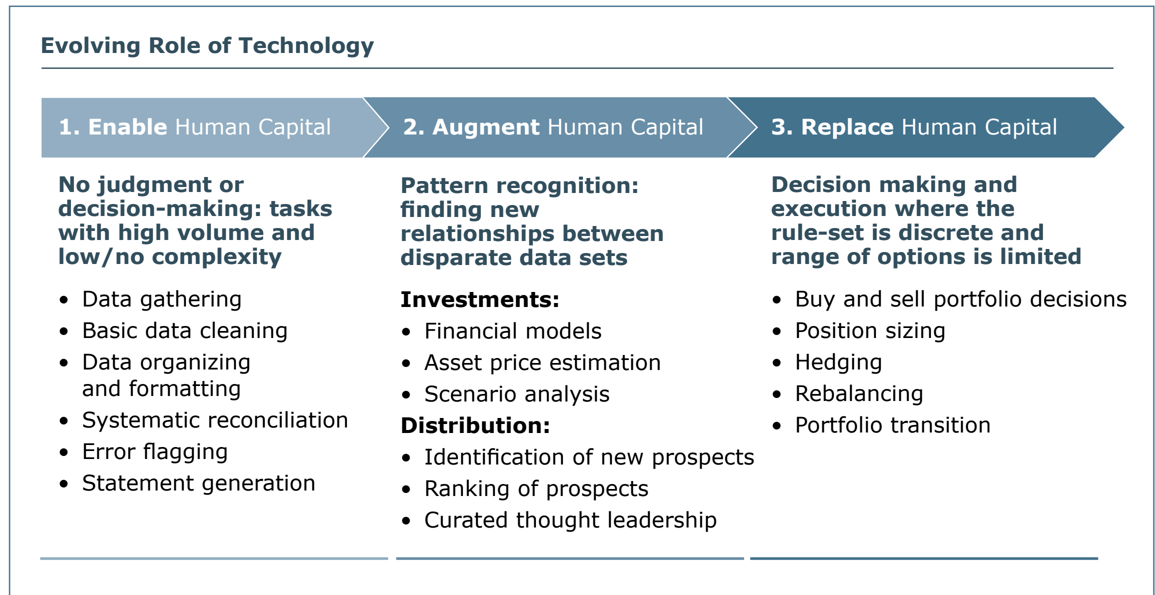
Finally, tokenization: in theory blockchain technology should enable the tokenization of virtually any asset, and in turn "bite-sized" tokens can be owned and traded by individuals (or funds). In practice, the legal and operational mechanisms definitively linking an asset's cash flows to tokens have been slow to develop. An additional pre-condition for tokenization to take off is robust secondary markets for tokens (and not solely of the peer-to-peer variety).

Given the libertarian ethos behind blockchain and digital assets generally, it is ironic that mainstream adoption of tokens requires (i) an institutionalized contractual and operational infrastructure linking cash flows to tokens and (ii) the embrace by exchanges and institutional market makers of these standardized tokens. For these reasons, intellectual property (IP)-related cash flows are likely the earliest candidate for tokenization, as opposed to say real property or exotic assets such as rare art or wine. Specifically: royalties tied to NFTs, "rents" from metaverse assets, and (in the real world) royalties from medical patents and licenses are good early candidates for tokenization.

Therefore, asset managers seeking to be pioneers in tokenization should consider IP-related investments (royalties, revenue-shares, concessions, etc.) and work with exchanges on the mechanics of institutionalizing this technology.

4. AI Tipping Point

Role of Technology



"...the rush to incorporate ESG into privates should prove a fertile ground for advanced quantitative techniques..."

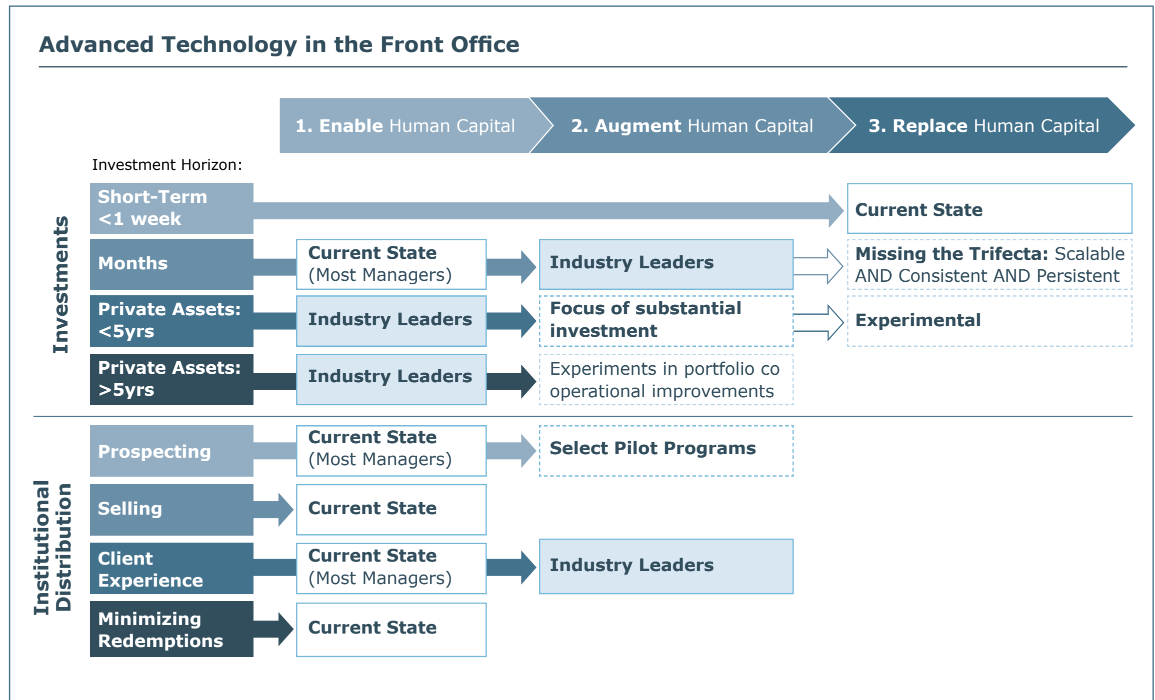
No, Siri isn't coming for your job. However, investment managers should take a close look at how legacy business processes in the front office (investment, distribution, business leadership) could benefit from advances in data science and predictive analytics.

Technology's impact on core front office activities has been limited to "dumb" tools that enable human capital. In contrast with the revolution in trading, settlements, pricing, custody and administration, an equity PM or an institutional sales professional teleported to 2022 from twenty years ago would find merely superficial changes to how they fulfilled their primary responsibilities. We expect this will not be the case for today's professional being teleported to 2030.

Within investments, the role of AI is most discernable as a function of the investment horizon and the nature of the assets (public or private). For public assets, the ability of technology to speed up and potentially improve investment decisions is starkest in trading-oriented strategies. As the investment horizon extends to months and then years, technology's real value-add is in focusing senior PMs' time and effort away from lower-value-add activities, flagging non-financial factors, and serving as a feedback mechanism on PMs' decision-making success, predicting when decisions are most likely to be correct.

Private asset managers have been slower to adopt advanced techniques into their investment processes. However, in many ways the potential upside is greater for privates, both during the origination process and the asset improvement process. Furthermore, the rush to incorporate ESG into privates should prove to be a fertile ground for advanced quantitative techniques, given the data-intensity ESG monitoring entails. For new entrants, technology will prove to be the great leveler for some private assets, partially replacing the need for deep networks of relationships and allowing newer, cheaper players into private asset classes.

Investments & Distribution



Finally, advanced technology in distribution has seen, so far, greater adoption in the retail channels. As with the PM example above, institutional sales' application is one of not replacement but augmentation, focusing the sales professional on the highest value-add activities and prospects, and equipping them with the most impactful client content.

5. Globalization Goes Local

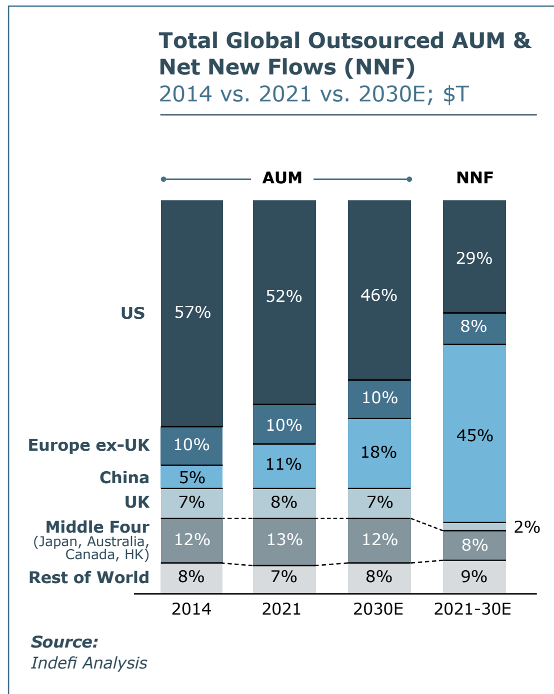
> "Four major markets (US, China, Europe-ex-UK, UK) account for 80% of industry revenues… Leadership in any one of these four markets required a deeply local effort…"

Perhaps the most widely accepted "truism" guiding business decision-making over the past few decades in asset management was that globalization moved in one direction. This meant that investments were being globalized (via integrating capital markets, cross-border vehicles like UCITS, global and international investment strategies) as well as distribution capabilities (via a gradual convergence of investor standards and practices, and to a lesser extent via regulatory harmonization). The 2008 financial crisis slowed things down a bit, particularly when it came to regulatory harmonization, but the direction of travel didn't change. A strong commitment remained in the C-suites for regional hubs, and in some cases global hubs, to serve client needs globally.

The ultimate goal was a "hub-and-spoke" model where a single platform housing investments, operations and business management, ideally in one location (the hub) powered a common set of strategies and products for sale globally in local sales offices (the spokes). There was a recognition that the spokes should be localized, but the business model was global.

The reality is that this model only worked for serving large institutional clients, and as those clients become a marginal source of revenues, the model is truly no longer fit for purpose. It won't go away entirely, but managers pursuing this kind of globalization will be limited to two buyer segments (large institutions and potentially a few global wealth platforms) and certain investment strategies (global/international, GEME/GEMD, and select alternatives).

Four Mega Markets



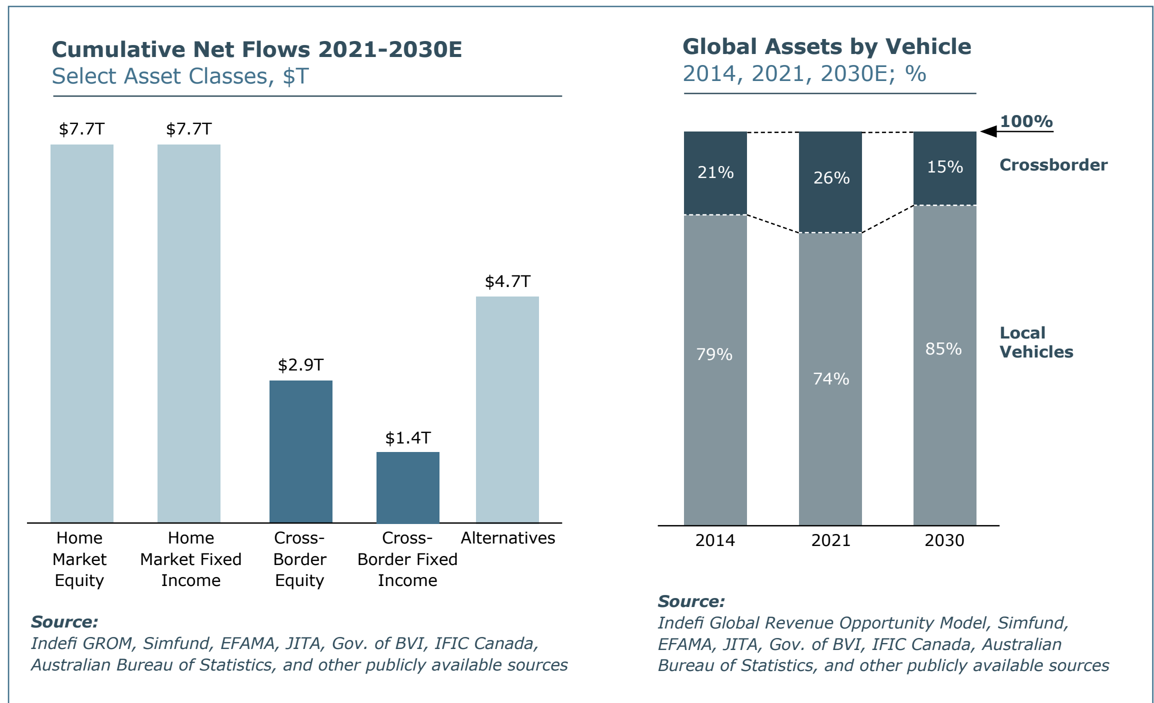
Addressing the vast majority of global revenues will instead require a locally driven business model, with thinner linkages across markets.

Four major markets (US, China, Europe-ex-UK, UK) account for 80% of industry revenues, and are mutually exclusive, with increasingly limited cross-selling opportunities across them. These four markets are diverging when it comes to policy priorities, regulatory approach, demographic requirements, and buyer preferences. Some of the divergences are stark: Europe's ESG requirements, especially around "S" and "G", are problematic in China.

Leadership in any one of these four markets requires a deeply local effort, including local manufacturing, local vehicles, close relationships with local regulators, and local distribution. This scale in any one major "anchor hub" will prove to be a competitive advantage, especially in smaller markets. Managers based in smaller markets should carefully consider which of the four major anchor-hubs they would like to "localize" in. Managers based in the big four markets should tailor their expansion strategies accordingly and be selective about where to make the (sizeable) commitment to localize.

Finally, the pursuit of global synergies and scale should be re-sized accordingly. Beyond the large institutional channel, globalization happens along a different dimension: brand, talent mobility, select best-practices in customer experience and product design.

Local Wins



Conclusions

Asset management continues to be a growth industry. Yet it finds itself at the confluence of many of the great questions and issues the contemporary world is tackling: funding responses to climate change and biodiversity, addressing demographic needs (retirement) and aspirations, and the stewardship of the immense wealth that has been created in the years since 2008. That said, the industry in 2030 will look radically different than in 2022: and the changes between today and 2030 will be more substantial than what we've seen in recent decades, going to the core of what it means to be an asset manager.

The 2030 Checklist

The Checklist

1. Individual Investors Dominate

- ☐ Determine where you can best serve individual channels, and how to sequence efforts
- ☐ Re-orient resources, management bandwidth, and mindset towards individual channels

2. Returns Redefined

- ☐ Determine where, and how, non-financial objectives are a reality for your business
- ☐ Implement an Investment-led, not Marketing- or PR-led, solution

3. Expanded Investment Toolkit

- ☐ Let investment objectives guide strategy design, not legacy style boxes
- ☐ Expand your investment universe, and evolve your staffing model accordingly

4. AI Tipping Point

- ☐ Keep up with what "state of the art" is, for both investments and distribution
- ☐ Push towards using technology to *Augment* talent, not just *Enable* it

5. Globalization Goes Local

- ☐ Go deep in a smaller set of focus markets, rather than broad and shallow

Indefi SAS
30, rue de la Boétie
75008 Paris

Indefi LLC
400 Madison Ave
Suite 10C
New York, NY 10017

www.indefi.com

This report contains general information only. Indefi LLC is not, by means of this report, providing financial, investment, legal, or other professional advice. This report is not a substitute for such professional services. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor.