Important Features of the Development of the Asset Management Industry

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Abstract: Under the pressure brought by economic downturn, financial market turbulence, fierce competition in the industry, as well as facing the changes and challenges brought by technological development, asset management institutions have to try their best to find ways to achieve better survival and development. These breaking through methods involve various aspects, including improving investment research capacity, promoting innovation and evolution of products, attaching importance to cost control and cost management and so on. In this article, the common advantages and characteristics of the winners who break through numerous difficulties are summarized. The successful experience has important reference significance for the development of other asset managers and the entire industry.

Keywords: Global Asset Management; Passive Product; Alternative Products; Development

1. Passive products

The rapid rise of passive products ranked first in terms of the growth rate of assets under management. The proportion of size increased from 9% in 2003 to 12% after the crisis and further to 22% in 2020, maintaining a compound annual growth rate of more than 10%.

The two outstanding passive products are ETFs and smart beta. ETF is the most typical passive management product, which develops rapidly after the crisis. Indeed, in a post-crisis environment in which long-term risk-adjusted returns are expected to decline, investors have preferred low-cost products that offer average, market-tracking returns. ETFs are well suited to the goals of institutional and high net worth investors, as they build broad index-tracking positions. Net asset value of ETFs in the US, the world's most mature ETF market, have also increased rapidly since the crisis.

Smart beta is a passive product with active management characteristics. It is a kind of strategy which tracks the index passively, but also embeds active investment strategies based on specific rules. Smart beta products, although small at present, have maintained a high annual growth rate since 2012. Smart beta seeks the results of active replication management, but charge lower fees, thus putting downward pressure on the share of traditional active management products.

The popularity of passive products leads to an increasing product share in all asset management products. However, due to the characteristics of low fees, passive products have limited contribution to the revenue of asset management institutions and lower the profit margin of the entire industry. In view of the characteristics of passive products, only large asset management institutions with its cost advantage to achieve scale effect and industrialization can better control the passive products to achieve profits, otherwise small asset management institutions which operates passive products are likely to cause losses.

2. Alternative investments

In the early stage after the outbreak of the crisis, alternative assets suffered a heavy blow, mainly because their correlation with the actual market was much higher than expected, which led to the unsatisfactory effect of risk diversification and caused investors to suffer losses However, with the recovery and improvement of the market, for the purpose of seeking high returns in the low interest rate environment and diversifying assets to disperse risks in the context of market turmoil, alternative assets are growing and their product structure is changing.

The composition of specific parts within alternative assets is not even. Since 2008, private equity, real estate infrastructure, etc., have grown at a large compounded annual growth rate and constitute the main component of alternative assets. Hedge funds, however, saw a significant decline in asset growth over the previous decade, with their AuM of alternative investments falling from 30% in 2003 to 25% after the crisis and continuing to fall to 23% in 2019. Private equity investment has rapidly grown into the income pillar of alternative products. Since 2003, the proportion of private equity has been advancing rapidly and its AuM proportion of alternative investment has increased from 24% to 35% in 2019, and its contribution to the income of alternative assets has also soared from 30% in 2003 to 49% in 2019.

From the point of view of industry revenue, alternative assets play an important role. Alternative assets account for nearly half of the global asset management industry's revenue. The growth of assets under management is driven by passive products, while the revenue growth of the asset management industry is mainly due to the contribution of alternative assets, which also constitutes the main reason for the decoupling of assets under management and the industry revenue. Passive products, while expanding strongly, contribute only 6% of the industry revenue, while alternative products account for 42% of the whole industry revenue with only 16% of the industry’s assets under management.

3. Investment solutions

Customized solutions have grown in popularity with investors over the past decade. Typical solutions include asset allocation funds, target-date funds, and debt-driven investments. Solution products are oriented to specific investment results and time frames, or are explicitly linked to balance sheets and specific macroeconomic trends, or both. Many asset management institutions have captured the strongest new asset flows in the market and achieved high revenue growth through investment solutions.

There are five driving factors behind the accelerated development of the solution. The first reason is the disappointing performance of traditional actively managed core assets linked to the benchmark. When the benchmark is low enough, even exceeding the benchmark means losses and poor returns. Second, people's traditional investment ideas have been shaken. The market fluctuations during the financial crisis have weakened investors' attention to the maximization of risk-adjusted returns, and people's investment goal has changed from maximizing immediate returns to matching assets with future liabilities. Third, the traditional diversified asset class strategy failed to pass the test of the financial crisis. The correlation convergence between traditional asset classes affected the performance outcome. The successful strategies are more oriented to the macro trend, and take advantage of the opportunities of different asset classes to dynamically adjust asset allocation. Fourth, the increasing complexity and internationalization of financial markets and the increasing difficulty in managing them have created new special asset classes and demand for higher asset allocation skills. Simple allocation strategy is no longer suitable. Last, investors seek exposure to niche, non-traditional, low-correlation asset classes and this kind of preference contribute a lot to the soar of investment solutions.

4. Fintech

The use of fintech in the asset management industry is mainly reflected in data and analytical capabilities. Many asset management institutions have already paid attention to and invested in fintech, and those who hope to improve their digitalization and data analysis skills will gain a greater competitive advantage and be in a better position to develop in the future. Research shows that digital leading institutions outperform other institutions in terms of expenses, AUM growth rate and profit margin.

Fintech has many important applications in the asset management industry, mainly in the following aspects. First, it participates in the process of investment management and decision-making, extracts valuable information by using large-scale and multidimensional data, and then integrates the information into a rigorous analysis model to assist in the determination and execution of investment decisions. Second, it can help to collect, process and analyze data related to customers' behaviors and tendencies, accurately picture customers, track changes in customers' preferences, update and analyze them in time, and ultimately provide customers with products and high-quality services that best meet their needs. Third, it can make full use of rich data resources, advanced algorithm model and advanced analysis technology to help asset management institutions to establish a complete risk control system and sensitive pre-warning system, and improve the ability of asset management institutions to understand, monitor and resist risks. Fourth, it uses digital technology to simplify information process, and realize the automation of many steps, improve the efficiency of the whole asset management, gain a breakthrough on speed and accuracy, and ensure quality under the premise of reducing the cost greatly. Through the above four aspects of optimization, the financial technology will help the future development of asset management institutions to rise to a new level.

5. ESG investment

Under the guidance of sustainable investment, asset management institutions should consider not only risks and returns, but also environmental, social and governance factors when making investment decisions, and strive to achieve positive results in these three aspects as well.

Asset management institutions need to pay attention to three main aspects when investing according to ESG factors. First, ESG factors is critical for long-term investment performance. Enterprises with high ESG score have stronger risk control ability, show stronger anti-cycle and risk resistance ability, and enjoy relatively high valuation. A number of studies have also shown that companies that adopt behavior with sense of social responsibilities in business-related areas will also improve their financial performance. For long-term investment, it is necessary to consider ESG factors, which can help decision makers deepen their understanding of risks and facilitate the exploration of new opportunities. Second, investors want their investments to have a positive impact, making ESG-related investments more popular in the retail market. To keep up with this trend of demand, asset management institutions should pay more attention to sustainable investment, integrate the individual needs of clients into the product development process, and increasingly customize products for the ESG sector. Third, at present, the standards of ESG are not standardized and unified, and the relevant data are lacking or of poor quality, leading to uneven quality of investment targets. This requires asset management institutions to be more careful when choosing sustainable targets, strive to build their own ESG's evaluation standard system, improve the data collection and processing process, and strengthen the ability to discover and evaluate ESG investment opportunities.

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