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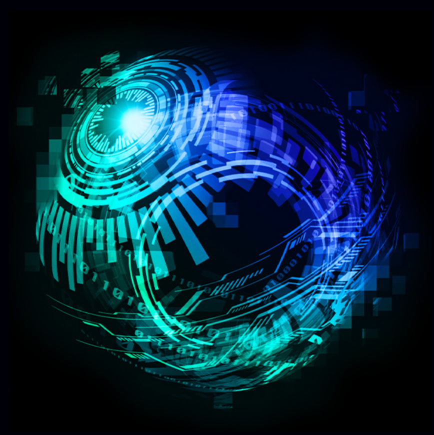

Righting the ship

Transforming active equity for a competitive world

Long-only active asset managers, especially those focused on quoted equities, **are struggling:**
- Of active investors in public markets, only 23 percent of investment strategies worldwide, representing 41 percent of assets under management, consistently deliver excess return
- The challenge is acute in long-only listed equities, where only 31 percent of AUM consistently outperform, compared to 57 percent of fixed-income AUM
- Nearly two-thirds of firms have less than 25 percent of their AUM in consistently outperforming strategies
- Challenged investment strategies have suffered at least five times the fee compression of consistently outperforming peers

The changing fortunes for long-only managers have three major implications for the industry:
- Investors will adapt their portfolios, further separating alpha and beta providers
- Indexing will become more prevalent, and factor investing will become more widespread
- $2 trillion of quoted active equities will shift toward private markets and fixed income

While active asset management faces powerful headwinds, its death is exaggerated. Strategies that exhibit consistent outperformance will fuel expansion among a small number of winning asset managers. These consistent performers will outdeliver:
- 7 percent annual revenue growth among liquid active equity
- 6 percent annual revenue growth among liquid active fixed income

Most asset managers will need to transform their product lines by addressing noncompetitive investment strategies, particularly in equities. The degree of change possible will depend on:
- Transformation potential: the feasibility of making necessary changes
- Market potential: the economic impact those changes would have

Investment strategies with sizable transformation potential and higher market potential could benefit from **enhancing investment processes:**
- Using new sources of data and advanced synthesis techniques
- Flexing shareholder muscles through ESG, engagement, and activism
- Providing access to more privileged capital markets

Those strategies with more transformation potential but less market potential could benefit from **reducing the cost of delivering** the investment capability:
- Systematizing investment processes
- Optimizing talent, data, and workflow
- Rationalizing product

In all cases, **innovative pricing** will play a greater role in competitive differentiation.

While the recent **COVID crisis** creates market uncertainty, **the long-term implications for active management do not change.** Active managers who transform their equity platforms will likely be positioned to retain assets, win-back investors into active strategies, and capture **growth in a volatile market.**

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Introduction

Active asset managers focused on long-only portfolios of quoted securities, particularly equities, have been the global asset management industry's bedrock for decades. Yet deep secular shifts in capital markets and asset management's operating environment are reshaping investment opportunities. Many active managers of listed equities are finding it harder to find alpha. Allocators increasingly seek investors who can truly distinguish between alpha and beta. Consequently, these investors are demanding fewer actively managed equity portfolios, and when they do buy them, they value them less.

Yet the death of long-only active equities is exaggerated. Many portfolio managers consistently provide net excess return across actively invested strategies, but such investors are in the minority. The number of asset managers who can extend such outperformance across their entire product range is exceptionally small. As rivalry intensifies in an oversupplied market, many asset managers are discovering that their slim number of quality investment capabilities will fail to subsidize a wider range of less demanded, less differentiated strategies.

Asset managers who realize challenges with active equity management are secular, not cyclical—and therefore require proactive modernization—stand to gain from this unfolding dislocation. By leveraging consistently outperforming active equity strategies to shoulder out rivals while rehabilitating weaker offers, asset managers can improve their economics despite secular headwinds. This white paper's four main conclusions outline this transformation:

- **Cyclical and structural trends are reducing the number of active investment strategies that consistently outperform,** requiring new skills, information, and methods to generate and deliver alpha.
- **Demand for long-only actively managed equities will weaken,** slowing overall revenue growth and strengthening winner-take-all competition for remaining assets.
- As most asset managers maintain product ranges with both competitive and challenged strategies, **they stand to benefit from objectively addressing their active equity capabilities.**
- **Thoughtful change management programs can strengthen weaker active equity offers** by enhancing them, delivering them more cost-effectively, or taking more dramatic action.

Data cited in this paper and its figures, unless otherwise indicated, comes from several Casey Quirk research initiatives, including its various demand models forecasting future organic growth in the asset management industry. Performance data for key Casey Quirk analyses comes from eVestment and Morningstar.

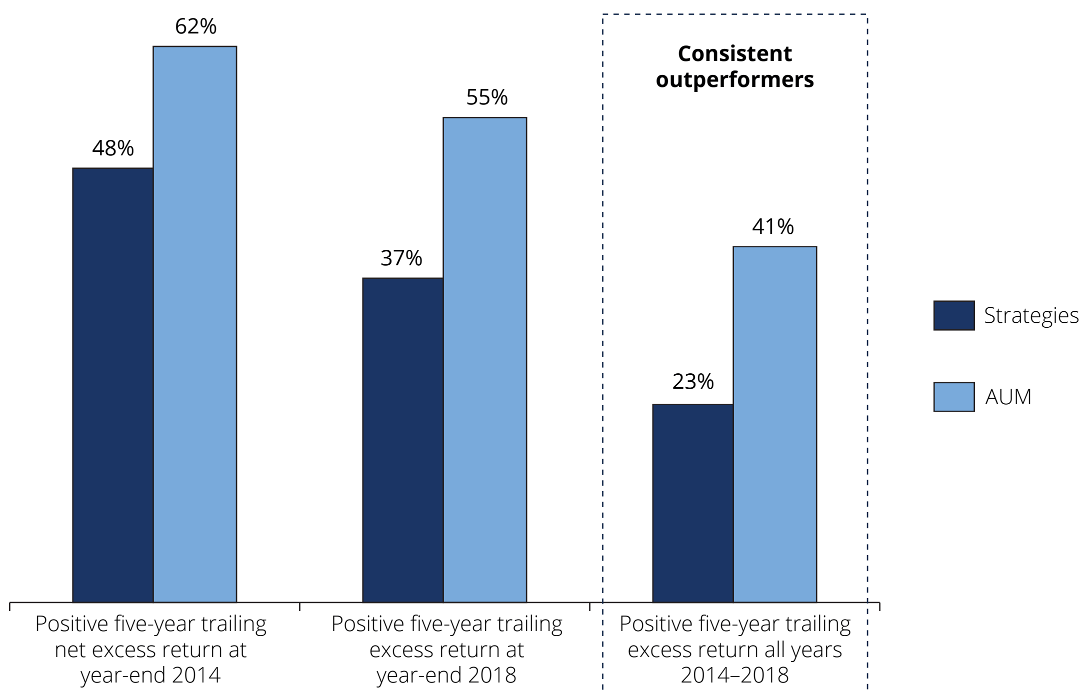
The current state of liquid active management

Several factors are reshaping both global demand and performance for actively managed portfolios of public securities:

- **The number of publicly traded companies in developed markets has dropped by half since 1996,** according to data from the World Bank. Coupled with a **rapid expansion in the number of investment products**—now numbering more than 100,000 globally, according to eVestment—the result is too many active asset managers chasing too few opportunities.
- **Greater availability of transparent public information** has made it difficult for traditional proprietary research to provide a competitive advantage.
- The **restrictions on position size in large pooled funds** have reduced active asset managers' ability to place large bets or capture illiquidity premia, diluting alpha. Such limits also have made it more difficult for portfolio managers to influence companies, weakening efforts to drive value through shareholder activism.
- The result has been **"closet beta:"** broad diversification, particularly among large registered products that offer limited additional methods for diversifying risk, prompting correlation with major benchmarks. This has coincided with the proliferation of beta offerings at near-zero fees.

Consequently, fewer than 25 percent of actively managed investment strategies worldwide delivered consistent outperformance—defined as consecutive periods of five-year trailing positive excess returns, net of fees, exceeding the relevant benchmark.

Figure 1. Cumulative active outperformance (% strategies worldwide)

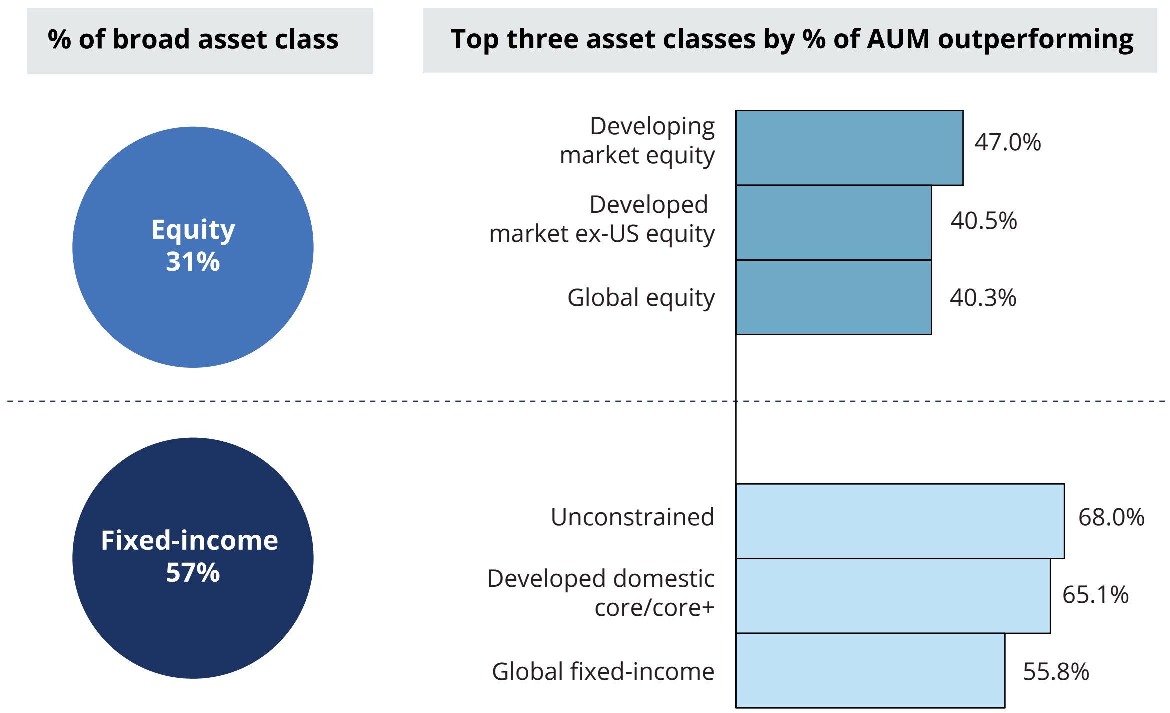


Note: Consistent outperformance = positive five-year trailing net excess returns delivered in five consecutive years from 2014 to 2018.

Sources: Morningstar, eVestment, Casey Quirk analysis

Actively managed equity capabilities are the most challenged. Even among the active equity strategies where outperformance has been most common, only a minority of assets have consistently beat benchmarks. For US equities, the proportion is 21 percent (according to the same analysis cited in figure 2). Conversely, among fixed-income strategies where outperformance is prevalent, a majority of assets generate excess return.

Figure 2. Cumulative active outperformance within selected asset classes, 2014–2018 (% AUM worldwide)

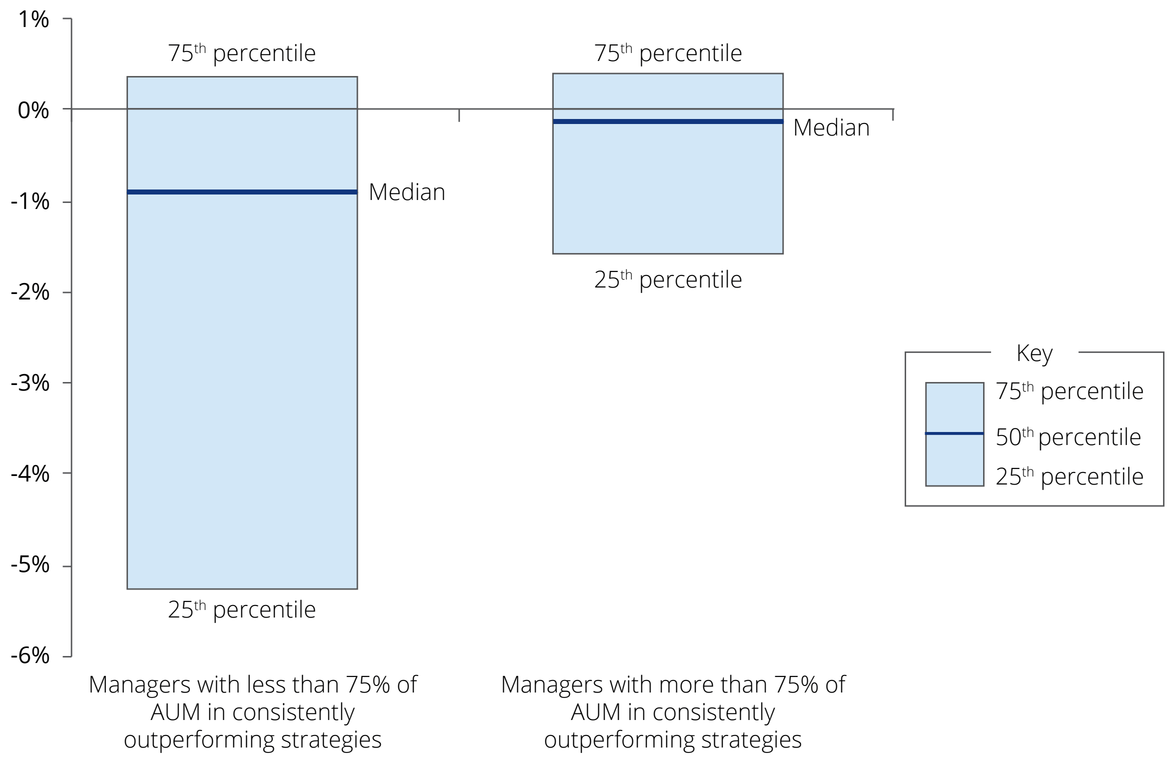


Note: Consistent outperformance = positive five-year trailing net excess returns delivered in five consecutive years from 2014 to 2018.

Sources: Morningstar, eVestment, Casey Quirk analysis

Despite a fee-sensitive environment, investors are willing to pay for consistent performance. On average, the few asset management firms with more than 75 percent of their AUM in consistently outperforming strategies have resisted fee pressure for the past five years, while below-median performers among their weaker peers have seen fees shrink at least 5 percent and as much as 25 percent since year-end 2013.

Figure 3. Average annual management fee change (by % managers, worldwide, 2013–2018)

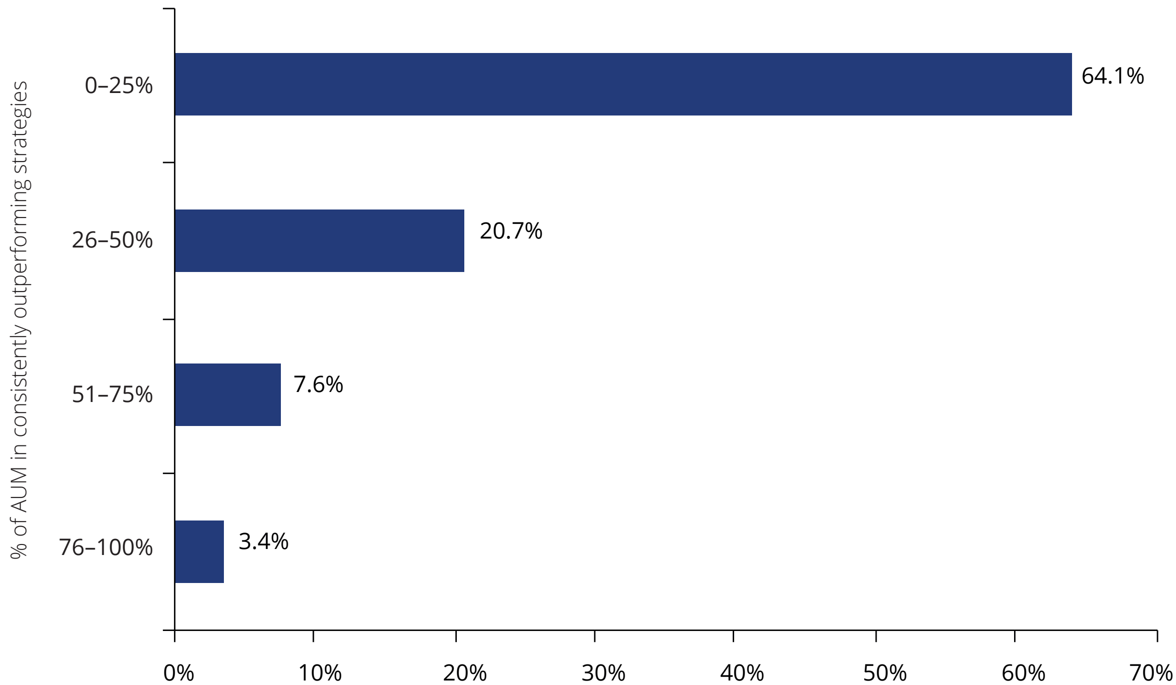


Note: Consistent outperformance = positive five-year trailing net excess returns delivered in five consecutive years from 2014 to 2018. Data reflects listed management fees and excludes institutional discounting.

Sources: Morningstar, eVestment, Casey Quirk analysis

While many asset managers have widened their product arrays, few have successfully extended consistent outperformance across their platforms. This inability to provide persistent alpha has bloated and overstretched product lineups. Only 11 percent of the world's asset managers have more than half their assets in consistently outperforming investment strategies.

Figure 4. Asset managers by % of AUM in consistently outperforming strategies (# managers worldwide, 2018)



Note: Consistent outperformance = positive five-year trailing net excess returns delivered in five consecutive years from 2014 to 2018.

Sources: Morningstar, eVestment, Casey Quirk analysis

Firms with mostly inconsistent or poor performance across more than 75 percent of their assets—the wide majority of asset managers—can suffer from a number of headaches: brand dilution, lower distribution productivity, inefficient investment staffing, distracted management and, perhaps most importantly, weaker economics from maintaining fixed costs of a long tail of subscale investment strategies.

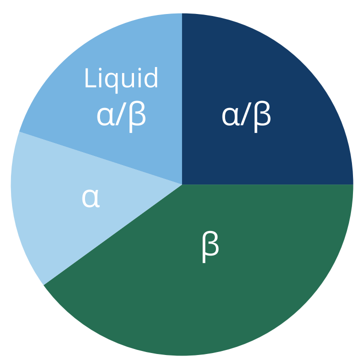
Future repercussions for liquid active management

The changing fortunes for long-only active managers—across all types of securities, but particularly listed equities—are reshaping the global asset management industry in four ways:

1. **Investors will likely adapt asset allocation and portfolio construction.** Asset owners and intermediaries worldwide are reducing their exposure to liquid "closet beta" strategies that further correlate to benchmarks as they expand in size. Buyers are reallocating assets toward three types of strategies:

    - *Beta exposures:* Primarily market-weighted passive portfolios, but increasingly systematic and factor-based strategies
    - *Benchmark-agnostic alpha:* Less constrained, more concentrated capabilities, with a growing emphasis on shareholder activism
    - *Illiquid assets:* Strategies where it is structurally impossible to separate alpha and beta, and market betas tend to be less correlated with one another and public markets in general

Figure 5. Emerging asset allocation trends



Legacy liquid active

- Benchmark-aware liquid strategies
- Highly susceptible to fee pressures and beta substitution

Private markets

- Structurally inseparable alpha and beta
- Market predominantly composed of private equity, real estate, infrastructure, and private debt

Benchmark-agnostic alpha

- Go-anywhere strategies
- Flexible implementation
- Increasing "activist" engagement

Beta exposure

- Heavily dominated by market-weighted passive products
- Expanding to include factor and formulaic quantitative strategies

Source: Casey Quirk

2. Consequently, **passive strategies will likely become more prevalent**, particularly in long-only equities, as investors are provided with a broader menu of factors and indexing methods. Secular portfolio reallocation, rather than simply cost sensitivity, has emerged as the stronger driver in this shift. While fixed income has been less affected to date, prolonged quantitative easing, coupled with the rise of factor-based bond strategies, likely will promote passive debt portfolios.

Figure 6. Passive investing worldwide

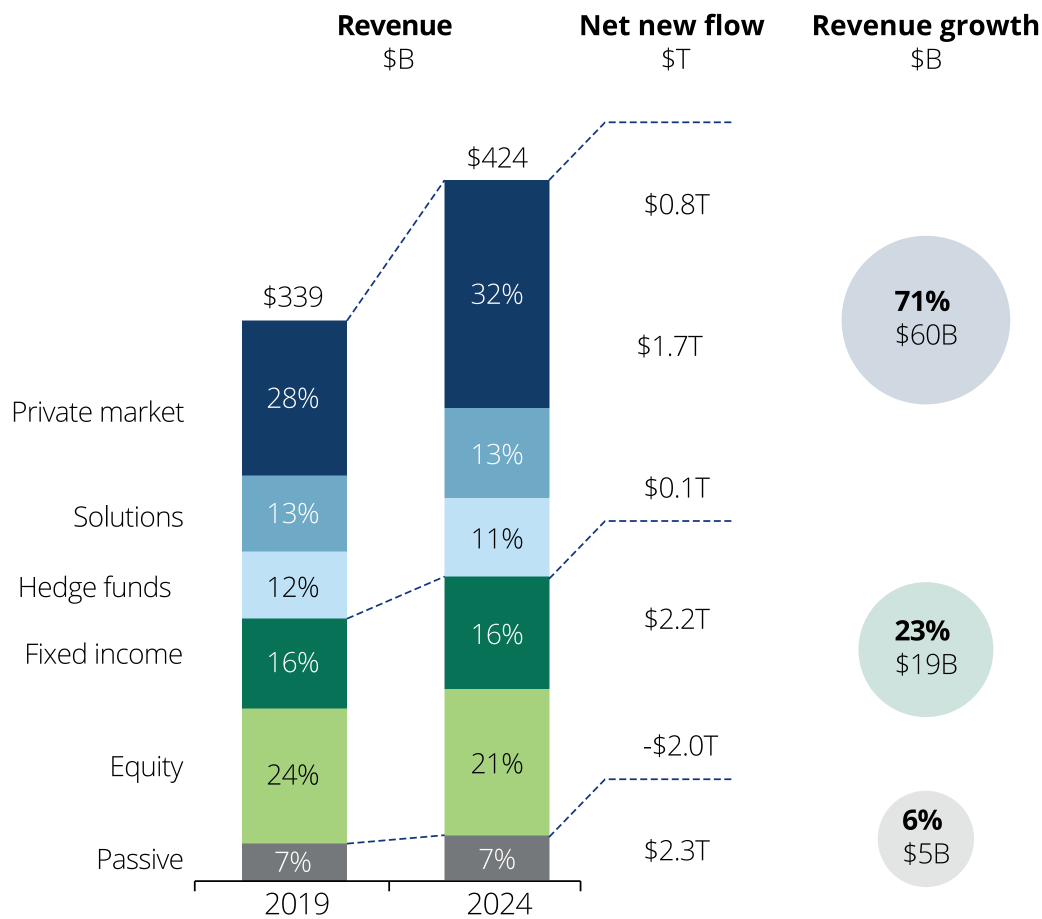
	Equity	Fixed-income	Solutions	Hedge funds	Private markets
Current active vs. passive share % AUM, 2019	37.3% Passive 62.7% Active	14.3% Passive 85.7% Active	8.6% Passive 91.4% Active	1.4% Passive 98.6% Active	0.0% Passive 100.0% Active
Direction of travel	**Decelerating passive growth** Passive market share near maturation outside of non-US retail	**Accelerating passive growth** May ultimately approach equity levels due to factor-based passive offerings	**Accelerating passive growth** Future components will be near entirely passive, beta-neutral, and illiquid	**Nascent passive growth** Expansion of alternative beta indices	**Structurally impeded** Despite increasing democratization of investment
Remaining active opportunities	• Quality outperformers • Beta-neutral alpha • Niche and high-active providers	• Quality outperformers • Market-neutral alpha • Niche and high-active alpha providers • Thinly traded/high-yield such as loans and collateralized loan obligations	• Quality outperformers • Active allocation and passive components • Multi-asset illiquid	• Beta-neutral alpha • Thinly traded/ high-frequency • Operationally intensive strategies for (e.g., distressed or activist)	• All direct strategies

High — Susceptibility to passive — Low

Sources: Morningstar, eVestment, Casey Quirk analysis

3. **Demand**—and consequently, future economics—**will shift away from listed active equity toward private markets and bonds.** As alpha proves more elusive in equity capital markets, and public markets provide fewer high-yield options in a low-rate marketplace, investors will turn toward real assets and private capital. Between now and 2024, private markets will account for more than 70 percent of the industry's new revenues.

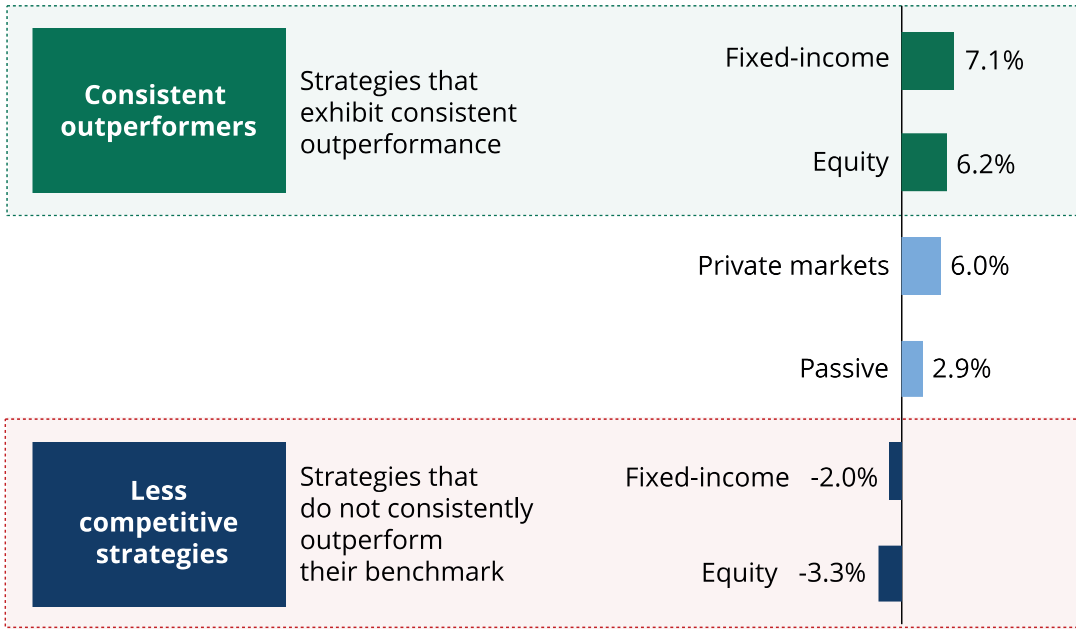
Figure 7. Asset management industry revenues and net flows by strategy type, 2019–2024E



Sources: Casey Quirk Global Demand Model, Casey Quirk analysis

4. **Among actively managed public markets strategies, competition will likely intensify.** Consistently outperforming investment strategies, less susceptible to fee pressure and leveraging brands with a reputation for investment quality, could represent nearly all organic growth in long-only actively managed portfolios during the next five years through a combination of both new money and assets siphoned from a wide band of weaker rivals.

Figure 8. Asset management industry revenue growth CAGRs by strategy type, 2019–2024E



Sources: Casey Quirk Global Demand Model, Casey Quirk analysis

Looking forward, several positive and negative external trends could affect performance, but none is likely to change the trajectory for liquid active portfolios, particularly long-only equities. This leaves most asset managers with a broad range of strategies ripe for transformation. The quest for alpha is far from over, but it needs to evolve.

Assessing active equity competitiveness

Many liquid active investors have waited through market cycles hoping for performance improvement that will deliver value from the many call options within their portfolios. The hard truth remains that waiting and hoping is not a strategy. Asset managers should actively address the wide proportion of their investment capabilities that fail to consistently outperform.

Fortunately, many asset managers have also strengthened their product development functions during the past decade, shifting them from support operations into more senior research and development functions armed with competitive intelligence and analytics. (Casey Quirk's 2016 white paper, *New Arrows for the Quiver: Product Development for a New Active and Beta World,* outlines this organizational change.) These product development functions will play critical roles in improving competitiveness across the investment offer.

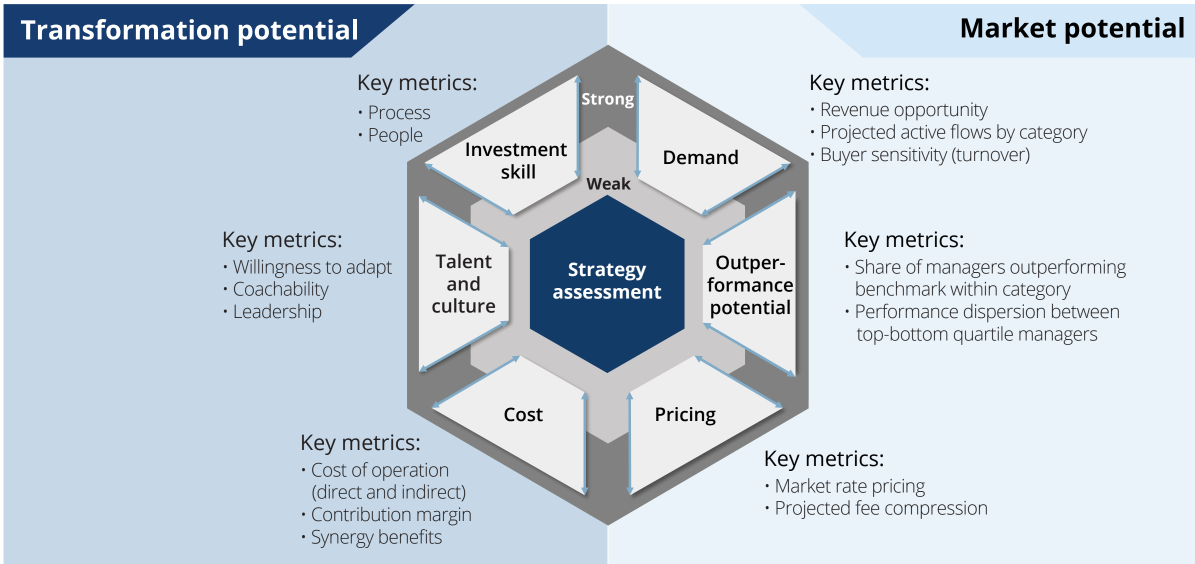
The most straightforward step in strengthening a product range involves acquiring or building new capabilities that better match demand. Asset managers have been adding private markets, specialty fixed-income, multi-asset, and allocation capabilities. Doing so, however, is expensive, either in terms of time (organic approaches) or money (inorganic methods). A high number of underperforming or outdated capabilities also can impede this transition, as strategies with slowly eroding revenues chained to stubborn fixed costs tie up resources and operating capital.

To effectively transform their product lineups, asset managers need a clear-eyed, metrics-driven assessment of each investment strategy's current and future competitiveness. Weaker investment strategies should be measured on two axes:

- **Transformation potential:** Can the firm rehabilitate the investment strategy to deliver consistent outperformance and compete with peers?
- **Market potential:** Does the investment strategy meet both current and evolving asset allocation and portfolio construction needs of clients?

Several factors, most of which can be measured qualitatively if not quantitatively, compose each broad measure of competitiveness. *Transformation viability* is a function of *feasibility:* defining the lift required to succeed. *Market viability* is a function of *priority:* outlining the capabilities that, if rehabilitated, align best with demand and therefore would have the biggest impact on firm economics.

Figure 9. Investment capability assessment



Source: Casey Quirk

For asset managers, some of the greatest challenges are capabilities with low transformation potential—those resistant to change. Such capabilities often involve inflexible talent, clunky operating processes that create rigid cost structures, or simply the weight of poor long-term performance. Rehabilitation options for such strategies are limited:

- For strategies with *low transformation potential but high market potential,* solutions often involve at least one of two actions: selling the capability to a rival with better performance but subscale assets under management or rebooting talent through new hires in either a gradual or sudden transition. Both are high-risk, disruptive, and reliant on the right external opportunity set (a buyer or new investment professionals).

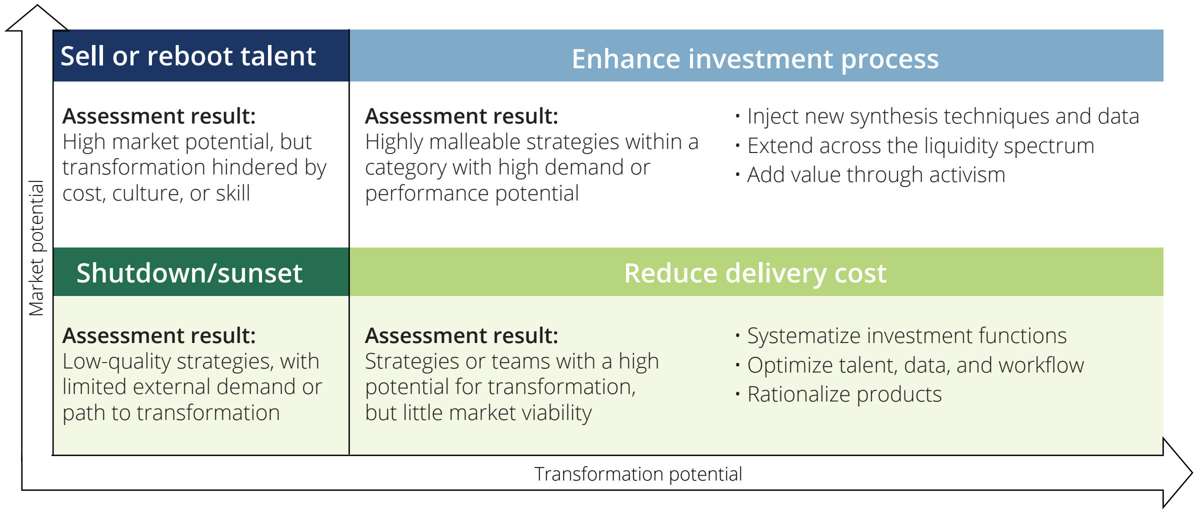
- For strategies with *low transformation potential and low market potential,* little can be done, and the value of shedding costs may outweigh the short-term pain of losing revenue, particularly for loss-making strategies that are melting down from redemptions. In such cases, the least-worst alternative likely involves shutting down the strategy.

Fortunately, for asset managers with creative and strategic leadership, these cases will account for the minority of challenged capabilities. In most cases, change is possible through a wider set of transformation options:

- For strategies with *high transformation potential and high market potential,* enhancing the investment process—through technology, activism, or access to a wider range of capital markets—can differentiate the capability from competitors and potentially improve performance.

- For strategies with *high transformation potential but low market potential,* reducing the cost of delivery increasingly represents the best solution. Raising the contribution margin on such strategies makes inevitably shrinking revenues more profitable, defending or even improving overall economics.

Figure 10. Transformation options for challenged investment strategies



Source: Casey Quirk

Technology will play a critical role in transforming product arrays. New data and systems can provide options for enhancing existing investment processes without changing core philosophies behind security selection or portfolio construction. For capabilities facing lower future demand, technology can help systematize and automate process elements, improving the strategy's profitability.

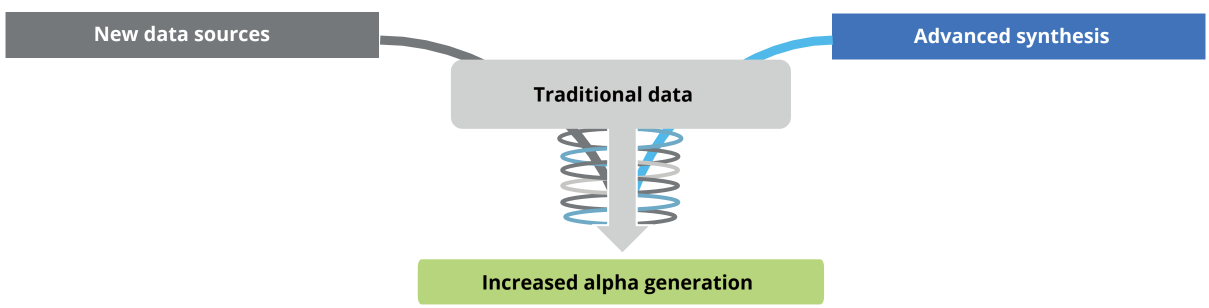
The rest of this paper focuses on the steps that asset managers can take to help improve weaker investment capabilities with moderate-to-high transformation potential. The recommendations particularly focus on the strategies most likely to face challenges: long-only, actively managed quoted equities.

Enhancing investment processes

One of the biggest opportunities for managers of active listed equities resides within challenged strategies with high transformational potential aligned against strong demand. Technology has widened the toolkit for strengthening these weaker strategies, potentially improving consistent outperformance and differentiating such capabilities from less competitive peers. Successful asset managers likely will consider three approaches to enhancing challenged investment processes.

1. **Use new information synthesis techniques and alternative data.** Technology provides portfolio managers ways to find more signals faster, potentially improving their ability to deliver alpha. Artificial intelligence, machine learning, and natural language processing algorithms can quickly process vast seas of traditional equity research data, using computing power to create an information advantage from finding different correlations and conclusions. Better and faster data analysis also offers portfolio managers more informative diagnostics and scenario analyses that can pinpoint suboptimal trades, unhedged risk, and cognitive bias.

Figure 11. Technology in the investment process



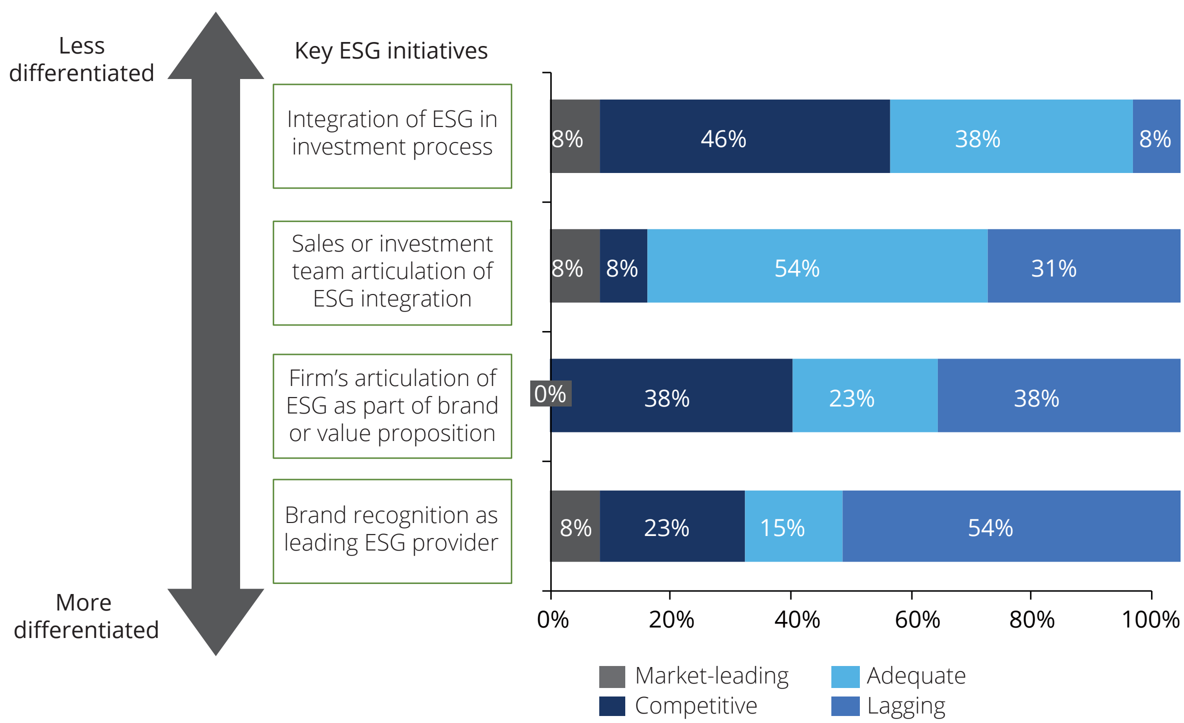
Source: Casey Quirk

Newly created data sets will amplify the power of faster, better analytics. Advanced synthesis already can unlock information from unstructured data sets, such as search engine activity and social media. Revealing correlations between traditional and alternative data will give portfolio managers proprietary insights that they can apply to security selection. Integrated data analytics platforms will allow an asset manager's investment professionals to share and leverage each other's insights more effectively. Leading investment professionals operating in highly liquid, transparent markets such as quoted equities increasingly will need to be, or employ, expert coders that harness the power of an organization's data and analytic infrastructure.

Simply securing technology and data is necessary, but insufficient. Successful transformation will require integrating these capabilities into existing investment teams. This will require asset management firms to become comfortable with new types of talent, such as data scientists.

2. **Flex shareholder muscles through engagement and activism.** For decades, many "active" equity managers have been passive shareholders, often following board recommendations in proxy votes and remaining distant from management. Active equity managers can stand apart from one another—and, more importantly, from indexers—through more vigorous engagement on behalf of their clients. Portfolio managers that vigorously and publicly push directors and managers of companies to create more shareholder value can build a stronger active equity brand, call more attention to their investment philosophies, and potentially generate better portfolio performance. Such potential benefits also apply to active investors comfortable with sustainable investing, often measured with environmental, social, and governance (ESG) factors that an increasing number of individual and institutional investors value, in addition to pure benchmark outperformance.

Figure 12. US and European asset manager self-reported progress toward delivering ESG, 2019



Source: Casey Quirk Distribution Benchmarking Survey

3. **Provide access to less liquid capital markets.** A growing number of active listed equity managers, willing to court controversy in return for competitive differentiation, will likely explore adapting their investment processes and operating models to add illiquid capabilities into their traditional active equity strategies, where permitted and possible. These will include gated foreign exposures, real assets, direct lending, and private holdings at various levels of maturity. Liquidity and transparency concerns among clients will be significant. Distributed ledger technology and other innovations will create deeper secondary markets, and a wider array of individual and institutional investors will take more liquidity risk in a world that remains shaped by low interest rates and quantitative easing.

   Providing curated access to less liquid markets, however, will involve significant evolution of the traditional active equity investing platform, including:

   - Deeper fundamental research capabilities to deal with more opaque markets
   - A robust network of advisors to secure access through deal origination and flow
   - Specialist advisors providing tax, legal, and operating (for e.g., property management) skill sets to aid investment professionals in security selection and portfolio construction
   - An evolved distribution force able to handle more episodic fund-raising and co-investing
   - Fund and pooled vehicle structures highly aligned with the liquidity traits of the underlying assets
   - Enhanced risk management systems and processes

Reducing delivery cost

Many actively managed equity strategies may have high transformation potential but still face shrinking demand over the next several years. Active investment strategies that result in expensive, broadly diversified large-cap portfolios—muddling alpha and beta—are vulnerable to passive competitors. Additionally, equity capabilities geared toward certain client segments, such as corporate defined benefit plans, face shrinking demand because of allocation decisions and de-risking.

Yet such strategies still represent tens of billions of dollars of industry revenue, making drastic moves unsettling and undesirable. Instead, successful asset managers increasingly will explore three ways to deliver such capabilities at lower costs to existing clients, harvesting profits from slowly eroding portfolios.

1. **Systematize investment processes.** Using quantitative tools and techniques to automate equity research functions and handle more portfolio management decisions can make challenged strategies more profitable. Lower-risk "quantamental" approaches will prove least disruptive to existing processes and talent, but likely add more costs than they subtract. More aggressive transitions from fundamental strategies—through parallel development or outright replacement—will reduce human capital costs, but also could rattle clients who favor fundamental research. Most importantly, transitioning to systematic approaches will involve thoughtful approaches to pricing, because most clients expect such strategies to cost less.

Figure 13. Transition approaches for systematic asset management

Support fundamental processes with quantitative tools	Incubate systematic strategies alongside legacy strategies	Replace legacy teams with systematic teams
• Reduced delivery cost by replacing analysts with technology • New quantitative tools may create alpha-generating ideas for fundamental managers	• Revenue upside due to ability to cross-sell redeemers • Decreased revenue risk given product diversity • Significant up-front investment required	• Significant near-term cost savings from rationalization • Lower-run rate cost of delivery • Limited fee potential diminishes revenue upside • Increased risk due to product concentration and potential quantitative crashes
✔ Increasingly viewed as a requirement by investors ✔ If well-executed, may provide differentiation ✖ May not "move the needle" in terms of performance or sales ✖ Change in process or philosophy may lead to turnover	✔ Increases the number of investors that can be targeted ✔ Maintains optionality for the future investment organization ✖ Competing philosophies may present a challenge for the distribution organization ✖ The systematic and smart beta universe is increasingly competitive and fee-sensitive	✔ Viable in integrations; results in clear philosophy ✔ Aligns with industry direction of travel ✖ Limits the target buyer universe to passive and systematic adopters ✖ The systematic and smart beta universe is increasingly competitive and subject to fee compression
Low	Degree of transformation	High

Source: Casey Quirk

2. **Optimize talent, data, and workflow.** By fine-tuning the current operating model and leveraging technology more cleanly and widely, median-sized asset management firms can reduce run-rate costs of delivering investment capabilities by as much as 16 percent. Effective optimization programs, however, will require tough decisions. Process refinement—automating certain middle-office functions and reducing redundancy in portfolio management systems, for example—already has taken place across many asset managers, leaving little left to save. Consolidating trading platforms will have a bigger effect, as will better governing market data, one of the largest investment-related expenses in asset management. True optimization will come from adjusting compensation. Keeping challenged strategies profitable increasingly will involve reducing run-rate pay for portfolio managers, linking more incentives to performance, and delayering poorly performing investment teams.

Figure 14. Optimization levers for investment organizations

	Estimated run-rate savings (% of total costs)	**Primary levers**
Optimize team structures	**3.5–11.5%**	• Delayer or eliminate highly paid underperformers • Adjust investment team compensation • Enhance service delivery model through offshoring or outsourcing components
Streamline data and technology	**2.0–3.5%**	• Consolidate order management systems and trading platforms • Improve market data governance, management, and information delivery • Consolidate vendor relationships
Improve processes	**0.5–1.5%**	• Improve processes to eliminate redundancy and lower risk • Automate areas such as trade operations, compliance recon, and other repetitive processes

Note: Estimated cost savings for a $250 billion AUM asset management firm.

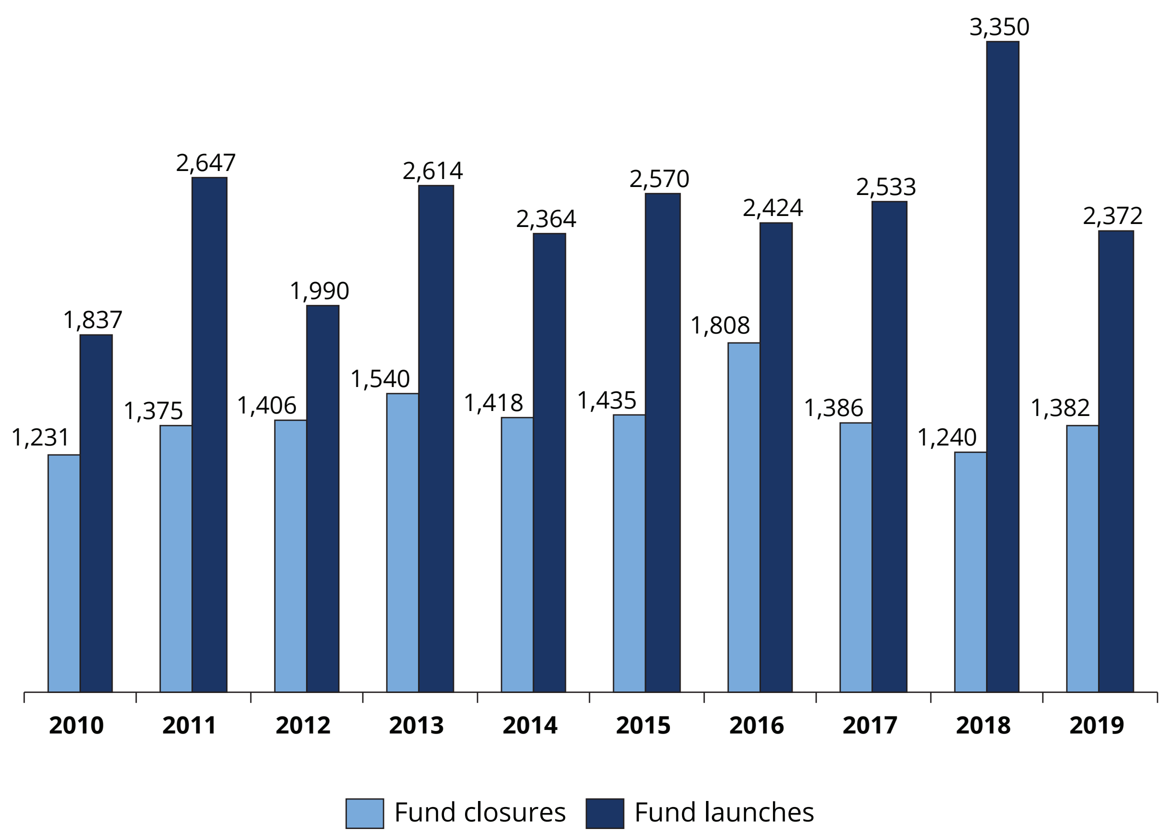
Source: Casey Quirk/McLagan 2019 Performance Intelligence Survey

3. **Rationalize products.** Merging investment products and strategies can create operational and compliance issues, but larger challenged capabilities remain marginally better than subscale ones. As liquid strategies that blend alpha and beta fall out of favor, allocators are less likely to fragment shrinking core large-cap equity exposures across a variety of small portfolios with slightly different objectives and approaches. They also are more likely to accept larger, cheaper active equity strategies as substitutes.

   Thoughtfully combining equity strategies can create larger capabilities that meet professional-buyer minimums and better offset fixed delivery costs. Larger products also remain equally profitable at lower price points, allowing asset managers to retain, and potentially gain, more clients through price reductions. Merged listed equity portfolios will likely migrate toward larger-cap stocks—but that also would make them better candidates for a transition to systematic approaches.

   Not all weaker equity capabilities are candidates for rationalization. Capacity-constrained equity strategies, such as small-cap and emerging markets stocks will not benefit from increased size. Increasingly, however, the lower costs of managing a smaller number of larger capabilities will more than offset any incremental revenue from subscale products.

Figure 15. Worldwide mutual fund launches and closures

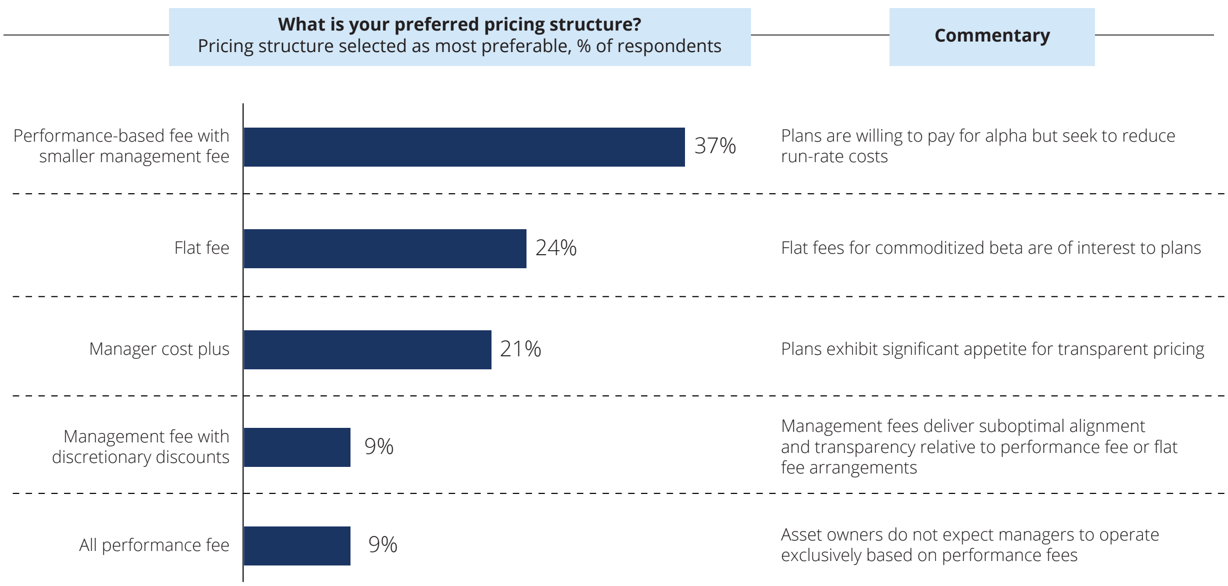


Sources: Morningstar, Casey Quirk analysis

Pricing

Asset managers have an additional tool to make challenged investment strategies more competitive: pricing. Discounts alone likely will be less effective. Absent other changes in an investment strategy, reducing fees often results in redemptions rather than new flows, if clients interpret the move as a loss of confidence. Innovative pricing schemes, based on performance or client tenure, can play a role in differentiating challenged active strategies. Increasingly, professional buyers worldwide seek clients that offer unconventional pricing, particularly as a means of long-term retention.

Figure 16. Demand for innovative pricing strategies among asset owners, 2018



Source: Casey Quirk Large Asset Owner Survey

Conclusion

Transforming less competitive active investment strategies, particularly those focused on long-only listed equities, requires tough decisions and significant change. During the next decade, the role of the chief investment officer (CIO) will evolve more rapidly. While CIOs still will play a key role in overseeing investment philosophy and process, increasingly they will need to make the crucial business decisions required to make an asset manager's product array more competitive for the long term. CIOs who are adept at talent management, comfortable with technology, strategic in their view of capabilities, and able to implement difficult change will provide their employers with significant competitive advantage.

The death of active management—in particular, fundamental, long-only, listed equity strategies—truly has been exaggerated. But innovation is sorely needed. As the small number of consistent outperformers squeeze the rest of the industry, asset management firms need to be creative and strategic with their product ranges and not hesitate to carefully and thoughtfully reshape, or even exit, outmoded and uncompetitive investment strategies. Asset managers with the right mix of high-quality strategies, coupled with well-managed legacy products, will compete effectively in a less forgiving operating environment.

COVID crisis implications

Immediately prior to the release of this paper, the COVID virus unleashed the largest market crisis since 2008-09. Equity values have dropped dramatically, outflows from equities have accelerated, and equity oriented managers potentially face significant top line revenue compression.

It remains too early to tell the performance impact on active management throughout the cycle of the crisis. However, past crises have generally shown the similar performance outcomes to our long-term analysis. As a result, previous crises ultimately served as an accelerator for investors to move more aggressively into less expensive passive alternatives. We expect this crisis will have similar impact. The strongest and most persistent generators of active performance will be best positioned to rebound out of the crisis.

The crisis will likely increase the urgency to prioritize efforts around the cost structure of the front-office and to pursue further product rationalization (which has already been well underway for the previous 3-5 years). When greater certainty arises regarding the end of the pandemic, we anticipate that there will another spike in M&A focused on driving scale and costs savings.

In summary, the strategic changes required to overhaul active equity businesses remain mostly unchanged by this crisis. A volatile market can provide the opportunity for high-quality active managers to prove their worth. And for those less capable, the crisis may expose their weaknesses. Decisive action organized by a salient long-term vision will be essential. Our recommended solutions lay out a clear plan to pursue higher performance, cost efficiency, and organizational focus; all which are essential regardless of the market environment.

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