

VISION

Positive
Outlook

New
Rivalries

Fit to Win

Asset Managers

Opportunities for Optimism?

A New Vision for Value in Asset Management

Featuring the findings of the State Street 2015 Asset Manager Survey conducted by FT Remark.



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State Street's latest global survey of 400 asset managers, conducted by FT Remark, reveals an industry positive about growth.¹ The challenge is to translate this optimism into long-term success, amid changing investor needs and new sources of competition and risk. This report explores four “value drivers” that define a roadmap for the industry.

88%

see opportunity for profitable growth in the next 12 months

79%

foresee direct competition from non-traditional market entrants

¹ State Street 2015 Asset Manager Survey conducted by FT Remark in April and May 2015. Unless otherwise noted, all statistics and data points are derived from this survey. The survey involved 400 senior executives in the asset management industry. Respondents from 23 countries participated, with the majority from Australia, Canada, China, Germany, Japan, Switzerland, the UK and US. Respondents manage assets for both institutional and retail clients, spanning traditional and alternative strategies.



78%

say a greater proportion
of client assets will
move to bespoke
solutions over the
next five years

46%

are evaluating targets
for acquisition today

Opportunities arise on many fronts, but traditional ways of doing business are changing. According to our new survey of 400 asset managers, conducted by FT Remark, leading firms are finding new ways to create value for their clients. They are revamping their investment strategies, upgrading their capabilities and hunting for acquisitions that could extend their expertise or reach.

Today's optimism is tempered by an awareness of emerging risks. Costs are under scrutiny. Clients want "more bang for their buck," and are seeking value that goes beyond simply beating the traditional performance benchmarks. Competition is also intensifying — not just from traditional rivals but from

potential tech-savvy challengers too. In this fast-changing environment, asset managers need to move fast to capture today's growth opportunities, while fending off new competitive challenges. Our research identifies several key trends that are reshaping the industry.

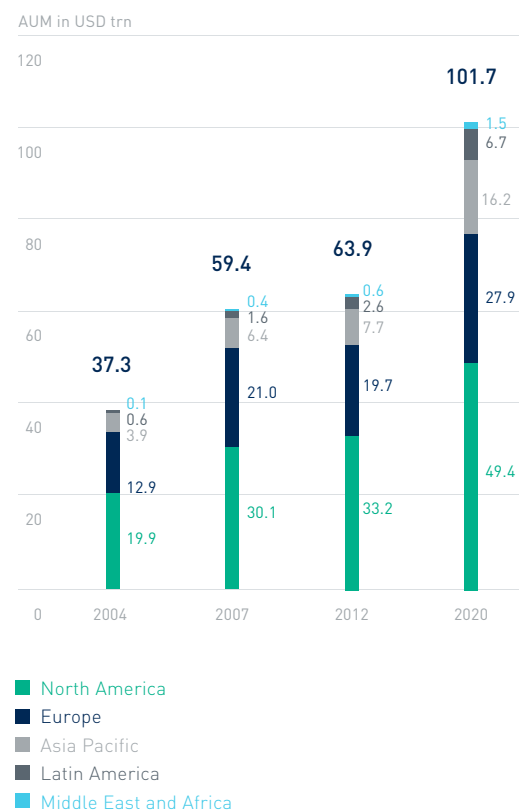
- **The race is on to capture new sources of growth.** Over four-fifths of asset managers (88 percent) see opportunity for profitable growth in the next 12 months. They are expanding sales teams to support this opportunity: 46 percent of our survey respondents are recruiting new talent in business development roles. Asset managers are racing to deliver new products and improve the distribution and servicing channels that will drive growth in the new environment.

- **New client demands change the game.** Over three-quarters of asset managers (78 percent) say that a greater proportion of client assets will move to bespoke solutions over the next five years. Clients are also looking for more transparency and insight from their asset managers. Leading players are responding by developing the tools and capabilities to deliver customized strategies that match clients' long-term objectives.
- **New competitors will potentially disrupt the industry.** Almost four out of five respondents (79 percent) in the survey foresee direct competition from non-traditional market entrants. Technology players like Google, Apple and Alibaba Group could mount a serious challenge. Asset managers also find themselves competing with their clients' own investment talent, as large investors bring more asset management in-house.
- **Acquisitions are on the rise as asset managers boost their capabilities or scale.** Underscoring the momentous changes underway, 46 percent of asset managers in our survey are evaluating targets for acquisition today. Leading players will move fast to plug capability gaps while increasing their penetration of the fastest-growing customer segments.

Against this backdrop, the rewards will go to asset managers who can deliver value to clients on multiple levels while achieving consistently high returns. Delivering greater value in today's environment entails offering solutions and services that are customized around investors' unique

needs. For some asset managers, this may involve forging closer partnerships with investors based on a transparent dialogue around risk and performance. For others, it may mean leveraging technology to offer smart investment solutions at a highly competitive cost. Creating more value for clients — while staying profitable — will be the defining challenge for the years ahead.

Forecast for growth in assets under management by region.

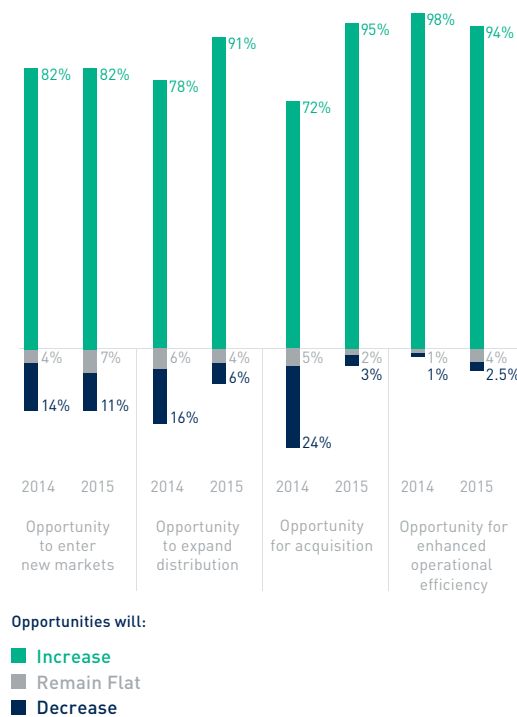


Source: PwC analysis. Past data based on Hedge Fund Research, ICI, Preqin, Towers Watson and The City UK data.

New Sources of Value, New Forces for Change

Asset managers have growth in their sights. Assets under management (AUM) have grown strongly in recent years and are projected to rise to \$102 trillion by 2020.² (See chart, opposite.) Almost 9 out of 10 asset managers (88 percent) in our survey see an opportunity to grow profitably over the next 12 months, while 83 percent have experienced growth in AUM over the past three years.

Asset managers' predictions for the change in opportunities for their business over the next year.



Source: State Street Asset Manager Survey, 2014 and 2015, conducted by FT Remark

Such growth figures give grounds for optimism. But the opportunities for growth will not be evenly distributed. Asset managers are racing to reposition themselves in response to the trends emerging in the new market landscape. These shifts are forcing asset managers to rethink how they focus their proposition and how they create value for their clients.

It's About Value, Not Just Performance

The asset management business is getting more personal. In our survey, 78 percent expect a greater percentage of client assets to move to tailored solutions over the next five years. This reflects growing demand for outcome-oriented investment solutions that are customized to clients' specific needs and objectives.

This changes the manager-investor dialogue. "We're almost entirely focused on building tailored solutions — the starting point on everything we do is about addressing the client's problem," says David Stewart, head of pension solutions at Santander Asset Management. "Investors don't care whether it's equities or bonds. They want particular investment returns delivered in a particular way — whether you call that risk budget, expected volatility or just manager style. Our approach is to identify the outcomes clients want, and then work back to identify what you need to do to deliver those outcomes."

²Asset Management 2020: A Brave New World, PwC, 2014



“Performance gets clients interested in you, but it’s the quality of other service and advisory factors that help sustain the relationship.”

FRANK HART

President, Managing Director and Chief Risk Officer, Greystone Managed Investments

At the same time, the way investors measure success is changing. Consistently strong investment performance continues to be critical. But investors are also looking for strategies that match their long-term liabilities, or that more tightly reflect their approach to managing investment risk. A recent study by State Street’s Center for Applied Research (CAR) found that only 12 percent of investors globally believe they are on track to achieve their long-term goal of comfortably retiring.⁴

“Asset managers are being asked to help a client reach a specific return assumption, rather than simply beat a benchmark. That’s the big dynamic that’s driving deep changes through the industry,” says Greg Ehret, president of State Street Global Advisors.

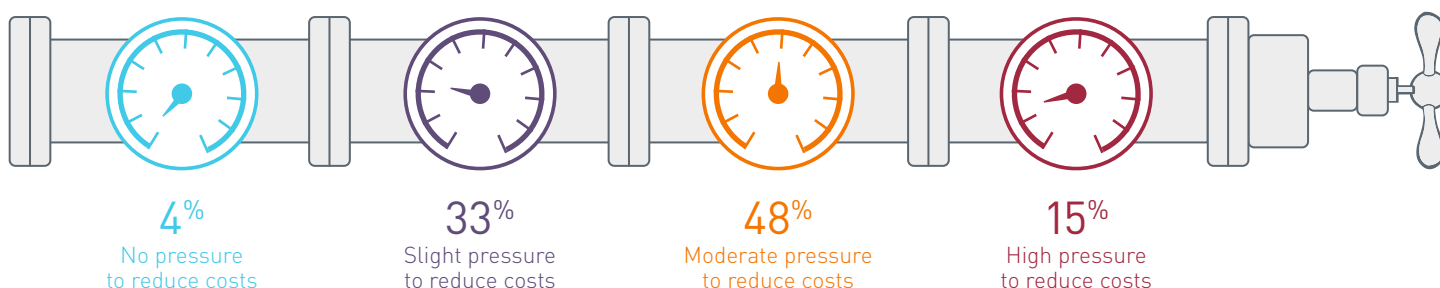
This focus on investment outcomes rather than products is changing the way asset managers think about their offerings. It is also about reshaping the relationship with their clients.

“Performance gets clients interested

³ State Street 2014 Asset Owners Survey, conducted by the Economist Intelligence Unit. Pension fund respondents. The survey was conducted in August 2014. Respondents from 15 countries participated, with the majority coming from the US, UK, Australia and Canada.

⁴ The Folklore of Finance – How Beliefs and Behaviors Sabotage Success in the Investment Management Industry, State Street Center for Applied Research, 2015. This report explores some of the steps that the industry can take to improve long-term outcomes for investors.

Thinking about the cost pressures facing your business today, how would you describe the environment?



Source: State Street 2015 Asset Manager Survey, conducted by FT Remark

“Our margins are being squeezed because Japanese investors are asking for more transparency, and we need more resources to deliver that, but profits are not growing in line with that expense.”

TAKASHI SARUTA
Executive Managing
Director, Nomura
Asset Management

in you, but it's the quality of other service and advisory factors that help sustain the relationship,” adds Frank Hart, president, managing director and chief risk officer of Greystone Managed Investments. “Clients are increasingly sophisticated — they want a close relationship with the people managing their money. This means providing the sort of information and advice they might previously have received primarily from a consultant, or even information they have not been getting from their consultant, including, for example, a deeper dive on risk management.”

What Will Clients Pay For?

Shifts in the market are forcing asset managers to become smarter at controlling their costs and at setting fees. Almost two-thirds (63 percent) in our survey feel moderate to high pressure to reduce their costs. Many investors are increasing their allocations to low-cost passive solutions. According to Morningstar, while passives made up only 11 percent of US equity funds in 2000, they comprised 30 percent by 2015.⁵ Smart or advanced beta, a predominantly passive strategy, is attracting more investor interest too. Research conducted by State Street Global Advisors found that just over 4 in

⁵ Morningstar Fund Flow Data, comparing Annual Report 2009 with US asset flows data through April 30, 2015

“If you’re not a mega-firm or a low-cost provider, you’ll need a specialty that you are renowned for. Mid-level players that can’t differentiate will come under real pressure.”

NEIL BATHON
Founder, FUSE
Research Network

10 institutional investors have already committed a portion of their portfolio to advanced beta, while a further 24 percent are planning to do so.⁶

One driver of the pressure on costs is the need for active managers to reassess their investment processes. The investment process and resulting alpha generation needs to be consistent with the fee structure. “It’s no secret that fees are under pressure throughout the industry,” says Steve Auth, chief investment officer at Federated Investors. “If you’re focusing more on the bundle of characteristics that the end client is looking for from their solution, it’s going to change the whole idea of what counts as good performance,” he says.

For managers that want to charge a premium for active management, they will need to work hard to try to deliver a differentiated approach. They need to prove that the extra fees are worth the money. Meanwhile, for those managers that offer a broad range of investment solutions and related services, it’s important to keep driving down costs to compete in an environment where more low-cost options are available to investors. What’s more, as technology in the sector improves — so that new

tools can perform tasks such as building portfolios to specific risk requirements — investors may be drawn toward high-quality self-service models.

Meeting the Competitive Challenge

As asset managers decide where and how they compete, some active managers are investing in the ability to construct highly customized multi-asset portfolios for their clients. Others will cater to the demand for niche expertise in alternative asset classes. Passive strategies also continue to attract strong investor demand, although only the largest players tend to have the platforms and scale efficiencies to dominate this market.

The key is to know where you can add value. “If you’re not a mega-firm or a low-cost provider, you’ll need to have a specialty that you are renowned for,” argues Neil Bathon, founder of the FUSE Research Network. “Mid-level players that can’t differentiate are going to come under real pressure.” PricewaterhouseCoopers LLP’s global asset management leader Barry Benjamin agrees, predicting that the majority of convergence and consolidation in the sector will occur between mid-tier firms. “They don’t have

⁶ Beyond Active and Passive – Advanced Beta Comes of Age, State Street Global Advisors, 2014

enough scale to compete in the global marketplace anymore because it's too hard and too costly from a regulatory and technology perspective," he says. "They'll look to fill in the gaps that might elevate them to the top tier." Competition comes from outside the industry as well as from within. Almost four out of five asset managers in our survey (79 percent) expect to face direct competition from non-traditional challengers in the next three years. Speculation that technology players like Google, Apple and Alibaba Group could mount a challenge in the distribution space in particular is being taken seriously (see *Owning the Client — Where Technology Firms Could Compete* on page 24).

There's another new dimension to the competition faced by asset managers. Increasingly, they are competing

with their clients' in-house asset management teams. Previous research from State Street revealed that more than four out of five pension funds (81 percent) plan to bring more of their asset management activities in-house — partly to reduce their costs, but also as a way to gain greater control and transparency over their portfolios.⁷

Typically it is the larger asset owners that are driving this trend, and insourcing of assets tends to start with the more traditional asset classes like equities and fixed income. For asset managers, however, it means they need to think again about how they create value for the largest institutional investors. Success in this environment requires asset managers to sharpen their focus on where they can differentiate and create unique value for their clients.



79%

of asset managers in our survey expect to face direct competition from non-traditional challengers in the next three years

⁷ Pension Funds DIY – A Hands-on Future for Asset Owners, State Street, 2014

Spotlight

Acquire or Partner?

How to Build Capabilities and Extend Your Reach

The industry is moving into a new phase of consolidation. Many asset managers are planning acquisitions or strategic partnerships to augment their capabilities and competitive offerings. Almost half of our survey respondents (46 percent) are actively evaluating targets for acquisition. Financial research specialist Moody's Investors Service believes this will translate into action, forecasting that M&A activity in the asset management industry will likely pick up in the next 12-24 months.⁸

Other asset managers are looking to strategic partnerships to boost capabilities in specific areas. For example, Nu Paradigm Investment Partners announced in June 2015 that it will partner with Berenberg Asset Management to combine multi-asset expertise with enhanced risk management capabilities. The partnership's stated goal is to "create

tailored, cost-effective, and risk-managed portfolio solutions to meet the growing need for enhanced, multi-asset solutions."⁹

A significant proportion of survey respondents will use inorganic growth as a means of extending their reach to new customers too. Over two-fifths (43 percent) of those asset

⁸ Moody's: Confidence among asset managers fuels expected wave of global M&A, Moody's Investors Service, July 2015

⁹ Nu Paradigm and Berenberg Asset Management Partner to Launch Risk Managed Portfolios, Nu Paradigm Investment Partners, June 2015

managers targeting an acquisition are also preparing to enter new markets, compared with just 27 percent of other respondents. Ben Slavin, head of product and business development at WisdomTree Investments, says they opted for this approach in 2014 when seeking to enter the European market from the US. "We saw tremendous opportunity in the market in Europe and decided to acquire instead of build organically to accelerate our entry," he says. "It's relatively easy to set a product and cross list, but having the right distribution resources to reach the Italian or German investor, for instance, is another story."

Where an asset manager doesn't, for example, have the skills to manage a specific asset class in a given region, it might choose to identify an appropriate third-party manager and set up a local fund that feeds into its fund.

The growing popularity of acquisitions and partnerships shows how the new client demands are reshaping the industry. For some, the focus is on achieving scale efficiencies, while others are primarily seeking to plug gaps in their skills and capabilities that will help them tap growing demand for outcome-oriented solutions. Either way, we can expect to see a new wave of consolidation in the coming years as asset managers restructure to boost their competitive positioning.

Our research identifies four emerging "value drivers" that will shape success in the future industry landscape.

46%

of asset managers
are actively evaluating
targets for acquisition

43%

of these asset
managers are also
preparing to enter
new markets

Value Driver #1

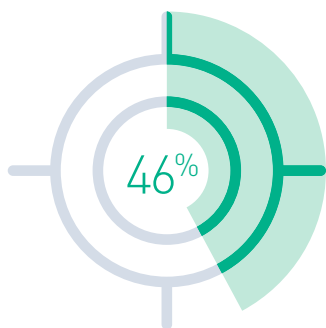
Asset Managers
Reshape the Product
Mix Around New
Client Needs

“If you are going to survive you need to provide asset classes and products which solve the big problems currently facing institutions.”

ANDREW CLARE

Professor of Asset Management at Cass Business School

Almost half of asset managers (46 percent) in our study are actively evaluating targets for acquisition.



Asset Managers Reshape the Product Mix Around New Client Needs

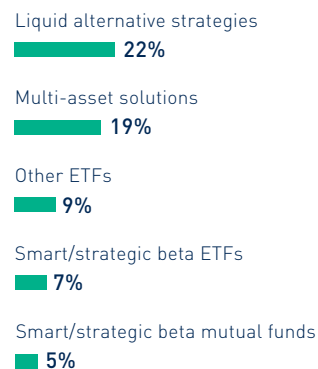
Our research shows that investor demand is growing for new types of investment products and solutions. Indeed, the majority of managers see product innovation as their primary route to growth: 42 percent say they are currently preparing to enter a product category for the first time, compared with 35 percent who are preparing to enter new markets.

Two products in particular are tipped for growth in our survey:

- **Multi-asset solutions.** Nearly half of asset managers (46 percent) plan to grow their presence in multi-asset investment solutions, while almost a fifth (19 percent) are planning to enter this product category for the first time. “We saw the demand for multi-asset solutions begin in about 2011 in Asia, where investors began buying multi-asset funds that delivered an attractive level of income from a wide range of assets,” says Graham Mason, head of investment for equities, multi-asset and retail fixed income at M&G Investments. “It has gained traction in Europe over the past year or so and multi-asset flows are probably a third of all our new fund flows.”

- **Liquid alternatives.** More than one in five (22 percent) survey respondents are planning to launch a liquid alternatives product for the first time. These may offer clients exposure to hedge fund-style strategies within a regulated and tradable mutual fund structure. “The number of asset classes is far broader because now we have alternatives,” says Andrew Paul, head of distribution strategy at Aberdeen Asset Management. “Liquid alts vehicles mean investors can access this asset class in a way that wasn’t possible before.”

For each of the following product types, please indicate whether your firm expects to launch a product for the first time in the next three years.



Source: State Street 2015 Asset Manager Survey, conducted by FT Remark



24%

say demand for passive strategies is significantly impacting product strategy

Other examples of innovation include smart beta funds that offer exposure to bespoke indices constructed with reference to dozens of factors — from volatility to dividend policy. In Japan, for instance, the \$1.3 trillion Government Pension Investment Fund adopted smart beta strategies for the first time in 2014.¹⁰ Meanwhile, today's liquid alternatives funds span hedge funds, private equity, real estate, infrastructure and commodities, among many other assets.

Our survey shows that investor demand for passive strategies is growing. A quarter (24 percent) of respondents say this trend is having a significant impact on their product strategy.

New Solutions Demand New Capabilities

This broader product mix has important implications. Managers that for decades have focused almost exclusively on long-only equity and fixed income investment strategies may now try to deliver expertise across a far wider range of asset classes.

The new investment model also places more responsibility on the asset manager, says Andrew Paul at Aberdeen Asset Management. Clients are giving them more discretion through dynamic asset allocation mandates — and expecting them to use this discretion to manage market volatility and shifts in

liquidity. “If you won a balanced mandate 15 or 20 years ago, you would still have been set quite tight ranges for asset allocation — for example, the discretion to hold between 50 percent and 60 percent of the portfolio in equities,” he explains. “Managers are now given far more discretion, to possibly even take that equities position right down to zero.”

Do asset managers always have the capabilities and expertise required to deliver these dynamic and customized strategies? The answer is “not yet” in many cases. Talent is one challenge — the specialist expertise to manage multi-asset portfolios is in short supply. This is one reason why some asset managers are increasingly bolting on capabilities through targeted acquisitions. “With the bigger firms, I think that’s part of their acquisitiveness — they’ve got to be seen as having a full array of investment capabilities,” says Neil Bathon at FUSE Research Network.

In addition, these new types of investment solutions require a more dynamic approach to risk and performance, from a whole fund perspective right down to the level of individual instruments. As they rise to that challenge, investment management teams will need access to sophisticated analytics and reporting tools to construct solutions

¹⁰ Japan's GPIF Appoints Smart Beta Managers, *Chief Investment Officer*, April 2014

and provide the depth of insight that today's investors increasingly expect. The new products are also being sold through new channels. Already fintech players that use advanced technology to deliver innovative finance solutions are developing tools that give the investor more control and visibility over their portfolios. For instance, Goldman Sachs and JP Morgan are providing backing to online broker Motif Investing, which allows investors to create portfolios built around their specific goals and views.¹¹

The search is on for the strategies and business models that will deliver long-term success for investors, and enduring profitability for the asset manager. The new product set changes the game. In the next section, we explore how the relationship between asset managers and their clients is radically changing.

How To Compete as a Solutions Maker



Articulate and communicate a clearly defined and focused proposition, from serving a specific market niche to active management capability.



Focus on the client objectives, rather than delivering relative performance through generic, manufactured investment products.



Plug gaps in capabilities, both in terms of product and the wider service proposition, using acquisitions, partnerships or outsourcing to augment your platform.



Master the multi-asset challenge by building the systems and talent pool required to manage risk and performance across today's complex portfolios.



Prepare to innovate as clients get more demanding and new entrants intensify competition, fostering the entrepreneurial culture required for growth.

¹¹ Why Wall Street is pouring money into companies that want to eat its lunch, Business Insider, March 2015

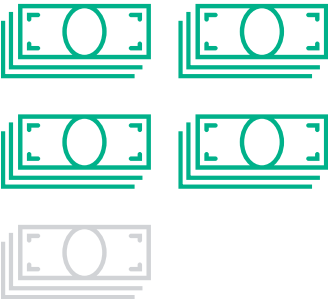
Value Driver #2

Client Services Become
More Transparent,
More Personal



VALUE DRIVER
#2

Four out of five asset managers say increased transparency in how clients' money is managed has a major impact on business strategy.



Client Services Become More Transparent, More Personal

Asset managers are working hard to create more collaborative and open relationships with their clients. Nearly four out of five (79 percent) in our survey say client demands for increased transparency on how their money is managed is having a major impact on business strategy.

"We are custodians of the clients' money and we believe in communicating with them in a variety of different ways," says Graham Mason of M&G. This will only become more crucial, he suggests, as dynamic asset allocation and multi-asset strategies come to the fore. "Clients have given us greater discretion, but we need to make sure the client is comfortable with what's happening. There will be more transparency, particularly when people go to multi-asset solutions."

Across the broader industry, asset managers are making major efforts to improve transparency. More than three-quarters (77 percent) say they now offer their clients more transparency on both risk and return. There is plenty more work to do, however.

For each of the following investor trends, please indicate the extent to which it is impacting your firm's business strategy, in terms of shaping your products and how you deliver them.

(% indicating "significant impact")

Investor demand for more transparency into the investment process



Investor demand for multi-asset, outcome-oriented investment strategies



Investor adoption of factor-based allocation models



Investor demand for impact investing strategies



Investor demand for liability-driven investing strategies



Investor demand for increased customization



Investor demand for passive investment strategies



Source: State Street 2015 Asset Manager Survey, conducted by FT Remark

"I'm disappointed the industry hasn't got better at forward-looking risk reporting," says Jeffrey Coons, president of Manning & Napier. "Talking about the performance of the manager going backwards really gives you little sense of what could happen going forward."

On-demand Reporting

This focus on transparency can create a number of challenges. First, asset managers need to be able to vastly improve their reporting systems. As more clients measure success against their own personal goals and objectives, managers need to be able to produce customized reports quickly and efficiently. The traditional process of reporting by product line isn't fit for purpose in the world of multi-asset solutions. Reporting increasingly requires sophisticated data and analytics, reporting tools and online delivery of information to clients, on-demand.

Client demands aren't the only factor. These systems are vital for managing increased regulatory scrutiny and stringent investment guidelines too. Three-fifths (59 percent) of our survey respondents say they are increasing their level of investment in regulatory compliance. Asset managers must ensure they are meeting complex quantitative guidelines across multiple portfolios. To do so, they need advanced look-through capabilities that incorporate fund-of-funds holdings and other commingled investment structures.

The most innovative asset managers are turning to a new breed of investment compliance tools to help them achieve this. Such tools enable more efficient governance and transparency across diverse portfolios, including testing across criteria such as asset mix, benchmarks, quality ratings and leverage restrictions. With strategic deployment

36%

say they have fully achieved
the use of advanced analytics
to segment clients

of these tools, asset managers can both aim to ensure their portfolios are fully compliant and empower their clients with the granular risk and performance information they demand. That way, they are turning transparency into a source of competitive advantage.

How Personal Can You Get?

Where stronger data capabilities can also help asset managers gain competitive advantage is in understanding client needs through data. Asset managers require better tools to segment and understand their client base. Asked to rank themselves on a scale of 1-10 for their processes on gathering feedback from clients, only a quarter of respondents give themselves a score of 8 or more — a finding that is similar across both those managers with more of a retail focus and those that predominantly manage institutional assets. The larger asset

managers in our survey are gaining the edge in this area however, with 43 percent of them saying they have fully achieved the use of advanced analytics to segment their clients based on their needs, compared to just 32 percent of small firms. Developing better client analytics capabilities will help to bring asset managers closer to their clients.

This kind of “personalization” is also a cultural leap for asset managers. “Managers need the right mind-set to adopt a more collaborative relationship because it involves a much higher level of engagement with investors,” says Daniel Farley, chief investment officer — investment solutions at State Street Global Advisors. “This is where the value lies, as opposed to the more transactional relationships based around a simple product push.”



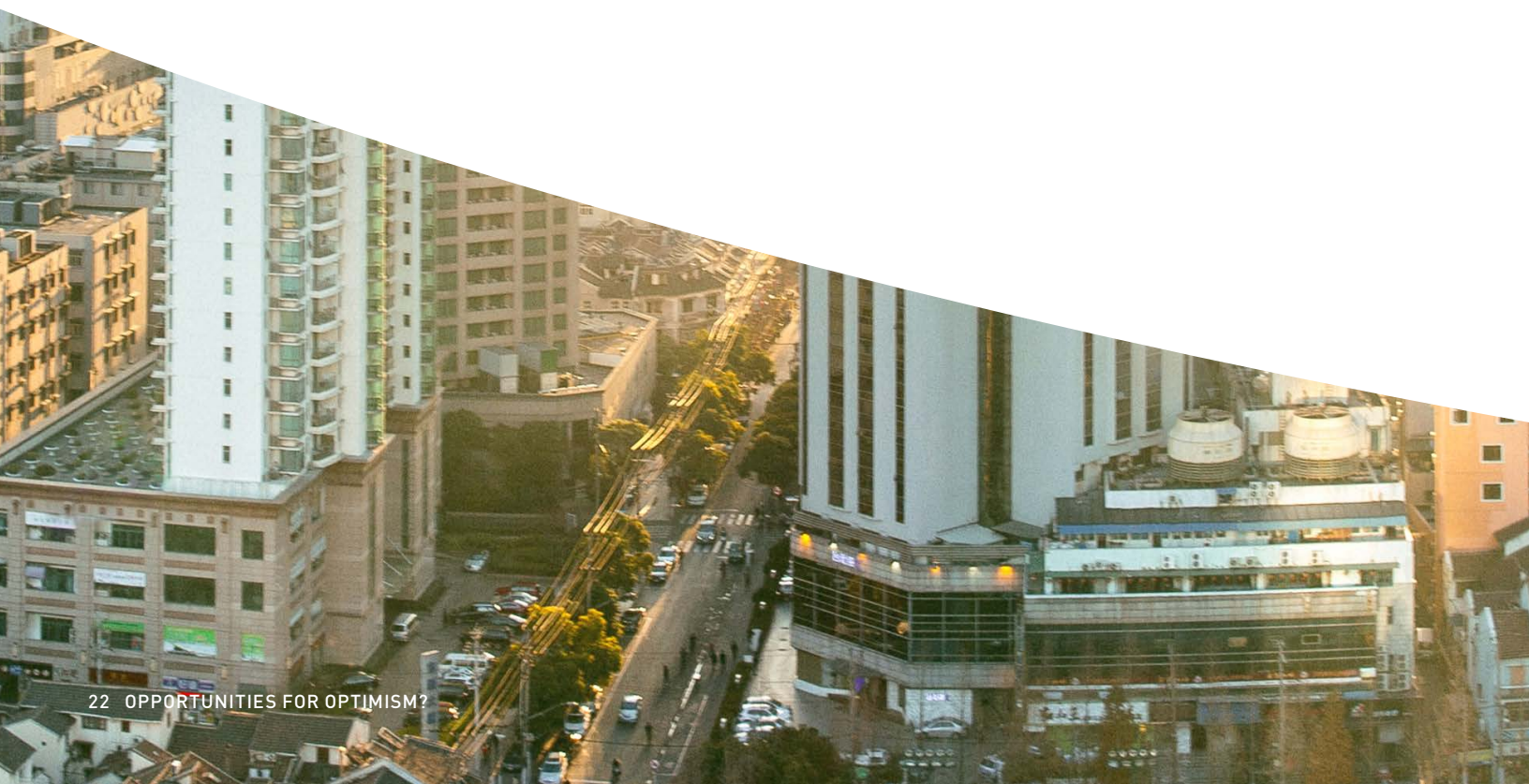
46%

say they are recruiting
new talent in business
development roles

This collaborative model also demands relationship managers that bring real insight into the conversation. “If we want to succeed as we move into more solutions-based strategies for clients, we’ve got to understand them better,” says Andrew Smith, co-head of the Americas at Aberdeen Asset Management Inc. This will be a key consideration as asset managers increase staff for growth: 46 percent of respondents in the survey say they are recruiting new talent in business development roles. “You need people that can understand both the specific liabilities that clients are facing as well as the best options clients have to meet those liabilities,” says Frank Hart of Greystone Managed Investments. “Clients are looking for asset managers with expertise and understanding of their liabilities and what specific options and solutions are available to them as investors. This often includes the need

for robust modeling tools that help demonstrate why specific solutions have the best chance of optimizing risks and returns, as well as how to manage cash flows and liquidity in the case of less liquid assets like alternatives.”

Greystone is building new analytics tools inside the client service teams to help them segment clients by type, and better tailor their services. They are also recruiting people with actuarial and consulting backgrounds to provide a more advisory type of service. It is this kind of sharp focus on insights and skills that will enable leading asset managers to build long-term, value-driven relationships with their clients.



“We have a customized solutions group which effectively tailors the approach to the client and can invest at the security or fund level, creating something very specific to the client’s requirements.”

ROBERT WHITE

President, Eaton Vance
Management International
(Asia) Pte. Ltd.

How To

Get Closer to
Your Clients



Provide investors with more granular detail about the performance and risk profile of their holdings. Meet the need for a variety of different formats and respond to bespoke requests.



Recognize that transparency is a two-way street. Develop new channels for investor feedback and use analytics to better understand clients’ needs.



Develop approaches to the increasing demand for information from regulators and investors. Prioritize specialist data units.



Invest in the consultative skills and intellectual capital that will enable you to deliver uniquely valuable insights to your clients.



Deliver personalization at scale. Build strategic asset allocation models that can be adjusted to accommodate client-specific overlays.



Spotlight

Owning the Client


Where Technology Firms Could Compete

Asset managers are taking the threat posed by tech-savvy challengers seriously. In our survey, 79 percent think it is likely that a technology or other non-financial services firm will become a direct competitor in the next five years. But where will these firms compete? And are the industry's concerns justified?

Big technology companies such as Google and Alibaba Group are well-placed to disrupt the distribution side of the asset management business. Alibaba launched a money market fund in June 2013 that amassed almost \$90 billion in its first year.¹² The fund is managed by Shanghai-based Tianhong Asset Management, while Alibaba handles distribution to the clients. One of the key strengths of Alibaba's approach is the ability to deliver an improved client experience. For instance, it allows investors to transfer or withdraw funds via a device of their choice at any time, without paying a penalty charge.

It is this ability to enhance the digital experience for investors that could give technology companies the edge, particularly in the distribution space where new entrants could aim to "own" the investor. And while the initial target might be retail clients, a push into the institutional space should not be ruled out. Only 36 percent of asset managers in our survey are highly confident in their ability to use advanced analytics to segment clients according to their characteristics and needs.

¹² Yu'e Bao Wow! How Alibaba is Reshaping Chinese Finance, *Institutional Investor*, May 2014



The key advantage for firms such as Google, Amazon, Apple and Alibaba is the combination of user data they capture, together with powerful analytical tools and skilled analysts with a focus on the client experience.

“Millennials are much more trusting of companies such as Google than they are of traditional asset managers. These firms have stronger brand strength and massive cash balances, and understand how to deliver services in the way young people expect,” says Andrew Smith, co-head of the Americas at Aberdeen Asset Management Inc.

It is not just the large, more established technology companies that have the potential to disrupt the industry, however. Online start-ups are changing the way that investment management solutions are sold and distributed, as a new wave of platform-based services and robo-advisors emerges. And younger generations, who are used to a self-service model enabled by technology, will demand

“Right across the financial sector the effects of regulation can make disruptive innovation very difficult.”

JOHN KAY

Visiting Professor of Economics,
London School of Economics

that the sector raises the bar in terms of the digital experience. They will expect a seamless experience across distribution channels, including mobile, and want the process of selecting investment products to be relatively quick and convenient.

Of course, the traditional players have key strengths, such as their expertise in investment strategy, managing risk and navigating regulatory complexity. New entrants would have to meet stringent regulatory standards to become fund managers in their own right. “Right across the financial sector the effects of regulation can make disruptive innovation very difficult,” says John Kay, a visiting professor of economics at the London School of Economics.

In addition, technology firms may face a battle to win investor trust when it comes to sharing sensitive financial data and delivering online payments.

But the ability of new entrants to use advanced analytics to understand investors’ needs better than ever before — and tailor the investing experience accordingly — could represent a major competitive challenge.

Value Driver #3
Risk Goes to
the Heart of the
Conversation

“Asset managers are setting out to differentiate their solutions in the marketplace through their ability to manage risk.”

JEFF COONS
President,
Manning & Napier



Risk Goes to the Heart of the Conversation

Managing investment risk has risen steadily up the agenda for asset managers. Almost three-quarters (72 percent) of respondents say their conversations with clients have evolved to focus more heavily on risk in the last 12 months.

Rate your level of agreement or disagreement with the following statements, relative one year ago.

Our conversations with clients have evolved to focus more heavily on risk



Our clients are demanding a more personalized approach to help them understand their risks



We have increased the level of transparency we offer to clients on their sources of risk and return



Heightened risk and compliance demands threaten to divert our firm's resources away from other critical business areas



Our firm is spending more time and resources on educating the boards of our institutional clients on risk issues



■ Somewhat agree
■ Strongly agree

Source: State Street 2015 Asset Manager Survey, conducted by FT Remark

In a sign that the dynamic between asset managers is changing, fully three-quarters of our survey respondents are spending more time and resources on educating the boards of institutional clients on risk issues. The risk dialogue is becoming more advisory in nature — it's the hallmark of a new relationship. "We're more direct with the clients about risk analysis now — we tend to present the risk of the portfolio to them in the same way that we present the risk internally," says Domenico Mignacca, head of risk management at Eurizon Capital.

Asset managers are developing new value propositions based on a more customized approach to risk management that meets their clients' unique needs. "Asset managers are making sure that they have a strong philosophy they can communicate, and they're setting out to differentiate their solutions in the marketplace through their ability to manage risk," says Jeff Coons of Manning & Napier.

As part of this shift, asset managers are developing highly tailored risk models for their clients. For example, one advanced approach to managing risk uses a "latent factor" model. "The more traditional model uses a predefined set of risk factors," explains Mark McKeon, global

head of risk management and analytics, State Street Global Exchange. “But you can achieve a better picture on risk if you don’t pre-impose what you think the factors are, but instead use a latent factor model that can tell you which risk drivers are important for your portfolio.”

The new risk solutions increasingly depend on the asset manager’s proficiency in using data and analytics tools. As more clients develop multi-asset portfolios, asset managers need to be able to integrate and analyze risk data from multiple sources, encompassing every conceivable asset class. Many will need to upgrade to modern IT architectures and the highest standards of data governance. It’s an area where asset managers need to make improvements: In another recent State Street survey both asset managers and asset owners cited risk analytics as a major focus for their technology investments, with 68 percent of respondents set to increase their investment in this area in the coming three years.¹³

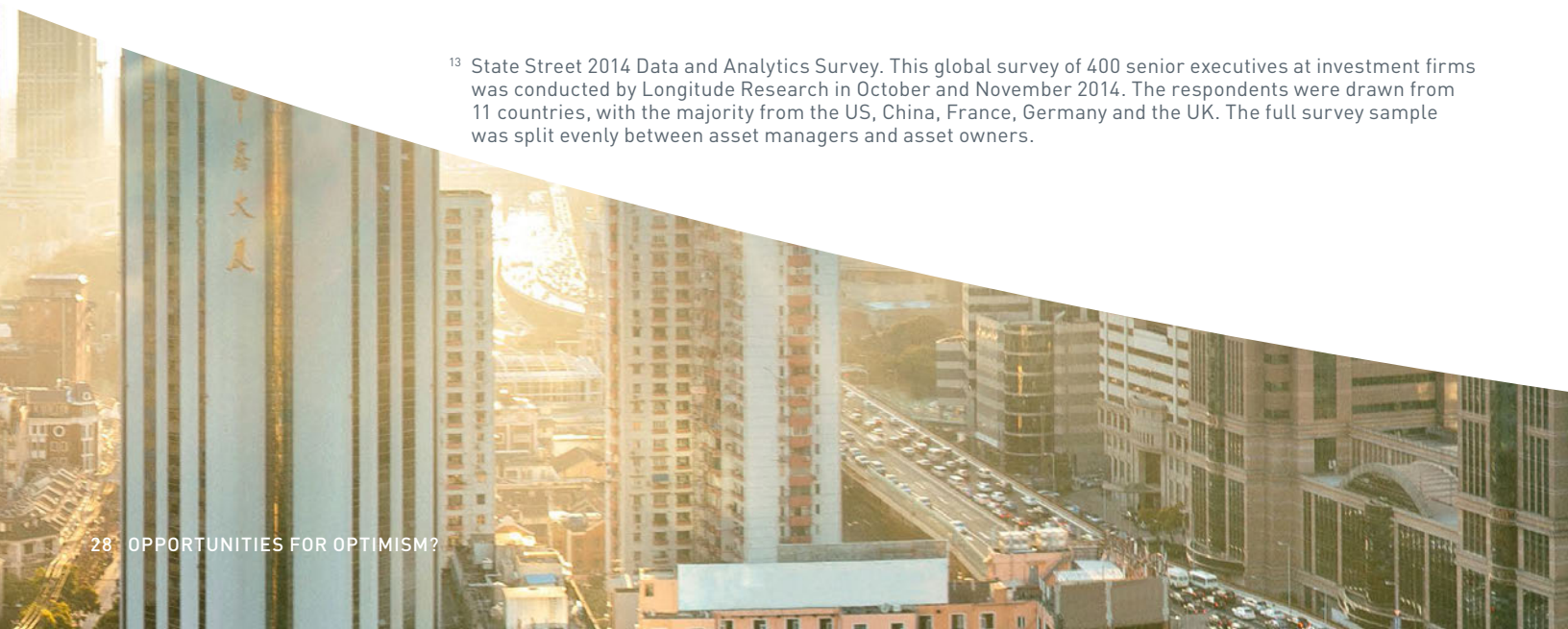
The trend is giving rise to new skills needs around risk too, but it isn’t an easy gap for many asset managers to plug. “The biggest challenge for Hong Kong, as a market, is our supply of good talent. There is a total shortage of skills in functions such as risk and compliance,” says Eleanor Wan, CEO at BEA Union Investment Management.

The leaders will combine cutting-edge technology with deep expertise in risk management. “We’ve created a specialized team to deliver bespoke asset allocation solutions for institutional clients, and customized risk management is a key part of our value proposition there,” says Ferdinand Haas, global co-head of active investments at Deutsche Bank Asset and Wealth Management.

Understanding the Bigger Picture

Investment risk is core to conversations with clients, but it’s not the only consideration. Asset managers need to think about the bigger picture. Frank Hart of Greystone Managed Investments

¹³ State Street 2014 Data and Analytics Survey. This global survey of 400 senior executives at investment firms was conducted by Longitude Research in October and November 2014. The respondents were drawn from 11 countries, with the majority from the US, China, France, Germany and the UK. The full survey sample was split evenly between asset managers and asset owners.



says investors are thinking about broader risk issues even before their relationship with an asset manager begins. “Clients are increasingly looking at risk not just from the perspective of the risk embedded in the investment decisions themselves, but also the risk of hiring a particular firm,” he says. “Clients are also increasingly looking more deeply into how good is the firm in terms of its talent management, leadership development, systems and the quality of their operations overall?” Leading investment consultants are developing new services to help investors evaluate asset managers on these issues that go well beyond their investment performance alone, but are ultimately critical to consistently delivering good investment performance.

Clients are therefore asking their managers more searching questions on risk. The conversation must start with asset managers developing a deep understanding of clients’ risk profile and objectives. There is no one-size-fits-all answer — the point of the personalized approach is that each investor has their own ideas on how much risk they will tolerate, and a favored approach to risk mitigation. The opportunity for asset managers is to deliver a more considered and intelligent set of solutions on risk, which can be cleverly tailored to their clients’ unique goals.

How To Compete in the Risk Arena



Recognize that investors are placing as much emphasis on risk management as they are on high performance. Allocate the right level of resources to meet this need.



Be prepared to educate investors on risk, developing more effective methods of communicating risk exposures to clients.



Ensure your data infrastructure supports the need for improved risk analysis across multi-asset portfolios. Make it an important competitive weapon in winning new clients.



Invest in new risk tools and more sophisticated risk models that give clients a more granular understanding of their exposures, both individually and consolidated across their portfolios.



Recognize that investors now consider a greater range of risks — including the operational risks that their asset managers may be exposed to.

Spotlight

Playing the Smart Card

Asset Managers Deepen Their Advisory Role

The trend among some larger asset owners to insource more of their asset management creates an added competitive pressure for asset managers. But it also offers new opportunities for those managers that can provide consultative advice and insight.

Earlier State Street research reveals some of the drivers of greater insourcing by large asset owners: 58 percent of pension funds struggle to gain a complete picture of risk-adjusted performance from external managers, while 52 percent find it difficult to ensure their managers' interests are aligned with their own.¹⁴ But enterprising asset managers are stepping up to the challenges posed.

As one example, Richard Brandweiner, chief investment officer at First State Super, the Australian superannuation fund, says they are currently working with a fund manager to help them develop in-house capabilities in smart beta. "We're building long-term trust through this experience, so I think we'll always have them working with us in some capacity," he says.

¹⁴ State Street 2014 Asset Owners Survey, conducted by the Economist Intelligence Unit. Pension fund respondents

The fund manager is assisting First State Super with developing the model, back testing and implementing the trading. "I see the relationship evolving to the point where we do the execution in-house. But there will be the need for research support as we continue to evolve and develop systematic betas. We might change the nature of the mandate to a fixed-fee consultancy-style relationship."

Institutional investors will move toward greater insourcing with or without the assistance of asset management firms. But for those asset managers willing to partner with them and demonstrate great expertise as they do so, there are long-term opportunities to serve the advisory needs of these investors.

58%

of pension funds struggle to gain a complete picture of risk-adjusted performance

52%

of pension funds find it difficult to ensure their managers' interests are aligned with their own

Value Driver #4

Advanced Operations Can Deliver Value at Scale

“What we do is the same as what Henry Ford did 100 years ago: we are building an assembly line for the asset management industry so it can make investment decisions on the basis of all available data in the market.”

HELMUT PAULUS
CEO and chief investment officer, Quoniam



Advanced Operations Can Deliver Value at Scale

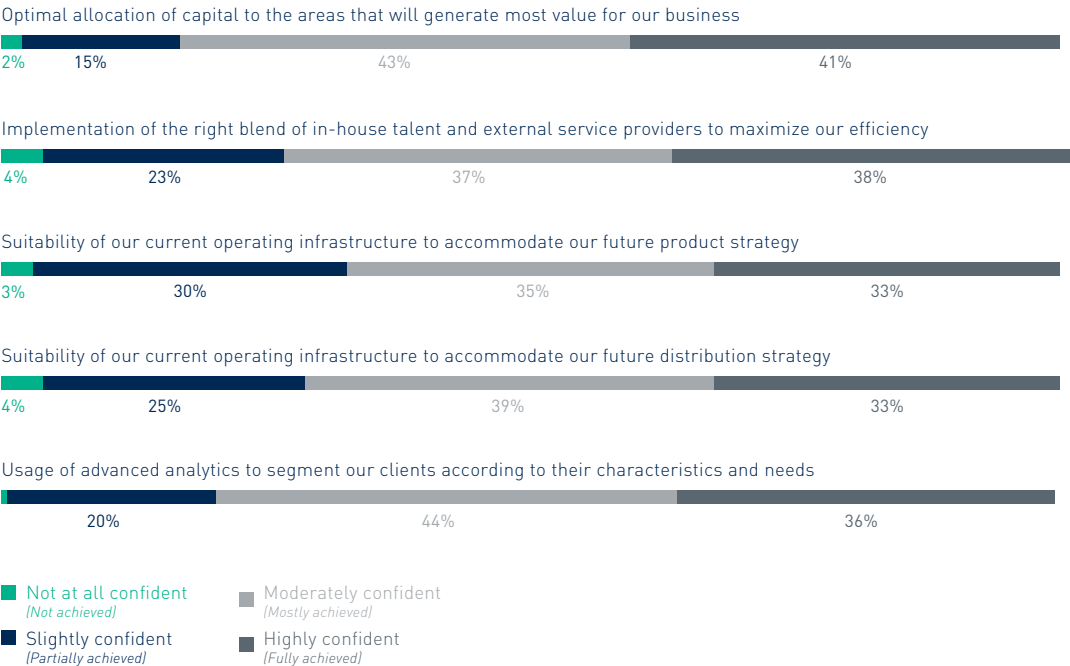
Investors’ search for good value includes a sharp focus on cost. Asset managers need an efficient but agile operating model to help them deliver improved offerings at a competitive price.

Cost pressures are already driving a search for scale in the industry — a fact that helps explain the appetite for consolidation. “We are seeing more and more globalization of our

industry, but to participate in that you need an infrastructure that can be scaled. This is why there are a number of players who offer good products but who have decided they now need to be backed by larger groups,” says Joseph Pinto, global chief operating officer at AXA Investment Managers.

The challenge is how to combine the benefits of scale with the agility required to meet the needs of different clients. Leading asset managers believe

Please rate your level of confidence in each of the following areas.



Source: State Street 2015 Asset Manager Survey, conducted by FT Remark

More than half (52%) of asset managers are expanding their distribution network to seize opportunities in the market.



technology provides the best hope for squaring that circle. Another recent State Street survey showed that 88 percent of asset managers have increased their spending on investment data and analytics infrastructure over the past three years.¹⁵ The same survey revealed that asset managers are investing heavily in a range of tools including improved data management systems, risk analytics and portfolio optimization tools.

“The challenge is data: To collect and process the relevant information to make reliable investment decisions about 50,000 global securities, you need intelligent systems engineered to process global data,” says Helmut Paulus, CEO and chief investment officer

at Quoniam. “What we do is the same as what Henry Ford did 100 years ago: we are building an assembly line for the asset management industry so it can make investment decisions on the basis of all available data in the market.”

Technology Changes the Game

The ability to exploit advanced technology is essential for asset managers seeking to deliver value more efficiently, says Steve Auth of Federated Investors. “We’ve used technology to allow our analysts and portfolio managers to focus on value-added activities,” he says. “Ten years ago, those people would have been dragged into manual research and calculations, but we can’t keep adding new staff every time we win a new client.”

¹⁵ Data and Analytics – A New Toolkit for Asset Managers, State Street, 2014

Technology is therefore a vital weapon in the competitive landscape that is emerging. But keeping pace with technology is hard for all but the largest and most well-resourced asset managers. This is why a growing number of asset managers are choosing to outsource their investment operations to specialist providers. One Asia-based asset manager that participated in our research cited the savings achieved through no longer having to upgrade in-house systems to the required level.

Many players in the industry are still finding the right balance in terms of developing the right skills to support this technology-enabled operating model. Only 38 percent of companies in the survey agree that they have “fully achieved” the right blend of in-house talent and external service providers to maximize their efficiency.

How To

Deliver More Client Value Through Smarter Operations



Recognize investors' growing concerns about fee levels. Be ready to demonstrate your added value.



Develop new fee structures that match the shifting focus from relative performance to a more outcome-focused approach.



Investigate whether new partnerships can help deliver more value to clients at lower cost. Build links with areas such as the fintech sector.



Automate manual processes to free up resources for more added-value tasks, ensuring operational efficiency helps protect margins in a climate of flat or falling fees.



Invest in the in-house technology infrastructure required to deliver value at scale and transform cost efficiency. Utilize alternative approaches such as outsourcing.

Spotlight

A New Platform for Distribution

Operational efficiencies can save asset managers money. At the same time, asset managers see opportunities to enhance their distribution channels as a way to boost their revenues.

Most asset managers in our survey feel they need to improve in this area. Only a third (33 percent) of respondents feel highly confident their operating infrastructure is currently capable of supporting their future distribution and product strategies.

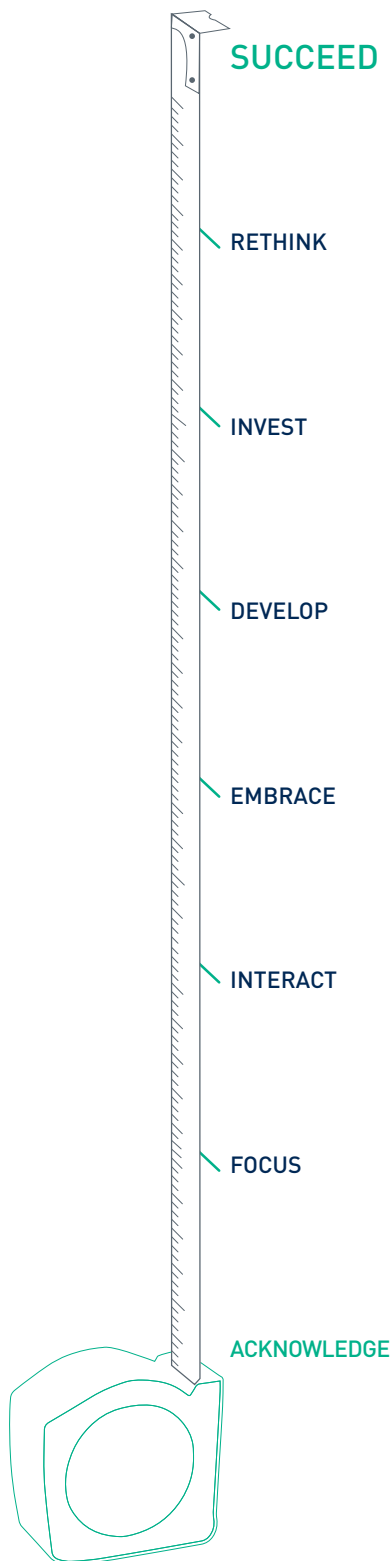
Asset managers want to extend their reach to fast-growth retail segments around the world. Today, however, many of them do not have direct channels to distribute to investors, as intermediaries often dominate this space. More than half (52 percent) of asset managers are expanding their distribution network to seize opportunities in the market, while 48 percent intend to access new distribution channels.

Only through such investment can asset managers get closer to investors both in existing and in new markets. Moving forward, more asset managers may choose to develop their own distribution platforms to interface directly with retail investors — benefiting from both efficiencies and unfiltered insight into investor needs.



Today's
Optimism

Tomorrow's
Success



Converting the Opportunity: How to Create Value for a New Breed of Investor

Asset managers are thinking hard about where and how they should compete in the growth markets of the future. In a world where clients increasingly define the yardstick for success, they need to deliver the right outcomes for investors together with an improved client experience.

Leading asset managers will focus their efforts in a number of key areas:



Focus your value proposition.

Investors are selecting asset managers based on more than just performance. Asset managers need to understand exactly what their unique value proposition is today, and further exploit those strengths. This may mean scaling up to offer a full suite of investment capabilities, or deepening expertise within a valuable market niche.



Become more client-centric. Leading asset managers will raise the bar in how they interact with clients. They will bring on board advisors who are skilled in communicating complex information about performance and risk to investors, so they can educate and advise their clients on the right investment strategies to meet their unique objectives.



Embrace digital change. Asset managers need to recognize that investors' expectations around the client experience are changing. They want easy access to their investments with the ability to manage and control their portfolios at the click of a button. Technology firms are a threat, but established asset managers can use data and analytics to find their own competitive edge.



Develop more innovative solutions.

The growth in outcome-oriented solutions is exciting but it requires asset managers to shift from manufacturing standardized investment products to a reverse-engineered approach based on individual client objectives.



Invest in new risk tools. Investors want asset managers who are willing to share their insights on risk. As investors increasingly turn to multi-asset solutions, asset managers will need to be able to deliver granular risk analysis. Those who can devise smarter risk models will also be in high demand.



Rethink your distribution model. It's difficult for asset managers to get closer to investors when intermediaries own the end-client relationship. Asset managers need to expand their distribution networks to target and reach key client segments. By developing their own distribution platforms they may be able to get a better understanding of client needs going forward. And where they must rely on third parties, they should seek to form closer partnerships with them to gain greater visibility of the marketplace.

The investment landscape is shifting. Investors are hungry for new solutions and innovative thinking — and asset managers are positioning to deliver new offerings around these demands. Competition will be intense for the most profitable markets and client segments. Leading asset managers are already investing in the talent and capabilities they will need to drive growth in this challenging environment.

Opportunities are there for the taking in today's investment industry. But asset managers will need to be at the top of their game to translate today's optimism into long-term success.

Rate Our Research

We'd welcome your feedback on this report. Please click [here](#) or go to www.statestreet.com/optimism to complete a short survey.

About the Research

This report is based on a State Street survey of 400 senior executives in the asset management industry. The State Street 2015 Asset Manager Survey was conducted by FT Remark in April and May 2015. Respondents from 23 countries participated, with the majority from Australia, Canada, China, Germany, Japan, Switzerland, the UK and US. Respondents manage assets for both institutional and retail clients, spanning traditional and alternative strategies.

Request our report: "Opportunities for Optimism?
A New Vision for Value in Asset Management."
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