Top Trends to Watch in 2020

In 2020, ESG moves front and center for the asset management industry.

ESG NICHE NO MORE

Globally, incorporation of environmental, social, and governance (ESG) principles into investment strategies is now a must-have for many firms, with product development increasingly driven by client demand. Europe remains ahead of the pack in advances in ESG/responsible investment (RI), with the United States marketplace continuing to make strides and Asia's ESG drive spearheaded by the largest asset owners, such as pension funds and sovereign wealth funds. Formation of new coalitions of investors, governing bodies, and advocacy groups open the lines of communication and establish new standards of transparency. Data-driven tools help managers and asset owners better analyze corporations' positions on key issues such as climate change and workplace diversity.

In the United States, tenets once sought after primarily by institutions are applicable to the broader retail market. Firms are taking an active stake as stock owners, engaging in more proxy voting and shareholder resolutions to promote various issues ranging from climate change to clean water to gender and racial equality. Development of ESG strategies accelerates, with two areas of priority being quantitative equity and fixed income. Managers with active heritages have a leg up on this front and appear intrigued by new sources of revenue that ESG innovation could deliver.

U.S. institutions, including public pension funds, increasingly view addressing climate concerns such as carbon emissions (*e.g.*, fossil fuel divestment) as an important factor in their fiduciary duty to guard long-term viability of their investments.

In the European Union, the long-awaited European taxonomy on environmentally sustainable activities could be a game changer in the creation of a standardized ESG and sustainability definition, reporting, and impact measurement.

In Europe, asset managers expect growth of ESG assets to be most rapid in Sweden, France, and Germany during the next 12 to 24 months, with private banks experiencing the highest level of demand for ESG products in the wholesale/retail market. Private equity firms are poised to make an impact due to the convergence of investment strategies and the UN's Sustainable Development Goals. Meanwhile, asset owners are increasingly asking hedge funds to show how they integrate ESG considerations into their investment decisions.

In the European insurance sector, insurers want to measure the environmental and social impact of their portfolios and employ the SDGs to communicate the impact of their actions. The largest insurers are ahead of the curve in defining RI policies.

In the U.K., net flows into ethical funds have ramped up steadily since 2015, spurring development of low-cost portfolios available to mass-market investors.

In Asia, there is a rapidly increasing slate of funds available to investors as firms are incorporating ESG principles into their processes. On a country basis, the extent of ESG adoption varies according to the stage of development and awareness in each market. ESG factor integration is the most popular strategy used in Australia. In Japan, institutional investors use the governance factor the most and prefer positive screening.

In Malaysia, firms are exploring the introduction of more foreign-invested Shariah-compliant funds. There will be outsourcing business opportunities available to managers with established track records in Shariah, alternative, and ESG investments.

In China, ESG-themed ETFs are getting more attention, given recent guidance from regulators and increasing global interest. There are only a handful of funds thus far, but more are in the pipeline.

BALANCING PRODUCT COMPLEXITY WITH MODEL OFFERINGS

Globally, retail investors are looking for regular income payments and portfolio diversification to go along with capital protection. Distributors seek products—in many cases multi-asset strategies—that can withstand market volatility and generate steady returns. Multi-asset-class solutions and the ability to fold proprietary strategies into model-delivered offerings are avenues through which active managers demonstrate their value.

In the United States, product initiatives include model-driven separate accounts, target-date funds, and strategic model portfolios. Income solutions are also a chief objective for many firms as the pool of retirees grows. Firms have room to grow actively managed international and global equity strategies. In the U.S. retail market, the democratization of alternative investments connects more downstream, retail-based investors to products uncorrelated to broader indices.

In U.S. institutional, outsourced chief investment officer (OCIO) providers see a small but growing number of queries coming from search consultants as clients struggle to identify the best OCIO provider in an environment where fee schedules vary and a multitude of service options exist. Search consultants can be part of larger consulting firms or small shops of industry veterans, including former CIOs.

In Europe, enhanced regulatory scrutiny and growing demand for transparency and cost-effectiveness drives growth of exchange-traded funds (ETFs). Better understanding from advisors of how to use ETFs as building blocks in their portfolios leads to robust product development. Demand from retail clients leads to heightened ETF business from direct-to-consumer platforms and robo-advisors.

In Europe, smart beta constitutes a broad spectrum of strategies, with dividend-based, risk-oriented, and multi-factor offerings most popular among investors.

In the U.K., managers aim for either broad, high-performing strategies or specialized offerings (ESG, thematic funds, etc.). Defined contribution schemes expand into alternative strategies, taking advantage of long-term horizons to gather illiquidity premiums.

In Germany, with demand for smart beta born out of a need for diversification and low-cost options, firms work to educate investors on the investments.

In Italy, managers focus on developing investment products aimed at drawing the USD 1.3 trillion of potential assets that sit in banking and savings accounts.

In Asia, although uptake of passive offerings remains comparatively low compared to other continents, smart beta funds are breaking through. Balanced funds have been among the top asset classes by net flows in Asian markets, excluding China. Net flows to balanced funds increased in Hong Kong, Taiwan, and Korea as investors continued to seek diversification and means to weather volatility.

In China, there is no better time to promote passive strategies, as ETFs garner an increasing share of investor allocations. New product development activity is bolstered by more consistent education from management firms.

In Hong Kong and Singapore, managers are building out their multi-asset businesses to carve out niche areas for their strategies in the face of increasing homogenization.

In Latin America, capital repatriations, tax amnesties, and a general trend toward tax transparency is encouraging investors to seek out tax-efficient solutions.

SALES/DISTRIBUTION: GROWING DATA LEVERAGING

Globally, new technological advances, digitalization, and growing data intelligence are fully breaking through. As product commoditization proliferates, managers recognize the need to find new ways to differentiate their capabilities. Bigger firms are experimenting with free models designed to build assets and strengthen relationships with key sales and distribution partners. Managers and distributors cultivate fewer but deeper relationships.

In the United States, managers embrace their roles as investment providers, and deepen partnerships with broker/dealer firms, by populating model portfolios with proprietary strategies. Strategists encourage advisors to embrace these models as a starting point for outsourcing investment management functions. Emerging fintech model marketplaces provide third-party strategists with a new avenue for distribution within the hard-to-access independent advisor space. In particular, younger advisors are more inclined to outsource investment management. Firms with target-date retirement fund suites explore more personalized strategies that leverage deeper data, going beyond a plan participant's age.

In Europe, many firms now employ machine learning engineers and data scientists to work with financial services specialists. The digital transformation will be further aided by increased investment in new technologies. Firms will invest in comprehensive, data-rich platforms to support internal sales and business development. Some revenue at most European firms is being directed into the development of advanced analytics and alternative data strategies.

In Asia, there is an increasing thrust on digitalization and the use of new technology in investment and distribution. Managers are also setting aside more budget for digital expansion. Yet, digital uptake is concentrated in **China**, and particularly in money market funds, with a very small segment investing in other types of funds through digital channels. This indicates that investors prefer to invest online only for less risky products, whereas for other products they will rely on advice from financial advisors or intermediaries.

In China, there is growing collaboration with third-party online platforms/distributors. These relationships between managers and platforms are moving from mere fund selection and sales to more customized, technology-driven collaboration. Platforms are able to quickly gather data about end-investor behaviors and interests, leveraging their advanced big data capabilities, and give feedback to managers for better product design.

In India, the regulator's measure on disclosing technology use is a step to ensure financial stability and protect investor interests.