November 2021

Asset Manager Mergers - Would you rather be a shareholder or a client?

An ongoing trend in the global asset management industry over the recent past has been the consolidation of asset management businesses. If one searches the topic on Google, you will find headlines that read "Merger Mania" and "Asset management primed for consolidation".

These mergers and acquisitions are often trumpeted as being a win-win for clients, advisers, and asset managers. But as we know all too well, when something sounds too good to be true...it just might be.

In South Africa, we may be a little behind the global trend, but our industry has not been spared from this activity. Over the last few years, we have seen increased levels of deal making. In this month's comment we investigate this trend and try to figure out what it means for local investors, and if this is a practice to cheer on or to be wary of.

Where are the deals happening?

When we review asset managers one of the most important issues to tackle is whether the company is business led or investment led. This distinction provides a good starting point to assess whether clients will receive the best outcomes over the long run.

Things we normally see in business led asset managers are:

- They are typically providing 'investment product' to service a wide range of inhouse advisory clients. Examples would be private wealth services offered through a bank relationship, or life insurance linked products.
- Business leadership is often quite far removed from the investment industry itself and tends to change frequently.
- Frequent changes in business strategy given the wider array of moving pieces in the group.
- A much larger range of investment options offered to cater to client requirements. Often many of these lack a durable investment case, and businesses are often rationalizing their product line up before rebuilding it again to ensure they are in a position to capture future investment flows.

This inherent complexity and instability make it quite difficult to establish a strong investment capability. As of 2020, exactly half of the Top 20 asset managers in South Africa were owned in part or entirely by a life insurance company or a bank.

Deals in this segment are happening for a few reasons. Mediocre investment performance, lack of competitiveness for client investments[1] and cost pressures, with an overarching business and profit-led shareholding, means that leadership teams are always on the hunt for efficiencies, synergies, cost savings and broader capabilities.

In almost every case it comes down to the bottom line.

"Show me the money"

- Jerry Maguire

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In these cases, mostly its business first, client second.

An investment led operation more often exhibits the following traits:

- Investment performance for clients is priority #1.
- Investment and client centric decision-making in their business planning.
- Strong investment DNA among the leadership, and a healthy tension between the investment teams and business leadership.
- More consistency in business leadership and key investment managers.

We don't see much activity here in the local market. Long established, independent, investment led businesses are better positioned to cope with the industry headwinds. Good investment performance is a scarce commodity, and if you have an established capability there will be natural industry demand for your products and services. There are still pressures however: the migration of talent and assets offshore, a shrinking pension fund asset pool and fee pressures are still meaningful items to navigate.

We expect them to continue as they were, managing client money, with diligence and care. What we are watching though is the continued risk of changes in the underlying business, how funds are managed and by whom.

The third segment we will describe for now is what we would term 'boutiques', those smaller fund managers who are often more focused, and in many cases have grander ambitions and are simply early stage.

There is merger activity in this segment, as smaller businesses who have been unable to reach sufficient scale start to look for alternate paths to long term stability.

A study by RMI in 2016 counted 126 'independent' asset managers, and between them they managed 47% of industry assets, with just 5% managed by those in the boutique segment.

Among these independent boutique managers there is incentive to join forces with a peer – you can consolidate your administration teams and double down on marketing and distribution. Sometimes merging with a friendly competitor who manages different asset classes adds to your value proposition. These businesses have their own set of challenges: being able to access client segments without a meaningful brand or marketing footprint, limited scope of investment products outside of domestic equity, and relative immaturity in managing global assets.

South Africa has a unique spin to it with BEE a greater focus and the requirement of some pension funds to use empowered asset managers. This has provided a tailwind for start- up fund managers who are often spun out of a larger independent or bank/insurance-owned asset managers. These smaller businesses, often reliant on a few big tickets to get them going, might give up their services at discounted rates. Perhaps we will see a new trend emerging for these participants to be able to offer the full range of capabilities on a sustainable basis.

For a business with demanding shareholders and portfolio managers who often aren't delivering the goods this poses a problem.

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Where are we headed?

Stories of successful transformations from being business led to investment led are few and so we don't expect much to change on this front. Although most businesses are certainly aware and are putting in considerable effort to make progress. Ultimately, they need to take bold decisions to change the status quo, and this doesn't seem too likely.

There is an interesting group of contenders who look ready to graduate to the status of best of breed. They should be able to compete for assets alongside the likes of Coronation, Ninety One and Allan Gray, but time will tell. These managers are often founder led and in need of strengthening the depths of the team around the founder. Success can be a curse as these managers struggle to maintain business focus and investment discipline as they grow bigger.

For clients, we will continue to seek out investment led fund managers, and those that we believe will put client performance first. A short but considered list.

[1] An RMI study estimated that bank/insurance-owned asset managers controlled 50% of the industry assets but only captured 20% of new business and investments.

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November 2021

data provided by Refinitiv

MARKET REPORT

30/Nov/21

		3m	YTD	1yr	3yr pa	5yr pa	10yr pa	5yr Vol1	10yr Vol1
LOCAL MARKET INDICES									
FTSE/JSE All Share Index (ALSI)	ZAR	6.4%	23.3%	28.5%	15.5%	10.6%	11.4%	15.5%	13.2%
FTSE/JSE SA Listed Property	ZAR	-0.3%	26.9%	44.3%	-5.7%	-5.0%	5.3%	26.0%	21.1%
SA All Bond Index (ALBI)	ZAR	-2.0%	5.6%	8.1%	8.4%	8.8%	8.0%	8.0%	7.9%
SA Cash Index (SteFI)	ZAR	1.0%	3.5%	3.8%	5.6%	6.3%	6.2%	0.4%	0.3%
Balanced Benchmark	ZAR	5.0%	18.2%	21.7%	13.6%	10.2%	11.5%	10.5%	8.8%
SA Inflation (1 month lag)	ZAR	0.9%	4.4%	5.0%	4.1%	4.4%	5.0%	1.2%	1.3%
GLOBAL MARKET INDICES BASED TO USD									
Global Equity (Datastream World)	USD	-0.8%	17.3%	22.3%	17.5%	15.2%	12.8%	15.0%	13.2%
Emerging Markets Equity (Datastream EM)	USD	-6.9%	-4.1%	3.0%	9.7%	9.9%	5.5%	16.6%	16.4%
Global Property	USD	-2.9%	20.0%	22.8%	10.5%	9.7%	9.8%	14.4%	13.8%
Global Bonds (Barclays Global Bond Index)	USD	-2.7%	-6.4%	-5.1%	3.8%	2.9%	1.1%	4.5%	5.0%
Global Cash	USD	0.0%	0.1%	0.2%	1.1%	1.4%	0.9%	0.3%	0.2%
MAJOR INDICES BASED TO RANDS									
FTSE/JSE All Share Index (ALSI)	ZAR	6.4%	23.3%	28.5%	15.5%	10.6%	11.4%	15.5%	13.2%
Global Equity (Datastream World)	ZAR	9.8%	28.0%	26.6%	23.3%	18.3%	20.8%	15.4%	14.4%
Emerging Markets Equity (Datastream EM)	ZAR	3.1%	4.6%	6.7%	15.1%	12.9%	13.0%	13.6%	12.8%
Global Property	ZAR	7.6%	30.9%	27.2%	16.0%	12.7%	17.5%	15.9%	14.3%
SA All Bond Index (ALBI)	ZAR	-2.0%	5.6%	8.1%	8.4%	8.8%	8.0%	8.0%	7.9%
Global Bonds (Citigroup)	ZAR	7.7%	2.1%	-1.8%	8.9%	5.7%	8.2%	15.3%	14.1%
COMMODITIES									
Gold (US Dollars)	USD	-1.5%	-6.2%	0.3%	13.4%	8.7%	0.2%	12.5%	15.2%
Gold (Rands)	ZAR	9.2%	2.3%	3.9%	19.1%	11.6%	7.3%		
CURRENCIES									
Rand / Dollar	ZAR	-10.8%	-9.1%	-3.5%	-4.9%	-2.7%	-7.1%	15.4%	15.0%
Rand / GBP Pound	ZAR	-6.5%	-5.6%	-2.6%	-6.2%	-3.9%	-5.2%	14.5%	14.5%
Rand / Euro	ZAR	-5.6%	-0.4%	2.6%	-4.7%	-3.9%	-5.2%	14.1%	13.6%

Spot Rates		30-Nov-21	Latest Quarter	1 Year Ago	5 Years Ago	10 Years Ago	20 Years Ago
CURRENCIES							
Rand/US$	Rand	16.02	15.05	15.48	14.03	8.10	10.28
Rand/GBP	Rand	21.22	20.29	20.65	17.53	12.74	14.68
Rand/EUR	Rand	18.04	17.44	18.51	14.88	10.90	9.20
RATES							
Libor 6m $	US$	0.24	0.16	0.26	1.29	0.75	2.03
Repo Rate	Rand	3.75	3.50	3.50	7.00	5.50	9.50
Prime	Rand	7.25	7.00	7.00	10.50	9.00	13.00
All Bond Index Yield	Rand	10.23	9.99	11.64	9.49	8.12	9.74
COMMODITIES							
Gold ($/oz)	US$	1 780.05	1 760.95	1 774.39	1 173.76	1 745.85	274.95
Platinum	US$	944.00	963.00	979.00	920.00	1 558.00	443.00
Oil (Brent Crude) $	US$	70.37	78.56	47.70	50.10	111.11	18.95
INFLATION							
SA Inflation	%	5.0	5.0	3.2	6.6	6.2	9.4

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