The Frontier Line

What fund managers (and consultants) really think

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Frontier Advisors | Forefront Thinking

About us

Frontier Advisors has been at the forefront of institutional investment advice in Australia for over 25 years and provides advice on over $630 billion of assets across the superannuation, charity, public sector, insurance and university sectors.

Our purpose is to empower our clients to advance prosperity for their beneficiaries through knowledge sharing, customisation, technology solutions and an alignment and focus unconstrained by product or manager conflict.

Wayne Sullivan
Director of Marketing and Business Development

Wayne joined Frontier Advisors in 2013 as Director of Marketing and Business Development. He manages business development activity and has responsibility for the marketing and communication program at Frontier, including brand management, content creation and publication, digital media, and public relations. Wayne has an extensive background in marketing of financial services, specifically in superannuation, having previously held senior marketing and communication roles with Hostplus, Sunsuper and QSuper. He is a past Rainmaker Australian Superannuation Marketer of the Year and has won multiple industry awards for marketing and communication at each of the funds he has worked for.

Wayne holds a Bachelor of Economics from the Queensland University of Technology, a Diploma of Superannuation Management, and an Associate Diploma in Marketing. He is a Fellow of the Association of Superannuation Funds of Australia.

Introduction

Frontier has been working with fund managers across a range of sectors, and from around the world, for close to 30 years.

We've met with thousands of firms across the globe, and here in Australia, and continue to talk to fund managers on a daily basis not just to assess and evaluate their capability for our clients, but also to understand their views on markets and the investment sector more broadly. After all, fund managers are at the coal face every day both in terms of managing assets and connecting with investors.

Frontier conducts over 1,000 meetings with managers each year, to review and refresh our understanding of managers we know and have met before and to unearth and examine emerging or evolving funds management businesses and strategies. Our meetings inform our understanding of the products, processes and personnel within firms and enable us to get a first-hand understanding of the culture present within each organisation, no matter how large or small.

We also use the insights of our Global Investment Research Alliance partners in Europe and North America – LCP and Segal Marco Advisors, to help inform our views and understanding of what is happening in offshore markets, including the areas of interest or concern from asset owners in their respective geographies. But ultimately, we form our own views based on our own discussions in order to provide the best advice to the asset owners we serve here in Australia and New Zealand.

Each year, we invite the funds management community to join us at our Manager Dialogue event where we reveal the themes and areas we are keen to explore for our clients in the coming year. This helps managers focus on how to bring their best ideas to us for the benefit of our clients.

At that event we release the key results from our annual fund manager survey, this year completed for the tenth time. We survey fund managers to take their read on a range of market issues and to test their predictive skills, while at the same time, we ask our own staff to answer some of the same questions for comparison purposes (and both sides enjoy the friendly competition).

In this paper we analyse the results of this year's survey[1] and how responses illustrate evolution in our industry over the last ten years that we have completed this exercise. We've started with a review of the predictive abilities of managers and Frontier, which has a slightly light-hearted objective at its core to fuel conversation at our annual Manager Dialogue event, then we examine opinions on asset owners, asset consultants and finally on asset managers themselves.

[1] Our survey was completed in September 2023 by 60 representatives from funds management organisations and 36 members of our consulting team

Backdrop

Despite the rapid and considerable growth of internal teams at some of the largest asset owner organisations, 'external' fund managers still play a major role in the investment of trillions of dollars of funds in the Australian market - $3.5 trillion in superannuation assets alone. While we believe asset allocation is the biggest contributor toward portfolio performance, returns are ultimately gained from the efforts of those actually investing the money.

As their portfolios increase in size, asset owners are keen to optimise the benefits of their growing scale both through demanding reduced fees and, in many cases, internalising investment management. In the last few years, superannuation fund consolidation has impacted managers significantly through the merger of portfolios and increasing internal expertise within funds. Since our study began the number of Australian superannuation funds (ex-SMSFs) has exactly halved from 268 to 134[2]. At the same time, money continues to pour into the Australian superannuation system with assets under management in that sector growing 89% over the period of our survey history – specifically, from $1.85t at June 2014 to $3.5t in June 2023[3].

So, while this pool of capital might be growing, the proportion being invested with managers is not and the fees being paid to managers are tightening. Nonetheless, managing funds for investors remains a highly profitable business.

Fund managers tend to be optimistic and bullish, although this confidence has been tested a little in recent years with two instances of negative returns in the last four financial years. Over the duration of our ten-year study returns have been generally strong with only three of the last ten years producing a median balanced fund (60-76% growth assets) return of under 6%[4] – a generally accepted long-term average return target. This is an incredibly strong result across a low-inflation environment for most of the last decade.
That said, the period has seen a downward trend in terms of lower expected returns and adjustments to long-term objectives.

The search for outperformance in this increasingly competitive and low-return expectation environment, along with well-resourced, inquisitive and competitive internal investment teams, has also shifted the way many investors approach their portfolio construction, often away from traditional managers and into newer or niche strategies. With the introduction of *Your Future Your Super* legislation, funds now also face the risk of underperforming benchmarks. This is not just a matter of underperforming competitors, but potentially a death march. This too has shaped investor behaviour in this sector across the term of our survey. Super funds have always wanted to outperform, but the behaviour is now much more benchmark-aware and the risk appetite for seeking alpha now depends much more on how much 'budget' a fund has based on previous outperformance.

So, in light of this background, how has the mood and attitude of fund managers changed, or remained the same, over the last ten years?

[2] https://www.superannuation.asn.au/resources/superannuation-statistics

[3] APRA Superannuation Statistics: https://www.apra.gov.au/quarterly-superannuation-statistics

[4] SuperRatings surveys 2014 - 2023.

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Predicting performance

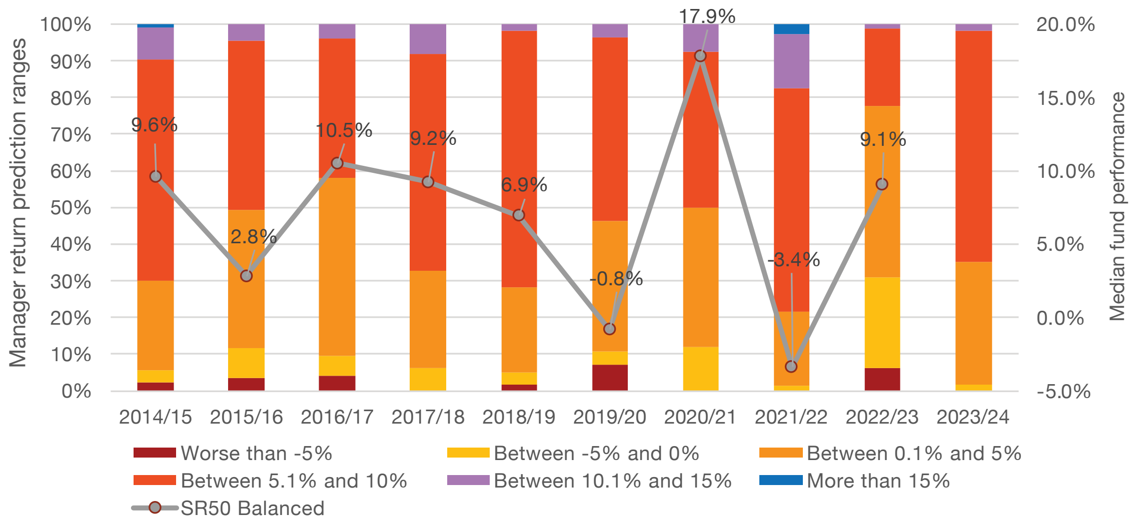
Balanced fund returns

At the end of each financial year when we survey fund managers, we ask them to predict the median return for the next financial year for a typical Balanced Fund, within generous 5% bands. Typically, most respondents (generally around 60%) settle for the relatively conservative 5-10% band, however recency bias means the result is often influenced by the performance achieved in the preceding year. Last year, when asked to predict returns for 2022/23, the prior year of negative returns seemed to influence judgement with more than three quarters of managers predicting a return below 5%, including almost a third predicting another negative result. The actual result for last year, measured as the SuperRatings median balanced fund, was a very healthy 9.05% with only 21% of managers successfully forecasting that result. Frontier's consulting team had more success predicting last year's result with 33% nominating the correct band.

This year's predictions for 2023/24 are notably more bullish than last year (again possibly reflecting the actual result of the prior year) with 63% of managers now predicting a return of between 5.1% and 10% and virtually all other managers tipping a lower return of between 0 and 5%. This is the most concentrated range of predictions of any year in this study. By comparison, our team were a little more subdued with just 44% in the 5-10% range and 14% even predicting a negative year.

So, it seems recent past performance is seen by some as an indicator of expected future performance, at least in the case of our survey!

Chart 1: Fund manager return predictions versus actual results (SR50 Balanced)



For the record, fund managers have been marginally better at predicting performance than our team in this study – this is a survey of all Frontier consulting staff, as opposed to our specialist capital markets team! Frontier has tended to be closer to predicting the result in years of low returns, while managers' optimism tends to suit years of strong performance, of which there have been more in the last ten years. It is important to note this survey is not a formal statement of forecast from Frontier but rather an exercise to generate discussion at our Manager Dialogue.

Asset class performance

It's not surprising to see that over time the asset classes predicted to be the best performing in the year ahead have tended to correlate with the sectors covered by those fund managers! Over the life of the survey international equities has tended to be the most nominated sector each year – albeit alternating between developed and emerging markets.

However, this year there is a strong preference for alternative debt (33%) to deliver the strongest results, with private equity (17%) also coming in ahead of developed and emerging markets (13% each). The increasing number of managers nominating private equity as the sector most likely to produce outperformance has been climbing each year for the last half of our study. In the first four years of our study not a single fund manager had flagged private equity as their nominated top performer.

Nominating the best performing asset class is an area where Frontier has consistently had more predictive success than managers during our study. For 2023/24 a quarter of our firm has also listed alternative debt as the sector most likely to be the best performer for the year, with our perennial favourite, unlisted infrastructure, being the tip of 22% of our team. This figure has been as high as 44% in previous years. Like managers, more of us (8%) are now predicting private equity as the most likely sector to deliver outperformance in the year ahead than ever before.

Asset owners

Influencers

When we started this survey in 2014 superannuation funds made up around three quarters of our client numbers - now they are only around 40 per cent. However, super fund investors are obviously still a major portion of the institutional investment market, many with very significant portfolios.

It has been interesting to watch the evolution of how managers answer the question of *"who are the most influential parties at superannuation funds when it comes to investment decision making"*. From five choices of CEO, CIO, Board/Investment Committee, internal team or asset consultant, managers historically nominated the fund CIO as the most influential person until 2021 when, for the first time, internal teams began to outrank their boss in terms of influence. And, outrank their boss's boss as well, with CEOs ranked the least influential from our set of five options - from the fund managers' perspective of influence in investment decision making at least.

CIOs were at the peak of their perceived influence in 2017 when 52% of respondents ranked the CIO as the most influential in decision making, with 27% nominating the internal team at that time. Since then, those rates have steadily transferred with this year seeing 32% of managers ranking the CIO as the most influential and 48% throwing their weight behind internal teams. The Board and Investment Committee remain in third spot ahead of asset consultants and the CEO.

By comparison, our team has not changed its long-time ranking of influencers with 44% opting for the CIO as the most influential and only 17% weighting internal teams highest, behind Boards and ICs (39%). These rankings of Frontier's perspective have been remarkably consistent over the last ten years.

This evolving divergence between managers' and Frontier's perceptions of influence is likely a result of the rapid growth of large super funds' internal asset class teams and delegations cascading down to those teams that result in more direct engagement with managers than may have previously occurred. While the asset consultant now holds a more strategic, whole of portfolio role with the CIO and IC of these larger organisations.

Internal teams

The growth of internal investment teams across the ten years of our study has been perhaps the most significant evolution for funds management businesses to negotiate. Each year we have asked managers to choose the answer they most agree with from a series of comments on internal teams.

Historically the comment that *"internal teams will change the philosophy and culture of funds for the better"* was the most supported sentiment, while *"internal teams are best placed to research and advise on investments for their fund"* was the second most favoured comment for managers to agree with. However, this year there has been a strong shift away from the "positive culture" sentiment, now ranked fifth at just 10%, with the notion of teams being "*best placed to research and advise on their investments*" climbing to the top spot, chosen by 39% of respondents.

This is not to say that managers no longer think internal teams can add positively to culture, but just that it is no longer the answer they most agree with. However, if we are to look for negative sentiment toward managers the comments that internal teams are *"a major cost for funds and just add to the process"* and *"internal teams will change the philosophy and culture of funds for the worse"* have almost doubled in aggregate over time. This is an interesting shift in perspective and worth monitoring further over time.

Table 1: Fund manager responses on internal teams

Internal teams...	2014 (%)	2022 (%)	2023 (%)
Change the philosophy and culture of funds for the better	30.5	20.3	10.2
Best placed to research and advise on investments for their fund	23.4	21.5	39.0
A major cost for funds but worth it for their value add	17.1	16.5	11.9
A major cost for funds and just adds to the process	11.7	16.5	17.0
Change the philosophy and culture of funds for the worse	3.9	10.1	13.6
Other	13.4	15.1	8.3

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The longer-term trends across responses could reflect the fact in 2014 the question was being answered from expectations of how internal teams might evolve, as they were just developing in many cases. Whereas now the question is being answered from actual experiences with more, and larger, internal teams being active along with an acceptance of the calibre of personnel being recruited within many funds. However, there has been a sharp turn in sentiment over the last twelve months, which is unusual given the relatively steady transition over the prior nine years. Next year's results will help identify if this is an anomaly or a genuine shift.

It may be that managers now accept large and capable internal teams are here to stay and their influence on the culture of the organisations they work for has well and truly taken effect. Most would agree the power balance, or relationship dynamic, between internal staff and managers has shifted considerably with the "rock star" persona now more likely to reside in the asset owner organisation than in the fund manager.

By comparison, our team has been quite consistent and spread with its responses. Initially a concern for our 'cost conscious' advisers, over time the impact of the cost of teams has been given less prominence and the calibre of the work completed by internal teams has been increasingly recognised.

Table 2: Frontier responses on internal teams

Internal teams...	2015 (%)	2022 (%)	2023 (%)
Change the philosophy and culture of funds for the better	31.6	26.7	30.5
Best placed to research and advise on investments for their fund	10.5	23.3	22.2
A major cost for funds but worth it for their value add	42.1	23.3	27.8
A major cost for funds and just adds to the process	5.3	20.0	11.1
Change the philosophy and culture of funds for the worse	5.3	6.7	8.3
Other	5.2	-	0.1

Fees

Fee pressure is often cited as a major challenge for fund managers. Frontier has led the charge for many years on the issue of a fair fee regime with the argument asset owners should retain more of the benefits of their scale for their beneficiaries. Since 2015 we have asked managers in our survey whether they think super funds focus too much on minimising costs and not enough on maximising net returns. Responses to this question have been very clear over time and becoming increasingly ‘clear’ as the study continues.

In our most recent survey, 83% of managers feel returns are being compromised in the quest to contain costs. This score has been steadily climbing each year since 2015 (70%). Conversely, and again unsurprisingly, Frontier had a different view on fees with exactly half of our team feeling that funds have too strong a focus on fees over returns – substantially less than fund managers.

In the last three years of our study, we have asked managers, and our own staff, to rank the most fee sensitive investor groups from across the institutional investment market. In terms of ranking first, the results do differ between managers and our own assessment on a volume basis, though not order. But, perhaps the most significant element to come out of this question is a very strong sense the largest investors, the large super funds (>$50b), are the most fee sensitive with 86% of managers nominating that group first and 50% of our team. Virtually the remainder of managers gave their number one vote to small super funds, while almost a quarter of Frontierians (23%) nominated small funds with 12% suggesting charities as being the most fee sensitive.

In a weighted sense (considering the full range of 1-7 scores), behind super funds, managers ranked insurers behind the super funds, then universities and charities next, while Frontier responses had that order reversed and a slightly higher score for smaller super funds than large funds.

Table 3: Most fee sensitive investors – rank (weighted score)

	Managers	Frontier
Large super	1 (6.7)	2 (5.3)
Small super	2 (5.9)	1 (5.6)
Insurers	3 (4.3)	5 (3.7)
Universities	4 (3.3)	4 (3.8)
Charities	5 (3.1)	3 (4.4)
Private wealth	6 (2.5)	6 (2.6)
Family offices	7 (2.4)	7 (2.6)

These results could reflect a manager focus on the total fee value given the larger sums being invested by the bigger asset owners. The fact asset consultants have more nuance across their responses covering all groups could reflect the fact we aren’t remunerated on the volumes invested and have more detailed and strategic discussions with smaller investors, relative to managers.

Issues of concern

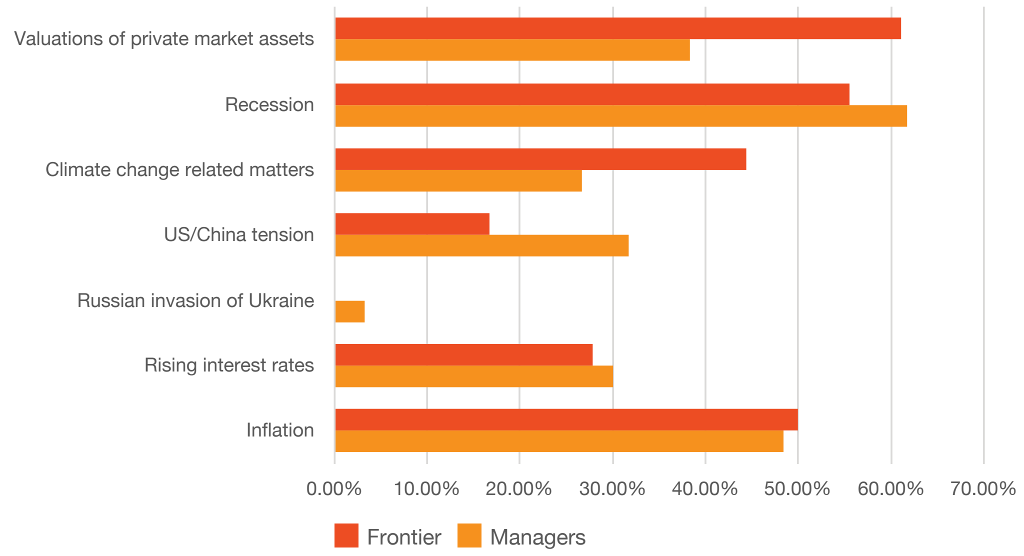
Effective managers will have a strong understanding of the key issues their clients are concerned about, rather than simply focussing on what products and ideas they want to put in front of investors and consultants. This question is a more recent inclusion in our study and changes each year to reflect the key factors in markets at the time our survey is released.

From a range of issues, we asked both managers and our team to choose up to three issues of most concern for their clients. The results were broadly similar between the two groups with some notable exceptions.

Most managers ranked the impact of impending recession across the globe as a factor concerning their clients (62%) with inflation ranked second (48%), remembering that respondents were asked to nominate three issues. In terms of geopolitical matters, US and China tension was seen as far more concerning that the Russian invasion of Ukraine.

Frontierians agreed that recession (56%) and inflation (50%) were key concerns, with similar levels being nominated, however the number one cited concern of investors, in the opinion of our team, was valuations of private market assets with 61% nominating this issue as opposed to 38% of managers.

Chart 2: Issues of most concern to asset owners



Asset consultants

During the life of our study, we have asked managers for their views on asset consultants. When asked about the most important attributes of a good asset consultant, the rankings have not changed materially over ten years, but the weight apportioned to them has evolved substantially and consistently over that time. While the *"quality of personnel"* remains the most important attribute for an asset consulting firm, this is now seen as less significant than previously. Increasing weight is now given to both being a source of *"thought leadership"* in the industry and the importance of *"independence and unconflicted advice"*. Table 4 lists the evolution of managers' answers around important attributes over the life of the study.

Table 4: Most important attributes of an asset consultant

Attribute	2014	2023
Quality of personnel	42.6%	28.3%
Thought leadership	13.9%	20.0%
Depth of manager/product research	17.8%	18.3%
Independence	5.4%	11.7%
Coverage of manager/product research	7.0%	8.3%
Other	13.3%	13.4%

*Other includes technical knowledge, local knowledge, analytics and research tech.

In terms of their view of Frontier specifically, managers have consistently nominated independence as one of Frontier's most important comparative advantages. The weight given to this has been as high as 52% in 2019 following the mood in the industry set by the Royal Commission into Financial Services held around that time. This year the number of managers citing that attribute of Frontier has returned to a level more consistent with the average over the life of the study at 28%.

The quality of our personnel remains our most important attribute in the eyes of managers, as it was at the start of our survey. Our Australian market knowledge is seen as our standout attribute by fewer managers now that it once was. We think this is still seen as a positive trait, but not considered to be as important as it once was. There is now a greater likelihood for managers to regard our personnel as our key competitive advantage, which we think is a clear endorsement of the evolution of our team over time.

Table 5: Frontier's most important competitive advantages

Attribute	2014	2023
Quality of personnel	27.3%	35.0%
Independence	26.6%	28.3%
Australian market knowledge	21.1%	16.7%
Thought leadership	4.7%	11.7%
Global Investment Research Alliance (GIRA)	4.7%	3.3%
Other	10.2%	3.3%

*Other includes additional resource, gatekeeper.

Asset managers

When asked about their own businesses, fund managers have generally consistent views across periods, though some shifts over time are interesting to note.

Asked to choose one of a series of statements they most agree with, managers have felt strongly they provide a depth of research and development that internal teams can't match. Alignment with this comment is virtually identical to the first year of the study, after reaching a high of 58% in the 2021 results. This consistency is at odds with the trend increase regarding internal teams being best placed to research and advise their own funds highlighted earlier in this paper.

On the notion fund managers should primarily be remunerated on performance, again managers are close to the same position offered ten years ago, however this metric did climb to a high of 42% in 2017 before returning to levels of 2014. This may be a factor of the pattern of returns over that period (wanting to be remunerated on performance when it is high) and indicative of a view future alpha might be more muted.

The full set of choices and this year's results are shown in Table 6. Note, managers were asked to choose the statement they most agree with.

Table 6: Statements on fund managers

Statement	2014	2023
Should be primarily remunerated on performance	34.1%	33.3%
Provide a depth of research & development internal teams can't match	44.2%	45.0%
Will need to trim fees to remain competitive	5.4%	6.7%
Will reduce product complexity and performance to meet fee targets	0.8%	5.0%
Other	15.5%	10.0%

*Other includes will drop in numbers, increase product complexity, be additive to internal teams.

Growth perspective

Despite the many challenges facing them, managers are a remarkably positive lot when it comes to their own business prospects. When asked if they expect their businesses to grow over the next five years (other than via market growth) the overwhelming majority are optimistic, a trend which has not wavered since our study began in 2014. Indeed, this year 93% of managers are predicting business growth between now and 2028. This figure has been as high as 97% back in 2016, and only ever as low as 86% the following year.

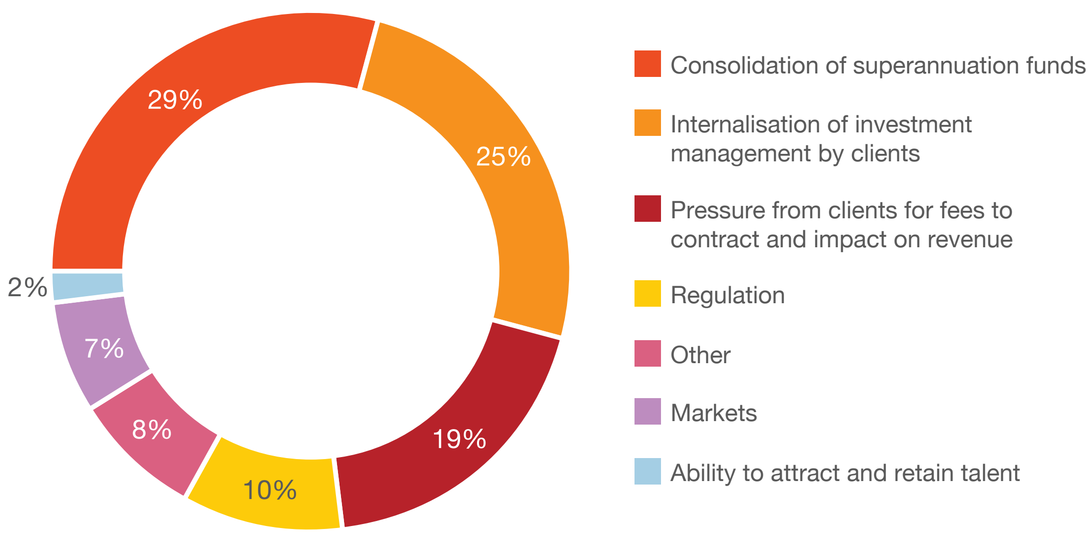
Despite that optimism, there are a number of headwinds to the growth of fund managers' institutional businesses. The pattern around these factors was quite consistent in the first four years of our study, from 2014 to 2017, with *"pressure from clients for fees to contract and impact on revenue"* clearly being offered as the single biggest challenge, generally by around 30% of managers.

However, in more recent years, two other factors have emerged as significant threats. These are internalisation of investment management by clients, and consolidation of superannuation funds. This year consolidation was seen as the most significant issue by 29% respondents, down from a high of 49% in 2022. As recently as five years ago consolidation was the third factor nominated and in 2016 only 8% saw this as the primary threat.

Over time the challenge of internalisation has been growing in terms of its prominence in responses. This year it has almost climbed into the top ranking with 25% choosing it as their most significant issue. It is obvious that, while consolidation continues to loom as a threat for managers (and for consultants as well), the majority of that appears to be behind us and the challenge of larger internal teams now looms as the more immediate threat for managers looking to cling on to mandates.

When we began our survey in 2014 there were 198 'profit-for-members' funds. Fast forward to today and there are currently 62[5]. Of course, there is substantially more money needing to be invested in the superannuation system now, but the concentration of that money across an ever-reducing number of funds is clearly causing concern for fund managers with respect to their operations.

Chart 3: Primary concern for funds management businesses



[5] https://www.superannuation.asn.au/resources/superannuation-statistics

Assessing fund managers

In testing the factors that are most important in assessing an investment manager there has been little shift over the course of the study. There is generally quite strong correlation between managers and Frontier which is pleasing as it is important for both parties to be in alignment on this point. Minor differences occur around process and performance with Frontier attributing more weight to process than managers and the reverse with respect to performance.

Table 7: Importance of factors in assessing fund managers – rank (weighted score)

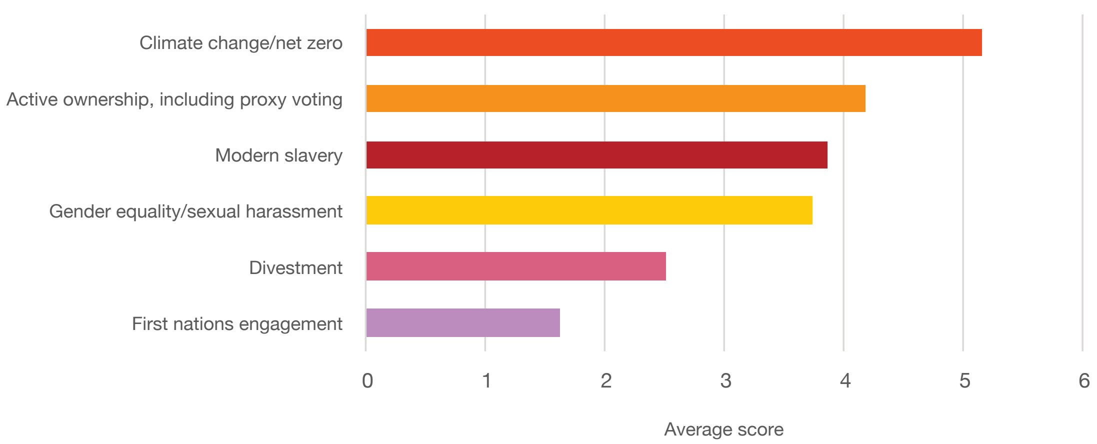
	Managers	Frontier
Quality of personnel	1 (4.9)	1 (4.8)
Investment process	2 (4.3)	2 (4.6)
Ethical/trustworthy	3 (4.1)	3 (4.1)
Net performance	4 (3.8)	4 (3.6)
Diversity of personnel	5 (2.0)	5 (2.0)
Responsible investment	6 (2.0)	6 (1.8)

Responsible investment

In recent years we have introduced a question to reflect the emergence of a range of specific responsible investment matters that demand increased attention.

We give managers a range of elements across the E, S and G areas to rank in terms of their current focus. More than half of our respondents indicated *"climate change and net zero"* was their primary focus in the responsible investment space, ahead of *"active ownership, including proxy voting"*. On a weighted basis there is certainly a mix of areas of focus across different managers, no doubt based on the nature of their particular strategies and sectors. A low score does not necessarily mean that area is not seen as important, it merely reflects its rank relative to other areas of focus.

Chart 4: Areas of responsible investment focus



The final word

The institutional investment market has evolved significantly over the last decade and particularly so for fund managers and asset consultants alike.

Our longitudinal study provides an interesting picture of how views on the structural factors that impact funds management businesses in Australia have evolved over this time.

Over the life of the study, the number of superannuation funds has reduced while assets in the sector have climbed. For larger funds, strong internal capability has been developed both in terms of in-house research and direct investment. The way asset owners have re-modelled their businesses has presented challenge for managers. Although the sentiment toward internal teams remains generally positive, this mood has shifted as funds' aspirations to bring more investing activity in-house have moved to reality. This, along with superannuation fund consolidation, has occurred at a much faster rate than most had predicted at the beginning of our study and has changed the nature of the way internal investment teams work with managers.

This ten-year period has seen generally very positive markets for investors, although the last four years have produced periods of significant negative returns and volatility driven by a global pandemic and significant geopolitical developments. The former has brought with it a change to the way all organisations work and the way managers engage with their clients has had to evolve. This will impact the nature and depth of the relationships managers are able to develop with clients and consultants.

While managing fees remains a critical factor for funds, government regulations may also start to influence investors' strategies and broader objectives. This will likely impact the type of products investors seek and managers will need to respond.

Studies of this nature often show there are fundamental elements that always remain over a long period of time. But gradual incremental shifts can lead to significant trends over time. There will always be opportunities for well-run innovative and fairly priced funds management businesses that adapt to changing circumstances in the way they partner with investors. Frontier will continue to enjoy the opportunity we have to work with both asset owners and fund managers as the industry continues to evolve.

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