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International

Global research and insights from Frontier Advisors

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Equities European Research Trip

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Frontier regularly conducts international research trips to observe and understand more about international trends and to meet and evaluate, first hand, a range of fund managers and products.

In conjunction with insights we share with our Global Investment Research Alliance partners, these observations feed into our extensive international research library.

This report provides a high-level assessment on the key areas and observations unearthed during this recent Equities research trip. We would be pleased to meet with you in person to provide further detail on these observations.

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Fraser joined Frontier in 2012 and is the Director of Sector Research. He was previously at Ibbotson Associates/Intech Investments for nearly 15 years where he held a variety of roles including five years as Head of Manager Research and five years as Head of Equities and Property. Fraser started his asset consulting career at Towers Perrin in 1994 as a Research Analyst in its Melbourne and London offices. Fraser holds a Bachelor of Commerce with Honours from the University of Melbourne and a Graduate Diploma of Applied Finance and Investments from Finsia, and is a Fellow of Finsia.

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Introduction

In late 2018 Frontier undertook an international research trip to meet with, and perform due diligence on, around thirty equities fund managers throughout Europe. This is an exercise Frontier completes regularly across all of the various sectors we cover for our clients and an activity we have been performing for almost twenty five years.

Recently we have noticed a trend in the types of issues we spend time discussing with fund managers. Or, at least, a shift in the amount of time we spend talking about, and exploring, certain issues.

Broadly, the industry in recent years has been experiencing change. There has been generational change at many fund managers. There have been many fund managers that have been bought and sold.

At the same time, new businesses are being created, often inside big organisations, and a new set of key people are emerging and building their profiles. The key message is that this change is not all smooth sailing.

While there is no doubt the fundamental areas for investors, and their asset consultants, to explore and consider remain; investment philosophy, process, personnel, performance, ESG practices and of course their approach to fees. However, increasingly more time is now being spent listening to and understanding organisational issues and dynamics.



The challenge of getting the funds management organisation operating smoothly

In our most recent equities research trip, we encountered a number of concerning organisational dynamics. Accordingly, we spent more time discussing organisational issues on this research trip than any prior trip. We know that all industries experience challenges, but we do wonder whether the egos within investment management, combined with especially high financial rewards, make this more pronounced.

We saw organisational issues related to past ownership changes (e.g. mergers) but also issues from pending ownership change. In reality, we rarely encounter a corporate event for funds management organisations without uncertainty and the creation of anxiety. We heard the speculation of possibilities of how an acquisition might play out – the good scenarios, the intolerable scenarios and many scenarios in between.

This served as a reminder not to look at any corporate event through rose coloured glasses, as there is always risk of considerable downside (particularly where corporate entities are involved as decisions are usually outside the control of investment personnel).

However, corporate events were not the only factor generating organisational uncertainty. We observed internal dynamics within teams that were concerning. Business management and investment management staff are not always operating in harmony and we even encountered one investment team that has ultimately fragmented into two separate investment teams partly because relationships had soured.

We continue to place a considerable weight on the importance of organisation, seeking out ownership structures that create strong alignment and seeking out teams that work harmoniously together, while still maintaining high performance standards.



Employer of choice in a market

Operating in a major financial city is typically what we associate with many of the leading fund managers. However, this research trip was a reminder to Frontier that operating in a big city is difficult in many respects. While big cities draw a lot of investment talent, that talent ends up being dispersed across firms and there is competition for the talent. London is one such example.

In contrast, we visited managers in Europe that are essentially the employer of choice in their market. This seems a significant competitive advantage. The local talent all seems to converge on the one firm.

In addition to this, the level of stability is especially high as there is not the lure of another locally based competitor. In these examples, we meet with senior personnel with tenures exceeding 15 or 20 years on a regular basis.

This seems mostly a European competitive advantage as it typically relates to individual countries or certain European cities. We have increasingly found that the US market has attractive managers in many fringe cities, but we think the US talent is willing to move around so this comparative advantage does not seem entrenched.



The continued rise of the boutique incubator

We are highly familiar with the boutique incubator in Australia and this seems to be a continued trend in our market. With increased regulation and compliance burden in Europe, it is increasingly difficult to start a new funds management business without support. We have been wondering if the UK and Europe are destined to become dominated only by large firms, but this trip suggested the boutique incubators would play a bigger role going forward. There is still an appetite (plus lucrative incentives) for funds managers to potentially break free of the corporate and launch their own business. While it has become increasingly prohibitive to do this on their own, we expect to see this continue but with the boutique incubator playing a bigger role in this process.



The final word...

We sense that something is afoot in the funds management arena as the sector moves through a structural evolution. So, what does this mean for investors and their asset consultants?

Inevitably, we all need to spend more time ensuring that the selected managers in portfolios have strong cultures and organisational values.

Where organisational issues present themselves, we need to be especially wary. Investors may need to walk away from managers if the organisational issues reach a destructive level. Even for managers with strong investment credentials, it is difficult to meet performance objectives with the distraction of a toxic or acrimonious working environment.

Some of the best manager ideas may not exist in the major financial centres. A boutique investment firm in a niche location with an absence of local competition potentially has organisational advantages.

As the environment changes, and noting changes occur in the asset owner world as well, it is more important than ever to probe and understand the values and organisational mechanics of businesses we plan to work with.



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