Spotlight on Asset Management: A New World of Opportunities

“Fund managers really have to hone in on product knowledge because of how complex and regulated the industry has become.”

Revi Goldwasser,
Wall Street Personnel
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Asset managers are desperately seeking specialists. What will happen to the generalists?

by Deborah L. Asbrand

Recruiter Revi Goldwasser knew the financial services specialist craze had reached dizzying heights as she listened to the asset manager carefully detail the position’s requirements: the candidate must be a whiz with version 7.2 of the industry software.

Version 6.8 wouldn’t do, Goldwasser recalls. Only 7.2.

It was the ultimate in specialization. It was also early 2008. While post-financial-crisis Wall Street is a decidedly different place – though the rumors of impending layoffs indicate it’s not as different by now as most would have hoped – one quality remains the same: jobs go to the specialists. Generalists aren’t totally absent from asset management’s ranks and few investment companies today specify job descriptions down to software version knowledge. But investment companies – and the markets – still demand narrow focus.

Employers may admire a well-rounded person, but they need someone who knows how to hit the right buttons.

Next!

Advocating generalist contributions on Wall Street is a bit like touting a liberal arts degree’s value: employers may admire a well-rounded person, but they need someone who knows
how to hit the right buttons.

The thinking goes that specialized analysts and portfolio managers on the coveted buy side know their markets and sectors. They dig deep to follow tickers for a fund. In their business, depth beats breadth every time.

Generalists offer valuable cross-sector exposure that lets them spot patterns in companies and issues. They see forests, not trees.

Both points of view have their merits. But among asset managers, there’s a hands-down winner: “I haven’t seen generalists on the institutional side of money management in 25 years,” says Bob Gorog, a partner for recruiting firm CTPartners. “A domestic large cap trying to outperform the index? That’s not a job anyone wants.”

The jobs that analysts and portfolio managers prize are in emerging markets, where institutional funds slice and dice investments down to the country level. The fast-changing and largely unknown natures of emerging markets give asset managers a chance to make their marks.

“That’s where there are inefficiencies and where you can add more value,” says Gorog.

Form has followed function when it comes to asset management, with the specialist role evolving in response to the behemoth size of investment houses and their vast holdings. “Because companies become so big, they’re forced out of necessity to hire individuals who specialize in one sector,” agrees Goldwasser, who runs the financial services recruiting firm Wall Street Personnel in Boca Raton, Florida.

She adds that regulations have also driven the demand for narrow investment focus, creating an environment where asset managers have to fill their ranks with specialists so as not to run afoul of intricate compliance requirements. “[Fund managers] really have to hone in on product knowledge because of how complex and regulated the industry has become,” says Goldwasser.

WHERE THE GENERALISTS ARE

Given the jumbled state of Wall Street’s traditional hierarchy and the job market for financial services, do opportunities exist for generalists? The answer is yes. Small-cap and growth funds by definition cast a wider eye on the market and therefore are more welcoming of broad-based analysts and portfolio managers. So are investment firms that handle under $100 billion and advisor and wealth-management firms whose clientele comprise high-net-worth individuals.

In some cases, generalist job descriptions are less reflective of broad-based outlooks than the multiple roles they represent in a reduced workforce. Goldwasser says she recently

Regulations have also driven the demand for narrow investment focus.
layoffs loom for banks of all kinds – regional, European, and Wall Street – even as they struggle to rebuild their investment businesses. In July 2012, Deutsche Bank announced it will lay off 1,500 employees in its investment banking division. The figure represents 2 percent of the workforce of one of Europe’s largest banks – and an abrupt turnaround from the bank’s April claim that no layoffs were ahead. Days later, an executive for hedge fund BlackRock commented that there are simply too many people working in the U.S. banking system.

Not surprisingly, and whether they consider generalist or special career paths, young would-be analysts have it especially tough. “The analyst today at the junior level is a utility,” says Elizabeth Komachi, managing director and co-founder of CharlesChase Group in Boston. Top-tier companies like Putnam Investments and Fidelity, once prolific hirers of newly minted graduates, now do little entry-level hiring. While the firms and others still go to a few campuses, received a call from a small office looking for a portfolio manager who would not only perform research, analytics, and investment allocation—but also reporting and presentations.

Another exception to the specialist-is-best rule turns out to be global macro portfolio managers. Gorog says he is seeing more firms create these strategy positions as a hedge against the disruptive economic events that have taken many fund managers by surprise and crippled portfolios and investment returns.

“Firms are bringing in expertise at global macro levels where the individuals’ responsibility to the investment organization is to encourage different kinds of dialogue,” says Gorog.

WHITHER THE JOB MARKET?

This debate is set against the backdrop of a tough job market. Predictions are that more

Jobs in European Asset Management

3,100 companies

85,000 direct jobs

475,000 full-time equivalent jobs

says Komachi, “Most hire at the undergraduate level and bypass MBAs because it’s cheaper.” Worse, the contracted financial services job market has left Wall Street veterans competing for analyst positions that were once considered for rookies only.

There are bright spots in a weak market, however. Asset managers including JPMorgan Chase and Conning have been expanding their rosters as they jostle for mandates from insurance clients, Businessweek reports. The hiring activity reinforces the results of a survey by Goldman Sachs that found about one in five insurance companies is considering outsourcing more funds in the near term. In a move to diversify beyond traditional fixed-income assets, insurance CIOs named emerging-market debt, high-yield debt, and bank loans as the top three investment areas where the companies were weighing third-party managers, according to the survey.

Specialists, get your resumes ready. And then cross your fingers.
Regardless of your position on whether regulation of asset management is a good idea, it’s here and more is coming, both in the U.S. and elsewhere. Since the financial crisis of 2008, both European and American politicians have acted to add or strengthen limits on what financial firms can do. The question for asset managers isn’t so much whether this additional regulation will have an impact on them as it is how best to manage the inevitable impact.

In the U.S., the Dodd-Frank Wall Street Reform and Consumer Protection Act is the most high-profile of the recent regulations imposed since the financial crisis. In particular, many asset managers previously exempt from registering with the SEC now have to do so. And with SEC registration comes SEC examination authority.

Yet even laws not specifically written for asset management have become more relevant, such as the Foreign Corrupt Practices Act of 1977 (FCPA). Lanny Breuer, the assistant attorney general in the Department of Justice’s criminal division, acknowledged recently, “We are in a new era of FCPA enforcement – and we are here to stay.” In particular, government agencies are looking more into two areas close to asset managers: client solicitation and deals and acquisitions. (The SEC has also increased investigations of the actions of portfolio companies, but this risk is likely more important for purveyors of private equity.)

“We are now in a new era of enforcement.”

Lanny Breuer,
U.S. Department of Justice
Regulation has the potential to radically alter the fortunes of asset managers and their service providers – for better or worse,” according to Dervla McCormack of PricewaterhouseCoopers. “Almost all of the new regulations require more reporting.”

How should asset managers prepare? In a recent research note, McCormack advocates “a joined-up approach,” in which asset managers modify systems “most effectively by taking into account all of the different regulations at once.”

To do this, McCormack recommends a four-step approach:

1. Map the reform agenda.
2. Identify impacts and changes required.
3. Identify opportunities and threats.
4. Create an implementation plan.

MORE REGULATIONS MAY MEAN MORE BUSINESS.

ComRes/Cicero Consulting recently conducted a survey of European asset managers. It found that most of them considered new regulation an opportunity. For example, 53 percent of respondents agreed that increased transparency would lead to more streamlined markets and a reduction in investor costs.

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Increased transparency leading to more streamlined markets and a reduction in costs for investors
Safer markets as a result of granting the European Securities and Market Authority new regulatory oversight powers
Increased effectiveness of dealing with professional investors as a result of introducing stricter rules on advisory services provided by asset managers
An obligation to predisclose orders leading to a negative impact on liquidity

Base: All 101 MEPs
It may seem like common sense, because it is. The volume of new work needed to comply with new rules (see the infographic alongside this article) underlines the importance of a simple, straightforward approach. Indeed, each of these steps builds on the one before. You can better implement changes if you have listed the moves your firm needs to make to be in compliance; you can see how one move can help on multiple fronts if you lay them all out.

And one thing is for sure: more regulations are coming, even in the cases where new activities are permitted. The “Jumpstart Our Business Startup Act,” better know as the JOBS Act, enacted in April 2012, lifts the prohibition on general solicitation and lets issuers advertise private offerings under certain conditions. In August 2012, as part of its plan to implement the JOBS Act, the Securities and Exchange Commission proposed new rules regarding this new type of permitted advertising. How cumbersome might these new rules be? Well, the document proposing those rules is 69 pages long.

“How many more tasks as a result of Dodd-Frank?”

- **OPERATIONS**: 1,124
- **LEGAL**: 909
- **TECHNOLOGY**: 712
- **TRADING**: 597
- **RECORDS**: 402

“Regulation has the potential to radically alter the fortunes of asset managers and their service providers.” – Dervla McCormack, PricewaterhouseCoopers

Courtesy of DavisPolk
WHERE ARE ETFS GOING?

Low fees are driving institutional investors to ETFs, greatly increasing the funds they control. Will the ETF investor mix change?

by Deborah L. Asbrand

Exchange-traded funds (ETFs) have always been a bit confounding, with their part mutual fund/part stock fund mix. Now, just as more investors are getting comfortable with ETFs, experts are offering caution and marketing the funds has grown more complicated.

ETFs' hybrid nature makes the funds hugely popular. Their credo is diversification and protection from market swings, and the funds have generally been passive index-trackers following benchmarks like the S&P 500. Like stocks, however, ETFs trade daily on exchanges. They are also extremely cheap, generally boasting average annual fees that run about one-third of mutual funds. Inexpensive access to indices without buying the underlying securities has turned out to be a winning combination.

State Street Bank launched the first U.S. ETF – the SPDR S&P 500 ETF (SPY) – in 1990. It didn’t take long for the smart money to move in. ETFs’ combination of transparency and liquidity proved irresistible to investors. The result: more than a trillion dollars in assets. Investors have plowed $1.2 trillion into 1,400 ETFs in the U.S., according to the National Exchange Traded Funds Association. iShares, the San Francisco-based unit of BlackRock, manages $488 billion, or about 41 percent of all U.S.-listed ETF assets. Large trades among institutions are increasing. Underscoring this market shift was an investor’s redemption last spring of $779.3 million shares in State Street’s junk bond ETF for the equivalent amount of bonds.

Not surprisingly, the list of funds is growing rapidly. More than a few ETFs have strayed from the sector’s passive – and low-risk – roots. Now there are actively managed funds that try
to outperform the indices they track. Leveraged ETFs aim for even greater gains.

Narrow-focus funds have joined the ETF boom. In addition to broad baskets of holdings, investors now can find niche ETFs backed by everything from shares of real estate companies (REITs) to single countries like Argentina and Peru. Want more specialization? There’s an ETF for emerging companies involved with cancer treatment. While that’s nothing to laugh about, financial experts regularly guffaw at the fishing industry ETF.

WHERE INSTITUTIONAL INVESTORS COME IN

Success and popularity has transformed ETFs. “With the rapid growth of ETFs, we are definitely seeing changes in both the type of ETF investor and how ETFs are being used,” Morningstar analyst Michael Rawson noted.

Institutional ownership of ETFs is outpacing individual investors. Rawson points out that State Street originally marketed its SPY fund to institutions but until recently retail investors owned the greater share of assets.

Exactly how many institutional investors own ETF shares is a moving target. Morningstar points to estimates that put the number at 50 percent. A 2011 investment management study by Greenwich Associates found 14 percent of U.S. institutional investors use ETFs in their portfolios.

Among registered investment advisors (RIAs), institutional ownership has been especially brisk. RIAs charge asset-based fees rather than commissions and are more likely to use low-cost products like ETFs. Rawson notes that most ETF institutional investors are RIAs, followed by brokers with a much lower percentage of ownership by mutual funds and hedge funds.

Initially, institutional investors used ETFs for short-term, tactical holds of a year or so. They tweaked portfolios, made transitions, and maintained liquidity.

Now they are finding more strategic purposes for the funds, holding them for longer periods. Greenwich Associates’ May 2012 study found 57 percent of institutional ETF users employ the funds to achieve strategic allocation ranges. More than half reported average holding periods of one year or more, up from last year’s 36 percent, according to the Stamford, Connecticut-based consulting firm.

Investors’ highly diverse objectives for ETFs make it more challenging to market the funds.
Because ETFs have veered from their traditional definitions of active and passive funds, their role in core/satellite investment strategies is no longer clear. According to a 2011 survey of fund providers by Financial Research Corp. of Boston, the shift has left providers with increasingly complex decisions about their target markets, the fit of their products with the markets, and the effectiveness of their communications.

**CHANGE – AND REGULATION – ON THE HORIZON**

Will the influx of large players destabilize ETFs? Some say it already has, as the enormous State Street redemption cited earlier shows. Junk bond ETFs are especially attractive to institutional investors because they allow access at low prices. According to data from Bloomberg, institutional holders own 51 percent of BlackRock’s high-yield ETF, up 11 percent this year. The portion at State Street’s fund has grown to 60 percent, a rise of 18 percent.

The State Street trade was the biggest redemption of shares in four years, according to media outlets. To make it happen, the investor performed financial gymnastics, discretely buying shares of the ETF over time and then redeeming them all at once to gain a big position in the underlying bonds.

It was a tricky move, Barron’s pointed out. “Watch to see if this idea catches on,” blogged the newspaper’s Brendan Conway. “It could become popular among well-known investors who want to move into a given market quietly.”

**THE FUTURE FOR INDIVIDUAL INVESTORS**

At the moment, little-guy investors continue their enthusiasm for ETFs. Discount broker Charles Schwab reports that in the second quarter of 2012, ETF assets reached $135 billion, up nine percent over the past year and slightly above eight percent ETF industry growth.

But news of large, questionable trades may discourage individual investors – and Moody’s thinks that’s not necessarily bad. In May 2012, it issued a buyer-beware note highlighting the State Street redemption and warning retail investors about potential ramifications. “The rising use of ETFs as rapid trading vehicles by institutional block-traders and hedgers seems to be increasing investors’ risk,” wrote Moody’s senior credit officer Neal Epstein in the report.

Moody’s isn’t the only one concerned. Regulators worry that fund types have grown downright oddball and too narrow to provide long-term investment opportunities and decent returns.

In 2011, Canada’s Foundation for Advancement of Investor Rights (FAIR) called on regulators to warn investors of the risks of leveraged ETFs. In July 2012, European regulators got tough.

Investors have plowed $1.2 trillion into 1,400 ETFs in the U.S.
with ETF providers. The European Securities and Markets Authority (ESMA) included ETFs among the funds for which it issued new guidelines with the goal of improved investor protection.

Vanguard, however, says not to worry. In response to criticism that ETFs’ daily trading encourages speculative behavior, the mutual-fund-and-now-ETF-giant published research in July 2012 emphasizing that investors exhibit buy-and-hold behavior whether investing in a traditional index fund or ETF. But some will be skeptical of reassuring data from a leading ETF provider. The lowdown on ETFs, whatever the forecast, is that the funds’ investor profile is undergoing change and marketing strategies will need to change too.
GOING GLOBAL

The time is right for asset managers to expand into emerging markets.

By Jimmy Guterman

Asset management is often seen as an old-school financial service, available primarily in the developed countries. But in recent years asset management has grown dramatically in many emerging markets.

According to Cerulli Associates, the institutional asset management business in Asia (not counting Japan) totaled $8.6 trillion in 2010; by 2015, the company expects that to grow to $13.6 trillion, with more than 12 percent to be outsourced to external managers. And don’t forget that half of the world’s ten biggest stock exchanges are in Asia.

It’s not just Asia. Fast-growing BRIC and Middle Eastern nations are remaking the middle class. Frank Heideloff and Matthias Huebner of Roland Berger Strategy Consultants say that the global middle class, now 1.8 billion, will grow to 4.9 billion by 2030. Their advice: “Go for the middle. Asset management can succeed in emerging markets as long as it provides tailored strategies for target segments.”

The Middle East has many potential customers for asset managers: 2.5 million adults in the region hold assets above $500,000, making for a total potential market size well above $1 trillion. One way to enter the Middle East, Heideloff and Huebner advise, is to seek out...
established Middle Eastern banks without an asset management franchise among its offerings. There are other means of distribution, including incumbent asset managers and build-from-the-ground ventures, but allying with an existing trusted bank may speed time to market.

Africa does not boast the massive sovereign wealth funds of Middle Eastern kingdoms, but it was the fastest-growing region for assets between 2006 and 2010, with a compound annual growth rate (CAGR) of roughly 15 percent. As Nicolas Clavel, founder of the Afrocentric hedge fund firm Scipion Capital, observes, “In a continent that is progressing as fast as this one, this is the time for global investors to take advantage of its continuing growth.”

Depending on how you count, Clavel says, either six or seven of the world’s top 10 country growth rates are in Africa. And in an observation that rings true of the opportunities in many emerging markets — not just those in Africa — he adds, “The continued improvement in infrastructure makes transactions that three years ago would have been completely unrealistic become realistic.”

The Middle East has many potential customers for asset managers: 2.5 million adults in the region hold assets above $500,000.
Emerging markets are referred to as emerging for good reason: in addition to the economic changes happening in these countries, political and social upheavals are common as well. Countries like Russia, China, and Indonesia don’t have the same governing system they had a mere generation or two ago. It is far from a foregone conclusion that all, or even most, emerging markets will reach an end state similar to a Western democracy. The next two generations will see a great rise in these nations as they emerge, but even the most forward-looking asset manager doesn’t know what these countries will look like when they emerge fully. The only thing for certain is that these nations will be full of new assets to be managed.

According to a World Bank report, six countries – the BRICs (Brazil, Russia, India, and China) plus South Korea and Indonesia – will provide half of all global growth in 2025.

More money spent on entertainment in emerging markets means a growing middle class with more discretionary income.
As post-financial-crisis regulations continue to take hold in asset management (see page 7), customers – both customers and individuals – expect more transparency from their financial firms. Good governance helps make sure that institutions are managed in the long-term interests of their shareholders and customers. Well-defined shareholder rights, high levels of transparency and disclosure, and an independent, active board of directors are now the attributes of leading firms that individuals and business can feel comfortable investing in and with.

The benefits of good governance are not merely what come from steering clear of legal trouble; good governance makes for more solid companies. There is growing evidence from academia that financial firms with good governance also enjoy better returns. The truism that cutting ethical corners helps a company, at least in the short and medium terms, turns out, under examination, to be a myth. In an article by Gordon Clark and Roger Urwin, submitted to the Journal of Asset Management just after Lehman collapsed, the authors zero in on three areas in which asset managers can differentiate themselves...
and provide themselves and their clients with greater value creation:

- Organizational coherence: clarity about the business’s mission and capabilities.

- People: the quality, both in terms of talent and ethics, of those managing investments.

- Process: how investment decision-making is managed and implemented.

Separately, each of these areas speaks to different strengths an asset management firm should have. Taken together, organizations that are open about how they try to excel in all three areas are likely to gain investor confidence, with good reason.

Indeed, in today’s financial world, asset managers are seeking to differentiate themselves by highlighting their governance procedures. HSBC Global Asset Management, for example, states that it invests for the long-term, always on the prowl for sustainable long-term returns, so it looks to invest in companies with the same goal. Many other companies, such as Aberdeen, assert the same.

There’s a small industry of organizations aiming to improve corporate governance among asset managers, among them Hawkamah, an institute for corporate governance based in Dubai. Plenty of organizations provide granular guidelines on how to improve governance, such as the International Corporate Governance Network, which has developed a Model.

PERSONAL GOVERNANCE IN A NUTSHELL

The CFA Institute’s Asset Manager Code of Professional Conduct enumerates how managers should serve their clients:

Act in a professional and ethical manner at all times.

Act for the benefit of clients.

Act with independence and objectivity.

Act with skill, competence, and diligence.

Communicate with clients in a timely and accurate manner.

Uphold the applicable rules governing capital markets.

(copyright 2010, CFA Institute)
Mandate Initiative that suggests model contract terms between asset managers and investors. It serves as a useful checklist of what asset managers should deliver – ranging from risk management and fees to portfolio turnover and commissions – and what they should steer away from.

“Trust in those individuals who manage investor assets is a fundamental element in any investor-advisor relationship,” notes Jon Stokes, director of standards of practice development at CFA Institute, a global nonprofit organization of investment professionals. Having a code of conduct doesn’t necessarily mean that a company will live up to it, he acknowledges, but not having one may be a warning sign that governance isn’t important there.

For more on general corporate governance, a strong source is the Principles of Corporate Governance from the Organization for Economic Cooperation and Development (OECD).

ABOUT THE AUTHORS

Deborah L. Asbrand's word has appeared in The Industry Standard, Forrester, MIT Technology Review, and many other publications.

Jimmy Guterman has served as an editor at Harvard Business Review and MIT Sloan Management Review.