

Is There a Future for Active Management?

February 9, 2017

Executive Summary:

Reports of the death of active management are not just premature, they are altogether incorrect.

Greenwich Associates is optimistic about the future of active management.

There is no doubt that institutional investors are shifting investment assets into lower-cost passive strategies. Although several trends are contributing to this shift, the primary driver has been the inability of active managers as a group to consistently outperform their benchmarks net of fees. These results have caused many industry pundits to conclude that some markets—particularly highly liquid markets like U.S. equities—no longer provide sufficient opportunities for alpha generation. As such, they believe the best way to invest in these areas is through passive strategies that deliver market exposure at the lowest possible cost.

Although investors' increased appetite for passive investments appears to be secular rather than cyclical, active management will remain a viable and attractive business for the foreseeable future. This optimistic projection is driven by our views of the following:

1. The continued growth of the overall institutional asset pool both in the United States and around the world
2. The continued existence of complex, opaque and illiquid markets not conducive to passive strategies
3. Innovation on the part of active managers that consistently delivers new products and approaches
4. Profit margins that, although narrower than they were a decade ago, remain robust relative to those found in other industries
5. The development of new distribution and client engagement models that enable active managers to partner with clients to help them achieve their goals

Despite our positive outlook for active management, the shift in institutional preferences represents a real threat to the business prospects of some active managers. Going forward, there will be winners and losers.

Winners will be managers who: 1) Partner with clients in areas with high levels of complexity and in which they have unique insight or the capabilities to exploit information asymmetry, and 2) Provide solutions to clients' complex challenges, adding value in a cost-efficient manner.

Losers will be firms that stick to traditional, product-centric approaches. This applies in a growing number of increasingly liquid asset classes perceived by institutional investors as offering diminished opportunity for alpha generation. Active managers that fail to develop and communicate differentiated capabilities or introduce innovative new products in adjacent areas will see their franchises decline.

In this paper, Greenwich Associates helps active managers position themselves for future success by

analyzing the strategies now being deployed by the most successful investment management firms. These firms are carving out sustainable leadership positions by leveraging two key assets: intellectual capital (broadly defined) and new approaches to relationship management.



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