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A photograph of a person in a wetsuit sitting on a surfboard in the ocean at sunset. The sun is low on the horizon, creating a warm, golden glow across the water. The person is seen from the back, looking out towards the horizon.

Fund Managers

The Complete Guide

MATTHEW HUDSON

WILEY

Fund Managers

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Preface

Is your world a fund, Daddy?

– Rafe Hudson, aged 10

I am writing this book as a natural sister to my earlier book, *Funds: Private Equity, Hedge and All Core Structures* (which I will refer to as the ‘funds book’). This book concerns the managers of the funds. The funds book proved popular with asset managers that use it as a structuring reference guide to their own funds or to check structures of funds different from their own, MBA and finance students, and more widely as part of training for managers, finance professionals, lawyers, and accountants.

This book sits alongside the funds book and examines the managers and their structures, as well as their day-to-day issues, hopes, and aspirations. As such, it is a little more anecdotal than the funds book and contains quotes and ideas from many managers and investors that I work with. The company that I work at – MJ Hudson – advises over 600 asset management groups and 200 institutional fund investors.

I also reference a number of lessons that I have learned (often the hard way) over more than 30 years (so far) in asset management. During this time, I have been a lawyer, asset manager, business builder, chief executive officer (CEO), chief investment officer (CIO), and chief compliance officer (CCO) – a wealth of experience to draw upon.

The funds book focused on alternative asset management. This book is broader and considers managers across all asset classes – although alternatives is more my zone. There is an emphasis in this book on creating and building management companies, as well as the current trend for mergers and acquisitions (M&A) to build scale in an effort to counter complexity, regulation, and multi-investor demand.

In the past, I worked within a fund managers’ incubator at a bulge-bracket investment bank (Credit Suisse First Boston), and I also created a tech-incubator (Far Blue Ventures) which backed new IP-focused companies. I currently help others create new managers, such as Alpha Hawk (an emerging hedge manager incubator, where I am a co-CEO and MJ Hudson runs the infrastructure). Personally, I love new creations, and most of my career moves have involved starting something new. In this book I endeavour, therefore, to focus on the refreshing, the creative, and the new.

Starting an asset management company from scratch is always possible, although regulation has made it harder. I started one from scratch myself in 2000 and have helped many others start theirs. Creation is often the best fun. However, be aware that it might take several years of loss making. No doubt, your first plan will be too complex in its initial excitement and, for all your own joy, investors will want to wait and see. Do not be put off by increased regulatory requirements, but double your annual budget. Also, like any building project, double your first timescale estimates.

Spinning out a manager from a larger group is quicker. My top tip is to have your previous parent invest in the fund as a precursor, but not to invest in the manager, save with a call option in your favour, as this can put off new investors.

Ask yourself whether you genuinely have partners with whom you can establish a management company. If you think that you do, then be super clear, from the start, on what your strengths and weaknesses are. Also, each partner should commit hard cash to the venture in similar proportions and you should map out how the partnership will survive the first bad years. A fund manager ‘seeder’ is a group that invests in the management company. Seeders typically want 20% to 25% of the management company. Ensure there is a call option in your favour at an agreeable valuation. A cornerstone is an investor that cornerstones your fund. Such an investor will want a share of the performance of the fund and possibly a management fee break. Seeders and cornerstones can accelerate your business. The first investors are the hardest to close; everyone wants in once you are successful.

This book considers the ups and downs of the last ten years, as well as future-gazing to threats and opportunities of the next ten. The funds book came out during the immediate aftermath of the credit crisis (that I define as the period from mid-2007 to 2009, that saw the bankruptcy of Lehman Brothers and the collapse of Bear Stearns – to mention just two) and in the midst of the longer financial crisis (that I define herein as the period of negative to low growth from 2008 to 2013).

This book is also most timely, because it is set at the start of what I call ‘the new era of asset management’. This new era is marked by a shift in the focus and energy of regulatory authorities onto the asset management industry, which have been distracted until now with their endeavours to remove the major systemic risk of modern-day capitalism – mass bank failure. In addition (as a Brit), we also find ourselves in interesting times with the United Kingdom (UK) winding up for its departure from the European Union (EU) in 2019 (perhaps!) and dealing with the inevitable fallout. The new era we find ourselves entering is also one of AuM scale or very deep niche skills. The middle is the valley of death. M&A in asset management is becoming prevalent. Regulation, increased substance, increased disclosure, and technology-led threats and opportunities are very much with us, and scale is helpful in managing these challenges.

This book spends some time on the regulators’ new focus on industry practices, as well as the effects changing legislation will have on the UK, EU, and US – the three largest asset management blocs. Chapter 12, however, examines regional differences in asset management, with a particular focus on jurisdictions outside of these three blocs. Clearly, Asia is on a dramatic ascent in asset management.

I postponed writing this book to await 29 March 2019 – the planned date for the official departure of the UK from the EU (Brexit). At the time of writing, the date for Brexit is uncertain (but a second extension on the deadline has been agreed for 31 October 2019), and some words have now entered my swear-word vocabulary; such as ‘longstop’, ‘extension’, and ‘red lines’. Still, the world spins on and the asset management community must continue to thrive and get on with the day job. Similarly, authors must finish books. Thus, in this book, I have assumed that the UK will ‘Brexit’ and leave the EU. That, in my own business, I have assumed from the date of the referendum result in 2016. Hence, I set up a regulated Luxembourg platform in 2017 in preparation for loss of EU financial passports. Also in this book, I have assumed that some sort of withdrawal agreement is signed and trade talks commence soon (or the UK stays in the EU customs union). Either way, I have written this book on the basis that at some point the UK loses the EU passports. More on the B-word later in the book.

The ongoing tussle between man and machine is another important backdrop to this book. Each side to the ‘man versus machine’ debate professes to have humanity’s best interests at heart. Those supporting the use of robots argue that everyone’s quality of life will vastly improve, whereas those that are sceptical of technology’s rise claim that mass unemployment in an already wage-stagnant economy is a dangerous combination. This debate does not escape the boardrooms of asset managers as they look to cut costs, increase efficiencies, and stay relevant to the young.

So-called ‘ESG’ and ‘impact’ fund managers receive a heavy emphasis in this book, as rapidly growing key issues, as explained in Chapter 4.

This book does not examine the prior performance of different types of asset classes. Neither does it predict their future performance or make any detailed assessment of risk and return. Rather, it is a guide to all things fund manager – a mini-encyclopaedia to their structures, governance, regulation, taxation, technology, and, most especially, their challenges and opportunities.

Included in this book are some quotes from interviews that I have conducted with CEOs of asset managers to help me formulate a more immediate and relevant context for the technical aspects of the book. I have deliberately chosen CEOs from a range of asset classes, and all being founders of their company or strategy. This makes them all ‘lively’ and interesting. Their summary biographies are at the back of the book, and they are:

- Private Equity – Wol Kolade, CEO of Livingbridge, a UK-based private equity firm investing in growth and small to mid-cap, also with offices in the US and Australia.
- Hedge – Richard Novack, co-CEO of Alpha Hawk, a new multi-boutique hedge manager investing platform.
- Venture Capital – Alice Bentinck, MBE, general partner and co-founder of Entrepreneur First, a modern and widely acclaimed VC that is a business builder and start-up accelerator based in London.
- Listed manager – Tony Dalwood, CEO of London-listed Gresham House, focused on listed equity and alternatives.
- Social impact – Nigel Kershaw, OBE, Chairman of The Big Issue Group, the world’s most widely circulated street newspaper.

To help with the navigation of this book, a short summary of each chapter is set out below.

Chapter	Contents
1	Seismic Shifts – a look at the macroeconomic, technical, and political changes in the last ten years, with a focus on the most influential trends within the asset management industry.
2	What Is it Like Being an Asset Manager? – a fly-by tour of some hot topics discussed by managers, and the public’s perception of them. In addition, what is it like being an asset manager, and do various strategies lead to different behaviour?
3	Structures and Economics – an introduction to the inner workings of an asset manager. It offers a snapshot of the structuring, fund manager economics, popular manager jurisdictions, fees, and differences between listed and private managers.

Chapter	Contents
4	Governance – a look at how the business of an asset manager is run, with a particular focus on the relevance of boards, committees, and non-executive directors. The growing influence of both external regulation and ESG are also considered.
5	Investment Strategies – a review of the major investment strategies employed in asset management and how they influence asset managers themselves.
6	Investors' View of the Industry – an analysis of different fund investor entities and how they view their asset managers. This chapter therefore considers pensions plans, SWFs, family offices, charities and other investors in your funds.
7	Asset Allocation and Portfolio Construction – a look at how your investors and, by extension, you as the manager, construct a portfolio and some of the theories behind asset allocation. This chapter also reviews historical methodology and considers how some of these theories are holding up in 2019 and what the future holds for them.
8	Technology – an exploration of how technology is being harnessed for investment research and algorithm-driven investment, as well as the threat technology giants pose as potential asset managers in the near future.
9	Regulation in the Asset Management Industry – an overview of the regulatory environment in which asset management operates globally, with a particular focus on the UK, EU, and US.
10	Risk, Compliance, and Regulatory Trends – an exploration of the future of regulation, covering emerging rules, as well as the hot topic of risk and risk strategies in asset management.
11	Taxation – a brief guide to taxation within the asset management industry.
12	Regional Trends – a comparison and analysis of regional trends affecting asset managers, as well as the asset management industry outside of the core blocs of the UK, EU, and US. The future of offshore is also debated.
13	Future Trends – so where does this all lead us? This chapter considers makes some predictions for the next ten years.

Finally, I hope you enjoy this book, as well as learn from it. I have tried not to hold back from voicing my opinions or the opinions of others. Occasionally, I have been deliberately provocative. The funds book is technical and a little dry, whereas this book does contain an element of my own philosophy and personality, and with that (as people that know me would attest) comes both a long historical perspective and a healthy dose of humour.

Taking yourself too seriously, or not casting a questioning eye on either yourself or others makes for dullness and mild flattery.

Enjoy! – London, March 2019

Seismic Shifts

*There is nothing impossible to him who will try.
Remember on the conduct of each depends the fate of all.*

– Alexander III of Macedon

I decided to put down my two favourite Alexander the Great quotes, as someone that distinctly lived for both the moment and the long-term future (which, dying aged 32, he sadly never saw, but I suspect he glimpsed and deliberately defined).

This chapter takes a brief look back at the very long history of asset management, before examining the most influential trends within the asset management industry over the course of the past ten years, including volatility (Vol), growth in passives, rise of the internet and technology, extremism, migration, unemployment, Brexit, generational shifts, the Arab Spring, quantitative easing and then tightening, and the expansion of China. Although an investor's office may seem like a bubble, the asset management industry does not operate within a vacuum. This chapter draws connections between the key social, political, and technological developments over the past decade and relates them to the asset management space.

THE CODE OF HAMMURABI

The origins of asset management can be traced back to at least 1754 BCE and the Code of Hammurabi in ancient Mesopotamia, which set out a primitive system of property law, including basic rules about credit and security. The principal asset class at this time was land and the only people involved in 'asset management' were a limited demographic of powerful individuals. Later, in ancient Greece, international trade fuelled the development of basic banking activities, such as loans to seafaring merchants. At this time, the asset managers were slaves of the wealthy (think The Parable of the Talents). By the end of the Roman Empire, the first basic pension scheme had been invented – with some Roman military officers being given country estates (both for the modern-day financial reasons and to keep military leaders away from the politics of the city).

The Renaissance really ushered in the beginnings of modern-day asset management: mercantilism thrived, the Venetians invented double-entry book-keeping, the merchant banks

grew, and commercial fairs (protostock markets) developed. The sixteenth century saw the rise of extraordinarily large businesses like the British East India Company and the Dutch East India Company, which were so-called ‘joint-stock companies’ – companies in which shares of its stock could be traded by shareholders. This led to substantial wealth creation and the emergence of public markets, culminating in the establishment of the first proper stock exchange in 1787 – the Amsterdam Stock Exchange. Meanwhile, the First Presbyterian Church established the first modern-style pension scheme for its ministers in 1759.

Industrial revolution and technological development throughout the eighteenth and nineteenth centuries led to a dramatic increase in productivity, which gave rise to surpluses, and surpluses meant more investable assets. The asset management industry became much more established and in 1884 Charles Dow created the first stock index. The beginning of the twentieth century (the ‘Roaring Twenties’) was a wild time for asset management with the development of investment theory and rapid economic growth ending in the Wall Street Crash in 1929 and the ensuing Great Depression (which sparked significant US regulatory reform).

In the second half of the twentieth century, asset management experienced a golden age that set the scene for today’s financial sector: the first hedge fund was established by Alfred Winslow Jones in 1949; private equity was ‘invented’ in 1946 by the American Research and Development Corporation and pioneered in the late 1970s (and onward) by KKR; and the first index fund emerged, created by Jack Bogle of Vanguard in 1976.

CREDIT CRISIS TO FINANCIAL CRISIS

The financial crisis is a stark reminder that transparency and disclosure are essential in today’s market place.

– Jack Reed

On Monday, 15 September 2008, Lehman Brothers filed for bankruptcy. Images of former employees packing their personal items into cardboard boxes flew round the world. The anger, despair, but mostly shock of the 25,000 individuals who lost their jobs signalled a fact that many did not want to believe – Lehman Brothers was *not* too big to fail. Rewind to March of that year when Bear Stearns (subsequently sold to JPMorgan Chase) failed and it is difficult to imagine why systemic risk in other banks was not addressed sooner. This was just a snapshot of what was to come. What happened in the following years would be known as the ‘credit crisis’.

The collapse of Lehman Brothers resulted in large government bailouts in order to stabilise the rocking financial system. With Bank of America purchasing Merrill Lynch and AIG receiving a bailout from the United States (US) Federal Reserve, the financial ecosystem looked shaky at best. The cause of this is not singular and has been well documented in other literature – for example, collateralised debt obligations (CDOs), excessive leverage, mortgage mis-selling, securitisation of bad debt, poor judgment by agencies, and disproportionate risk-taking by financiers. This period, chronicled by the media and in film, is seen as a defining episode of the last two decades. A key consequence of this financial meltdown was the increase in financial regulation.

In the US, the Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd–Frank Act) was signed into US federal law by President Barack Obama on 21 July 2010. This legislation was implemented in direct response to the financial crisis and was the single largest overhaul of financial regulation since the 1930s. Underlying the many rules, which

were enacted to prevent similar events occurring again, is a theme of transparency. This has become the watchword for financial reform over the past ten years; used as a stick to beat, but also a badge of pride for those who follow through on their promises. The championing of transparency has been a key trend since the credit crisis.

The 2008 market crash was attributed partly to the housing bubble that burst in the US. The Dodd–Frank Act, in attempting to prevent this happening again, includes provisions to protect borrowers against predatory lending and to prevent abusive mortgage practices. The legislation aims to achieve this by establishing US government agencies to monitor banking practices and oversee financial institutions. Of course this reaction is seen by some as too little too late. The Federal Reserve did little to prevent the housing bubble and central banks in general should have done more to address the financial instability leading up to the crisis. The Bank of England (BoE) took a limited approach in maintaining a financially stable system (post-independence) and the European Central Bank (ECB) did not act in response to the credit surge.¹ Capital reserves pre-crisis were wafer-thin and not sufficient to cover more than a few percent of loan defaults. Some argue that high interest rates made it difficult for these institutions to influence the housing and credit boom. But the regulatory changes that have been enforced across Europe and the US are tools that could have been utilised before. For example, ensuring that banks kept aside more capital (and were not too leveraged, like Bank of America, Merrill Lynch, and Lehman Brothers, which almost entirely financed their purchasing of CDOs and mortgage-backed securities (MBSs) through loans – leverage on leverage) or requiring lenders to lower the maximum loan-to-value ratios for mortgages.

In Europe, these sentiments regarding minimum capital requirements resulted in the Basel III framework. The basic premise is that banks will be liquid enough next time to prevent the domino-like defaulting that occurred in 2008. Banks have also been required to improve the standard and quantity of their capital. This means having a higher proportion of equity to assets or debt. Furthermore, the importance placed on stress tests was felt by several major institutions that publicly failed. This led to banks limiting their diversification and retreating from certain asset classes as they feared the illiquidity and capital adequacy that came with them.

The credit crisis saw many banks fail or bail. Citibank went from being essentially a hedge fund to a retail bank in a sickening squeal of brakes. The credit crisis was a period of bank failure and subsequent regulation and ring-fencing. The financial crisis then consumed the credit crisis. All asset classes suffered. A number of EU member states went bust in all but name (for example, Ireland, Greece, Cyprus, Spain, and Italy) often from excess real estate (RE) excitement pre-crisis. The term ‘PIGS’ (Portugal, Italy, Greece, and Spain) was first used. For a few years, it felt like all the money had gone to the moon.

QUANTITATIVE EASING

A continuous programme of quantitative easing (QE) has kept interest rates artificially low following the financial crisis. QE is a form of monetary policy, the ultimate aim of which is to boost spending in order to increase inflation levels. QE is a process whereby central banks (like the Federal Reserve and the BoE) buy back existing government bonds (gilts) as a way to shovel money into the financial system.² As the demand for the assets increases, so do the prices of those assets which helps to raise inflation. As commercial banks receive more funds from the repurchase of the gilts, they will be encouraged to fund more loans to companies and private individuals.

During the period from 2008 to 2016, the BoE bought GBP 435 billion³ of government bonds. Although critics of the policy have argued that it helped to inflate asset bubbles, the BoE's own research has pointed to the benefit seen by individuals on the lower end of the housing market.⁴ For those people, the increase in housing prices meant a bigger proportional rise in the value of their assets than those towards the top of the market. However, the gains made on cash were far more substantial for the wealthiest in society. What is clear from the BoE's research is that every age group and every income group was better off as a result of the QE policies that were introduced.

The US and UK have both ceased QE (for now) and, in December 2018, the ECB also ended its policy of QE, although it might change its mind in 2019, as the EU lurches towards a wild recession. The ECB's policy entailed spending EUR 30 billion a month on buying bonds, which, similarly to the policy in the UK, was introduced in the years after the financial crisis. Since this was introduced, more than EUR 2 trillion has flowed into the European economy,⁵ which the ECB states arrested deflation and prevented any progression of the economic crisis. Similar to the criticisms of the BoE, this policy was derided by some because of the disproportionate gain for the wealthiest in society. However, it seems stating the obvious that those with a greater share of assets will benefit more when those assets increase in value. What the evidence suggests is that the individuals at all levels benefited from the policy and it helped prevent a further decline in the world's major economies.

SPOOKY MARKETS

As the financial crisis settled, spooky markets developed.

I would describe the last 20 years as the 'Long Sideways', which first started after the biggest of post-war economic implosions – the dot-com bust of 2000 (see later on dot-com bust II). Despite an even odder period from 2004 (launched by the 'success' of the Iraq War) to the credit pop of 2007 (a period characterised by extreme credit pumping and wild times), the markets have moved sideways since 1999. The FTSE 100 was below its 1999 peak in 2018.

With QE lifting the markets from their drop, and with generationally low (effectively nil) interest rates, we have spent the last four years in warm treacle – little growth, little activity, little Vol – all in all, somewhat false and spooky. This also gave rise to significant growth in passive or index funds that drifted gently upwards on these warm winds.

The years since the credit crisis also saw the banks pumped up, sometimes unwillingly, with too much capital. Barclays tried to escape state financing with a Qatari investment, which one might have thought a courageous thing to do – to not take money from the nanny state. However, its senior management are now, in 2019, being pursued by a previously wounded and maligned Serious Fraud Office (SFO). Banks had to spend the excess capital and QE somewhere, and have (in the UK and US) pushed much of it towards the residential mortgage market (as first-house mortgages are highly balance-sheet 'good'), as well as investing a lot in private equity (PE) leveraged buy-outs (LBOs) and bonds on large leverage multiples.

However, since February 2018, we have finally seen some changes – action – Vol. If President Donald Trump is to be believed, this is partly caused by the Federal Reserve increasing interest rates quickly. But the cessation of QE and beginning of quantitative tightening (QT) has also been a major factor – with some encouragement of Vol around trade wars and a

slowdown of growth in some parts of the world (China, especially). In 2018 there were 110 market swings of at least 1% in the S&P 500, compared to only 10 in 2017 – yes, 2017 was really spooky.

Perhaps 2018 marked the end of the 20-year Long Sideways. We should also now see the strike back by actively managed funds from 2019. That said, Japan has been in the Long Sideways since the end of the 1980s, so I do not believe the Long Sideways in the UK, EU, or US has ended yet.

Ageing populations, anti-youth immigration, the distraction of politics, the rise of passive funds, and lack of investment panache in both the UK and US will keep us longer moving sideways.

RISE IN ALTERNATIVES

During the financial crisis and beyond, alternative asset classes – private equity (PE), real estate (RE), hedge funds, illiquid credit, and other such asset types – have been growing more popular. The total assets under management (AuM) of alternative assets sits at over USD 7 trillion globally,⁶ which is principally spread across 562 managers as at 2018.⁷ PE managers alone have experienced an 18.5%, or USD 325 billion, increase in funding from investors between 2015 and 2018. Even more impressive are the levels of ‘dry powder’ that PE managers are holding. Dry powder is a market term referring to money raised by PE managers that has not yet been allocated towards the purchase of whatever assets the manager specialises in. The 2018 levels sit at USD 1.5 trillion,⁸ which suggests that PE managers are having a tough time sourcing deals they believe are reasonably priced.

Alternative assets have been seen as a form of diversification since the early 1990s when Yale Endowment created annual returns of nearly 20% through allocating roughly a third of its portfolio to alternatives. The increasing difficulty in generating alpha and hitting investor targets post-financial crisis has led many investors to start to pursue similar strategies to those of Yale Endowment. This is a step-change from a management model to an outcomes-based approach. Added to which, the return of Vol to the public markets in 2018 and the possible end of the 30-year bull market in bonds might make the long-term nature of closed-ended PE, RE, and infrastructure funds more attractive to pension plans. That being said, the increasing prevalence of alternative assets in sovereign wealth funds, pension funds, and both active and passive portfolios begs the question – are alternatives now mainstream?

The increasing popularity of alternatives and what that means for the wider industry is discussed further in the book. In addition, with interest rates at effectively nil, and banks hand-icapped by regulators, the thirst for yield has seen a ballooning of both private credit⁹ and infrastructure funds.¹⁰

THE ARAB SPRING

The term ‘Arab Spring’ was used by the American political scientist Marc Lynch to define the period from 18 December 2010 to the current date of violent and non-violent protests and civil wars in the Arab world.¹¹ The advent of the Arab Spring was not foreseen by experts in Middle Eastern politics. This misreading of the situation begs the question – what caused the Arab Spring? It has been suggested that there are four possible causes: demographic change, social media, *karama* (human dignity), and economic liberalisation without political reform.¹²

First, the uprising against authoritarian regimes may have been caused by the population of the Arab world almost tripling from 1970–2010.¹³ This resulted in a generational shift, with around 30% of the population in the 20–35 age bracket. In tandem with this change came high unemployment, increases in the cost of living, and limited opportunities. This was a key reason why the Arab Spring occurred.¹⁴ Second, the increasing prevalence of social media was a main driver. This enabled the flow of resentment felt by the increasing youth population to disseminate quickly amongst the Arab world. Third, the underlying theme amongst the range of uprisings across the Arab world was the focus on ‘human dignity (*karama*), freedom, and social justice’. This pursuit of an intrinsic respect for the human experience by members of the Arab world is a unifying theme and indicates that commonality can be felt in the pursuit of social and economic improvement.

MIGRATION

In August 2015, the image of a young boy lying lifeless on a beach near Bodrum in Turkey shocked the world. Yet what was the cause of the largest migration Europe had seen since the Second World War? Why were so many people dying? What could be done about it? When examining the biggest trends in the past ten years it is impossible not to ask these questions about an issue that permeated every news outlet across Europe and the world.

As a brief introduction, it is important to outline the key moments that resulted in over 1 million migrants crossing the Mediterranean Sea in 2015 and many hundreds of thousands since. War and terrorism in Syria and Iraq, along with the Arab Spring, are perceived as the principal causes of the migration crisis. This has facilitated the flow of migration through the Central Mediterranean Route. The EU was able to stop migrants travelling along other routes through negotiation and compromise with more stable governments (for example, the EU–Turkey Deal prevented migrants from entering Europe through Turkey). In 2015, the migration crisis hit critical mass with high death tolls and a constant news cycle of despair. In response, the EU began Operation Sophia to prevent people-smuggling. In 2016, assaults on German citizens during New Year’s Eve created a huge backlash against Chancellor Merkel and her government’s migration policies that had allowed over 1 million migrants into the country. Originally, her position was widely praised, especially considering other countries with strong economies were reluctant to take migrants. However, news reports that German citizens had been assaulted quickly resulted in negative press and a suggestion that opening the borders had been unwise. Chancellor Merkel has since decided not to run for re-election in 2021.

Migration has been a constant theme for millennia, however. People and tribes move for security, out of fear, hope for the future, or need for food or water. Migration built the global superpower that is the US and equally caused the collapse of the Western Roman Empire.

RISE IN POPULISM

What is there to be nervous about?

– Toomas Hendrik Ilves

Populism can be broadly described as a political approach that attempts to appeal to anti-establishment sentiment amongst the general public, and, in particular, to those who believe their values and interests have been ignored by the ruling elite.

Within the last ten years, there have been clear examples of this strategy characterising the political discourse as a binary division between legitimate and illegitimate. The level of debate is reduced so that nuance and context is often erased. This results in the framing of political arguments in the simplistic terms of ‘us’ versus ‘them’. By ‘othering’ their political opponents, populists race to the edge and base their ideological strategy on a siege mentality. Often perceived as a criticism of the ‘Right’, this approach is felt on both sides of the political divide. If anything, the allegiance to one particular movement or another is counterintuitive to the populist movement. Although this may appear to be a reflection of the democratic will of the people, populism reaches for the base fears of the public. This perception that populists speak truthfully is a combination of our own prejudices against establishment politics and the conventional political class’s inability to connect with the people. Populists are no more transparent than establishment politicians are, but they often have the media savvy to present themselves in this way. It is the politics of appeasement, and in the pursuit of the top job, populists encourage a race to the bottom.

Yet, in a world where soundbites rule the airwaves and image is more important than substance, populism is on the rise. According to the Institute for Global Change, since 2000, the number of populist parties in Europe has nearly doubled.¹⁵ The rise of populism in Europe over the past two decades marks the most significant transition in political thought since the Cold War. From Central and Eastern Europe to the Baltic, and now Italy and the US, populism has entered the political discourse and integrated itself into government. However, although populism appears to just be the positioning of oneself against the establishment, it is no easy feat. It is a deliberate strategy designed to influence and change mainstream politics. Although it may seem scattergun, the policies of populists are not random. They share common themes (for example, protectionist economic policies) and embrace similar political processes (for example, referendums).

In Eastern Europe, populist parties have acted against fundamental components of a pluralist society (for example, free press, constitutional courts, and civil rights). President Vladimir Putin’s influence as a strongman and populist-in-chief is also felt strongly throughout East and Central Europe.

In Western Europe, the spread of populism has not been as extensive but the impact it has made is arguably greater. Marie Le Pen doubled the voting share of her father and made the second round of the election in France. Although she did not win, undoubtedly she shaped the political landscape for that period. The German parliament has had a shake-up with around a quarter comprising members from the Alternative für Deutschland (AfD) and Die Linke.¹⁶ In the UK, Nigel Farage (and others) pushed a patently populist message (‘freedom’ and ‘independence’) to swing the Brexit debate in favour of the ‘Leave’ campaign. It was partly the threat of the United Kingdom Independence Party (UKIP) that pushed Prime Minister David Cameron to call the Brexit referendum in the first place. Farage’s anti-establishment, anti-immigration, and anti-institution approach carried all the hallmarks of a traditional populist message. His ‘take back control’ message and persona as a man of the people holds commonality with other politicians (for example, Vladimir Putin, Donald Trump, Marie Le Pen, and Boris Johnson) who have positioned themselves as ‘outsiders’. Of course, the irony of populist outsiders is that they are often themselves from super-privileged backgrounds. President Obama tried to make this point about then presidential candidate Donald Trump, but the blow obviously did not land.

The resurgence of populism in France, Germany, and the UK (amongst others) has caused the mainstream political parties in these countries to move closer to their respective leanings.

In Southern Europe, the Left-leaning populist parties have enjoyed the most traction. They project themselves as standing up to the establishment and aim to find and eliminate corruption. Synonymous with other general themes of populism these parties tend to endorse self-determination and a reclaiming of sovereignty. In contrast with more Right-leaning groups, this iteration of populism espouses anti-austerity rhetoric in the form of economic sovereignty through financial self-determination. Similarly to Western Europe, the rise in populism has resulted in some politicians running to the Right or Left. In Italy, we have a curious government from both the edge of the Left and the edge of the Right. Brazil has just appointed a heavily Right-leaning president who admires President Trump openly.

Although it can be shown that there has been a growth in populism throughout Europe over the past decade, it is less clear what its impact has been or will be. Specifically, whether the rise in populism has caused centrist parties to become more populist as well. Not a day goes by when something sensationalist is said in the press or on social media by a politician wishing to make a statement. Whether this translates into actual policy is another question. Suffice to say, politicians are becoming simpler in their messaging, less statesmanlike, and, frankly, ruder.

So where does this leave asset management? With nowhere to hide perhaps. Embrace the populist move or stay very quiet? Either way, I suspect politics will reach further into asset management. With social media, populist rhetoric is in constant circulation. There is little chance for asset managers to avoid being labelled as part of the ‘elite’ or ‘establishment’ against which populist politics rallies.

I wish I had the answers. My best advice is to stay dynamic and flexible. New laws might usher in higher taxes, the flattening of the offshore world, and the restructuring of the elimination of double taxation on returns (such as limited partnerships, Open-Ended Investment Companies (OEICS), investment trusts or offshore funds). Whacking rich bankers (and related finance managers) has always been popular since the credit crisis, and we can expect more regulation to this effect. So far, asset management has had a comparatively easy time of new regulation. Expect this to change.

BREXIT

Brexit means Brexit

– Prime Minister Theresa May

On 23 January 2013, Prime Minister David Cameron gave a speech at Bloomberg discussing the future of the EU. In this speech, he put forward his opinion that he was in favour of an in-out referendum to decide on a new settlement for the UK in relation to the EU. This was followed by a pledge in the Conservative Party Manifesto for the 2015 general election to hold an in-out referendum. On 23 June 2016, the UK voted to leave the EU. This result was not widely anticipated by the national media or the markets. What ensued was a collapse in sterling and disbelief amongst large portions of the political elite. There were arguments on both side of the spectrum – some strong, some weak. Broadly, these were structured around democracy, the economy, politics, ‘foreigners’, togetherness, and credibility.^{17,18}

‘350 million pounds a week for the NHS’ ... ‘immigrants are taking your jobs’ ... ‘the economy will collapse’ ... ‘house prices will crash’ – this was the start of the ‘project fear’ that arguably both sides ran. Both campaigns fell into blunt, simplistic, ‘who cares if it is fake’, rude, political soundbites.

So what does Brexit mean for fund managers? To me, Brexit means that at some point, the UK will leave the EU. I know this sounds obvious, but this simple fact is sometimes lost in the angry noise. Thus, asset managers have to assume that the UK will lose its passport for raising money in the EU. Similarly, EU member states will lose their passport to market to the UK. This is the safest bet, even in light of the FCA’s agreement with ESMA and EU regulators in February 2019 regarding cooperation in the event of a no-deal Brexit.

Therefore, prepare early and create an EU hub for distraction and management. This, combined with the increased need for ‘substance’ (more on this in Chapter 10), means money flowing out of the UK to establish a real presence in the EU, if we want to access it (we do not have to).

Beyond that, the effect of Brexit is minimal on the day job. However, its mid-term effect on the UK economy and trade and its long-term effect on the world’s view of the UK, appearing small and in need of ‘independence’ (I thought people declared independence from the Brits, not the other way around?), cannot be properly measured yet. Nor can what will be a hit on the City of London. I have a lot of faith in London to continue trading as it has so successfully for the last 2000 years. Londoners are, on the whole, pragmatic and reasonable. However, the City was a bit of a damp backwater until the Big Bang (the period of drastic financial services deregulation in the UK during the 1980s under Prime Minister Margaret Thatcher), and the helpful US ‘invasion’.

As a Brit, I hope that the US stays with us. We need the US to maintain some idea that we are a strong nation in the post-Brexit world. The only other option for greatness without the US supporting us as a 51st state, is to dramatically cut tax and regulation and out-Singapore Singapore. The problem is that Singapore is located in the young and fast-growing powerhouse of South-East Asia.

The notion that the Commonwealth nations will come back and help their former master, especially after their major assistance in two world wars, is clutching at very short straws. I wish some of the people that now produce Brexit-related soundbites had studied history more carefully at school.

SOCIO-ECONOMIC DIVIDE IN EUROPE

The interrelation of migration, health, populism, education, intergenerational conflict and wealth all lead into the discussion concerning inequality throughout Europe. It is not just a discussion about people who have money and those who do not. It is a more nuanced discourse, which requires an understanding of the transmission of wealth through generations and the perception of what it means to be advantaged or disadvantaged. This section will examine some of the key reasons why the socio-economic divide in Europe is growing and what that means for generations to come.

Broadly, since 2007, the economic recovery has not led to issues of inequality being redressed. First, income inequality is at its highest level since records began. According to the Organisation for Economic Co-operation and Development (OECD),¹⁹ during the 1980s,

the wealthiest 10% had average incomes 7.5 times higher than the poorest 10%. Today, the difference is around 9.5 times. This is combined with high levels of household debt, which in times of Vol is particularly dangerous. In the UK, the levels of household debt are a serious concern amongst analysts examining the risks associated with the property market. Underlying this is the perennial problem of wealth distribution. Today the unequal distribution of wealth means that 10% of the richest households possess 50% of the total wealth.²⁰ Perhaps a more revealing statistic is that the poorest 40% in society hold barely over 3% of wealth.²¹ How you examine the data will always bear a significant impact on the conclusions you draw. For instance, were you to examine the salary increases within the technology or finance sectors over the past ten years you would notice that they have seen an upsurge. In contrast, unskilled workers have seen far greater pressure on their pay packets and face a relative change in their wages which helps drive the inequality seen in those industries. This perhaps explains, in part, the recent voting patterns of certain demographics in various elections and referendums within the eurozone. It is not just the salary that is contributing to the rising inequality throughout the EU, but also the changing working patterns.

The flexibility afforded by part-time work and zero-hour contracts was championed as a solution to changing family structures, youth unemployment, and new approaches to work. Yet, with the growth of the gig economy and the lack of safeguards for employees, this particular solution for unemployment is not necessarily a perfect solution for everyone. For example, despite unemployment levels in the UK at a four-decade low²² the rest of Europe has in the past ten years faced significant levels of unemployment. Indeed, in 2015, Greece had an unemployment rate of 24% compared to Iceland's 4%.²³ This is partly caused by less structured working patterns in the form of part-time and temporary work, but also wider issues concerning working conditions and labour market structures.²⁴ This is particularly prescient in the UK where zero-hour contracts have become a political talking point in the past couple of years.

When comparing nation to nation, there have been major inequalities in employment. Indeed, during 2015, there were still 1.4 million fewer jobs than there were during 2007.²⁵ Older people have postponed retiring or have applied for lower-skilled jobs – a major issue in Italy, Greece, and Spain.

ACTIVE VS. PASSIVE

The growth in passive investing is a key trend of the past decade. Post-financial crisis, passive investing has risen inexorably. A manager's goal is generally to beat its benchmarks (the market). In contrast, passive investing does not require an assessment of an individual investment. Passive investors follow a particular index by trying to own all the stocks in that index in the proportion they are held in that index.

The debate over whether it is better to invest in passive or active funds has been going on for years and is one that is constantly referenced in all sections of the financial press. One of the most scathing reports of recent years has been the FCA's on actively managed funds. Perhaps unfairly, active asset managers (mainly of retail funds) have been staring down the barrel of the FCA's Beretta. They are the subject of current proposals for greater pricing transparency, as a result of some startling statistics showing that actively managed funds underperform passively managed funds due to the high and often quasi-hidden pricing. Whilst the logic is sound, and index-hugging should be a passive activity, you cannot help but feel sympathy for active fund

managers trying to compete with funds that have been tracking a rather healthy economy, a false market driven by QE, and interest rates engineered to zero.

Passive funds and their proponents articulate their perceived advantages regularly. Some of the typical arguments that are made in favour of passive funds are that they are cheaper and have performed better than their active counterparts since the financial crisis. Research has shown that 75–85% of active managers in the US underperform their benchmark.²⁶ Passive funds are unemotional and their construction merely follows the rise and fall of the companies share prices in their portfolios: follow your winners and reduce your losers. Investing in a passive fund also, they claim, prevents the risk of an investor inadvertently choosing an active fund that is actually an index-tracker in disguise²⁷ (although the FCA is cracking down on this in the UK).

Whether one form of investing or the other is better is up for debate. The truth, and sometimes the facts, often depend on who you ask. Dan Hunt, a senior investment strategist at Morgan Stanley makes this point. He states that it is important to take a nuanced view, but that ultimately it comes down to the priorities, goals, and timeline that an investor has. For example, someone who is anti-risk and does not want to incur any fees that are not strictly necessary would undoubtedly plump for a passive fund. In contrast, someone who is not so averse to risk and wants a higher return than tracking the index could provide would invest in an active fund. Interestingly, an actively managed portfolio can also offer the risk-averse investor steadier returns, even though they may be lower, as compared with an index-tracker, as hedging strategies are often implemented to counter market fluctuations rather than follow them.²⁸ The truth is that most investors probably sit somewhere in the middle. Investing in a combination of the two would provide a better answer for most investors.

I have to confess to a prejudice in this debate, as an active PE investor myself. I predicted, at the start of 2018, that passives were due a correction, as the soft momentum of the gentle upwards for the previous four years – with little Vol – was due to end. Passives were also in danger of creating an existential issue, where they could not get bigger than actives. If passives represent too much of a market, they end up eating it. Like yin and yang, or the Jedi light and the Sith dark side, both need each other. Passives need a larger active market created by actives to be able to have a ‘market’ to passively follow.²⁹ If more money flows away from actives and into passives, companies with significant index weightings will see their stock over-purchased and companies that do not, or rarely, appear in indices will be under-purchased, resulting in serious market distortion, as the underlying financials and other fundamental indicators of portfolio company value are increasingly ignored in favour of simple market capitalisation.

GENERATIONAL SHIFTS

The evolving combination of Baby Boomers, Generation X, and Millennials in the workforce is a topic of perennial discussion within the commercial world. Every generation faces new and old challenges. Some are not inherent to the world of work, but part of a much wider discussion about the role of society and where we fit within it. Housing, job prospects, politics, and even avocados have been part of the discourse centred on what it means to be a Millennial. However, the influx of Millennials into the workforce has also created a discussion about the different approaches to work. Often derided as lazy, weak, self-absorbed, profligate, and erratic, a dominant trend in the media is how fickle the Millennial workforce is. This section

will attempt to debunk some of these suggestions but also understand why they are made in the first place.

‘Millennials do not like work. They do not want to hold down a job and work for long-term rewards. Instead, they want to go find themselves on some far-flung island or at a full moon party in Thailand, where they can drink niche spirits and dance whilst covered in luminous body paint.’ The *Harvard Business Review* (*HBR*) suggests³⁰ this characterisation is unfair. Indeed, the reputation that Millennials put in less than what they expect to get out is quantitatively and qualitatively not true. *HBR* points out that Millennials want to be seen to be working hard and are more likely to forfeit unused holidays. Yet they are perceived as entitled and lacking in motivation. One study³¹ points out that there is probably little validity in any claim pointing to differences between generations in the work place as a new trope. Indeed, young people have always been perceived as different. The qualities that older generations associate with Millennials are the very same qualities that they were once accused of. Rather than assuming young people are different now, perhaps the answer is that older people have changed. The differences that are oft-cited are in fact minimal. A point convincingly illustrated by a study³² from IBM’s Institute for Business Value, which measured ten variables. One particular variable, the desire to make a positive impact on their organisation, demonstrates that Millennials actually care more about where they work.

Another criticism of Millennials is that they do not stay in one role for long and that young people today will have three, four, or five different careers. However, in the US, the average length of time a person in their twenties stays in a job is broadly similar to what it was in the 1980s.³³

So, the real conclusion here is likely that young people want and need more money, they take time finding out what it is they are good at, and what it is they want, and their motivations have always been thus and always will be. Job turnover will be particularly high in the early stages of a person’s career and relatively low in the latter stages.

There is equally some truth that the Baby Boomers have ridden strong economic waves and have significant RE value and large pensions, ‘taken’ by us (I am a Baby Boomer) as a gift from our parents’ darn-your-own-socks postwar spirit. The credit crisis we caused for the young today has also kept the younger generations’ pay low for over ten years. So, perhaps we owe the younger generations something here.

Each generation seems to perceive the ones that follow it as soft and luckier than they are. Certainly, my grandparents’ generation thought the postwar children had it better than they did. Each younger generation perceives the one before it to be out of touch. A classic line from *West Side Story* – a child to his parent in response to the parent’s “when I was your age” – sums it up best – ‘you were never my age’.

Asset management has also grown tremendously with the Baby Boomer generation in charge of the rise of global growth. We are now seeing increased succession questions, and managers like Blackstone, KKR, and Carlyle are all appointing the next generation. Expect subtle changes, such as technology growth and a closer focus on environmental, social and governance (ESG) issues, under the new and youthful leadership.

We all need to be sensitive to generational differences – even though I suspect they are actually small differences – if we are to build businesses with strong cultures. Listen, adapt, give a little, and build loyalty. Provide roles with clear direction and be sure to understand younger people’s philosophy on work in order to attract the best talent in the marketplace.

GLOBAL INFLATION

The first method of understanding inflation that is commonly used is the Phillips curve. It demonstrates that as levels of unemployment change there is a direct and foreseeable impact on the rate of price inflation. This theory was modified during and after the 1970s, where it looked like the correlation did not actually exist. The Phillips curve is now characterised as a series of smaller curves operating within a long-run Phillips curve. This theory is important as it gives central banks the potential to manipulate inflation levels through fiscal stimulus. By spending money, the government generates growth, which in turn reduces the number of unemployed. As this talent pool restricts, companies have to offer more competitive wages to attract employees. This puts workers in a stronger negotiating position to facilitate better wages, which will have to be met by their employers. The companies who now have a higher wage bill will pass this on to the customer by increasing the price of their products, resulting in price inflation.

Apart from the Phillips curve, the Fisher equation is also widely used as a tool in comprehending how inflation works. The Fisher equation, also known as the Fisher effect, is a theory proposed by Irving Fisher that scopes out the dynamic between inflation and both the real and nominal interest rates. The Fisher effect posits that the real interest rate is equal to the nominal interest rate subtracted by the expected inflation rate. Thus, unless nominal interest rates rise at a rate equal to inflation, real interest rates will fall as inflation increases.

Post-2007, the party line was economic recovery. Yet, for a large part of the past ten years, there has been a general global trend of low inflation rates, with the targets set by central banks often being missed. Along with the decline in oil prices, 2014 saw inflation rates wane to low and sometimes negative levels. This raises two obvious problems for any economy that has been stuck with this problem. First, when inflation is below the target set by a central bank it suggests that the monetary policy in place is ineffective or that the central bank is not serious about meeting its inflation targets. Second, low inflation is linked to periods of deflation, which in turn is symptomatic of a poor economy.

There are several non-financial theories as to why there has been low inflation across the world over the past ten years. In the US, prior to 2018, inflation rates had not reached the 2% target set by their central bank since 2012. One of the core arguments for this trend is the higher productivity attributed to improvements in technology. The argument is that this technology not only helps productivity growth, but also results in suppressed unit labour costs, which has in turn restricted inflationary pressures. Japan has suffered low inflation for a prolonged period, with one theory suggesting that ageing is a primary cause. The argument states that where old workers with firm-specific skills lose their jobs, they tend to go into entry-level jobs instead. This has a negative impact on younger workers' wages, which results in deflationary pressure. We have seen this in Italy and Spain. On a larger geographical scale, one of the contributing factors to this trend of low inflation is globalisation.

Another problem with inflation is an increasing trend for banks to set inflation targets. Since 1989, when New Zealand introduced the first form of inflation target, the number of such targets has grown to 28, with 21 emerging market economies and nine advanced economies doing the same thing. By making inflation the focus of their monetary policy, a globally low rate is to be expected. As the number of central banks that set inflation targets increase, it is likely that inflation levels will stay low.

As discussed above, there have been signs that this Long Sideways era of low growth, low inflation, and low interest rates may be coming to an end with US government bond yields, and yields of those issued elsewhere, tending to rise.³⁴ Whether this really does signal increased growth, inflation and interest rates remains to be seen.

So, how do asset managers deal with inflation? I have found over the last ten years that they do not reduce their anticipated returns low enough to handle a low inflationary environment. They stick for too long setting out their previous returns. Frankly, with no inflation, why set returns more than a few per cent in equities, and 2% or so for fixed-income? Growth is hard to come by in a low-inflationary economy.

IMPACT OF THE INTERNET

Tim Berners-Lee, Robert Cailliau, and a team of incredibly talented individuals (along with some abstract thinking) changed the world. Very few people leave an indelible mark on history, but the members of *Project ENQUIRE* and its later incarnations at the European Organization for Nuclear Research (CERN) did. The ‘World Wide Web’, which we now more commonly refer to as the ‘internet’, and all that has been made possible because of it, has helped shape the way people interact, do business and experience their lives. First created during 1990, the utility of the internet has grown dramatically over the past three decades. Specifically, over the past ten years there has been a notable shift in how it has impacted business and the asset management industry as a whole and with the rise of broadband, mobile dependency and efficiency, and social media – the ‘always on’ culture – has ensnared us.

Comparisons are often made between the latest iPhone and the computers used for the Apollo space mission or the technology available to President John F. Kennedy during the Cuban Missile Crisis. The processing power of the latest smart phones would be unimaginable to employees 10, 20 or 30 years ago. The transmission of information and the sharing of ideas is now infinitely easier. This has altered the way people engage with their work and how they interact with others. The ability to communicate seamlessly through video, conference calls, and encrypted chat from any location provides an unprecedented degree of flexibility. This provides a variety of advantages for asset management that engender a more dynamic and collaborative work force.

First, modern technology’s association with the internet has improved the access which clients and colleagues have to employees. This means that decision-making can occur at a faster rate, and that the right people can be involved from the word ‘go’. This simplifies the process by putting all the right parts in place, requiring less organisation and effort.

Second, for the majority of businesses, client contact is vital. Therefore, from the perspective of the client, the care they receive is directly related to how easily they can contact an employee. Consider that, in 2016, 89% of asset managers had a social media presence.³⁵ Mobile phones and other technology have enabled a higher rate of communication which gives clients more contact time. Although, this perhaps has raised the bar higher and perhaps in some situations creates an unrealistic expectation, which will inevitably not be met. The French have enshrined the ‘right to disconnect’ in the workplace by requiring employers to ensure employees do not have to check their emails outside office hours. The encroaching presence of mobile phones in people’s home lives may be mostly beneficial to their employers but it is also being blamed for relationship issues, lack of sleep, and high levels of stress. The value of talking to someone face to face has not been erased. It may be that the increase in technology has actually

raised the premium placed on business relationships being maintained in person. Moreover, as it becomes easier and easier to send an email, the value in arranging to meet with someone will be higher.

Mobile phones have not just made communicating easier, they have had a dramatic impact on the rest of our lives. This is driven by the vast majority of mobile phone owners using their devices to view content and information. Anybody with a product to sell or market needs to utilise this technology to be organised, drive connectivity, and network. Yet what is apparent is that these high usage levels are now forging change at a societal level. Try walking down a street in London and counting the number of fellow walkers that are not reading their mobile devices. Look across a restaurant and spot those diners actually talking face to face with others. Mobile devices and the internet have changed our lives. The ultimate punishment for a parent is to remove the device from the child or change the Wi-Fi code.

Third, the internet has facilitated not just how we talk with each other but how we interact financially. Money transfer services such as PayPal, Worldpay, Apple Pay, and Google Pay are now being integrated into our daily lives. From relatively humble beginnings, PayPal began as an idea for an online encrypted library. The original concept was imagined by Max Levchin, who upon seeing a lecture by American businessman Peter Thiel (who later invested USD 750 000 in Facebook) combined forces to develop PayPal. The speed at which this market has grown is marked by the arms race between the major players in today's technology sector. Google and Apple have both launched their own products in the last ten years. Apple Pay, which is combined with finger print technology, has changed the day-to-day shopping dynamic. Carrying cash or lending someone change becomes obsolete with the facility to pay the exact amount by using your phone. This method of payment is both incredibly intuitive and prevalent. Individuals with mobile banking and money transfer services are now completely autonomous from high street banks.

The speed and depth of the internet and mobile devices has not only changed the way asset managers operate over the last ten years, but also given them significant opportunities to grow. Access to clients – and retail – has never been easier, and tech-savvy younger people expect to be able to flip in and out of finance units and ideas. The US Jumpstart Our Business Startups Act (JOBS Act) allowed USD 50 000 unit ticket sizes, and pension reform enables individuals to have more control over their money. Increasingly, PE, private debt, and RE managers are now accessing what we would have all called retail money.

The internet really has changed everything. Clever asset managers embrace its possibilities, facilitating immediate and transparent access, information, and investment. However, clever managers appreciate clients still value old-school, face-to-face relationships.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE ISSUES

Environmental, social and governance (ESG) considerations (see more in Chapter 4) are no longer niche or part of a specific investment strategy. It pervades everything and every strategy. This has been an incredible change over the last ten years. ESG is also the Achilles heel of passives, which is why they talk about it so much. Essentially buying an index and all of its constituent parts means it is hard for passives to have an effective ESG policy or take ESG steps.

ESG is, however, in my view, much spoken of, but still minor in its actual effect. Expect this to change over the next ten years. Expect increased focus, especially if managers

increasingly are labelled the evil global elite that protect or, even worse, create inequality. ESG is one defence.

COMPLEXITY, TRANSPARENCY AND SCALE

With increased internet speed and access, being ‘always on’, and the demand for greater transparency, managers have to up their game. Then factor in the three to five lettered ‘words’ (CRS, GDPR, AIFMD, FATCA, MiFID – need I go on?), and the demand for greater regulatory and tax substance and reporting, you can see how asset management has become harder over the last ten years.

In addition, compliance and regulation are only heading in one direction, and the world regulators have only barely got going on asset and wealth management since the financial crisis. The joke in banks these days is that for every ten people in the lift up to work each day, only one is a client-facing banker.

All this leads to the need for scale – see the recent asset management mergers, such as Henderson Janus and Standard Life Aberdeen. This trend is sure to continue, so: (1) be very niche, (2) get into the trillion-dollar AuM club fast, or (3) go home.

SOME CONCLUSIONS

The economic strategy during the financial crisis (and beyond) of austerity in the UK, US, and EU has also no doubt fed into an increase in phenomena such as populism and the growth of socio-economic division. The US has only just announced – ten years later – that austerity has ‘ended’.

Similarly, the Brexit referendum result, President Trump’s ‘America first’, and the rise of populism, are the first major challenges to globalisation. The world views of Prime Ministers Tony Blair and David Cameron and President Obama are in retreat.

Private credit is on the rise. Italy only recently allowed non-banks to lend. Many PE managers see private debt as the way to scale AuM. The last ten years saw the regulators whack Wonga-esque high-rate lending, but regulated private lending, and debt has seen a dramatic rise in the last five years.

Asia is on the rise, but this is not just about China. India is a force to be reckoned with.

Data is big! And this trend has become unstoppable. A third of all digital data out there has been created during the last three years.

I write more on these and other trends in Chapter 13.

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What Is it like Being an Asset Manager?

People may say I can't sing, but no one can ever say I didn't sing.

– Florence Foster Jenkins, amateur operatic soprano, 1868–1944

Asset managers have a certain view of themselves that they sometimes find hard to express, or convince the broader world about. Fund managers have been labelled ‘locusts’, ‘squid’, ‘pigs’, and ‘dogs’. They have been described as ‘boring’, ‘academic’, ‘aggressive’, ‘self-important’, and ‘unaware’. Yet the majority of people in the world never interact with fund managers and have no idea what they do. They are, nevertheless, suspicious of them. They suspect that they are far too rich, do not pay their fair share of taxes, and along with the bankers, likely caused the credit crisis. How many managers, when they meet someone they suspect of having no engagement with finance, will say that they are a hedge fund or PE fund manager? More likely, they might say that they ‘manage money’ or are ‘involved in finance’. It is easy to ignore or disengage from outsiders to the sector, but this is done at the manager’s peril. Governments regulate and tax the industry; meanwhile, social media opens up managers to direct criticism and even bullying. This chapter therefore attempts to give an overview of what it is really like to be an asset manager.

Since asset managers are driven either by delivering alpha or beta – or variants between like smart beta (return-orientated, risk-orientated, and something in-between) – I am going to approach this chapter with the assistance of the ancient Greek alphabet. This is partly in homage to the first and most important two letters within the asset management industry and partly as a two-thousand-year-old apology by Western civilisation to the destruction of the Alexandrian library of ancient Greek knowledge.

A α , Alpha, is clearly the holy grail of active management. Alpha is outperformance of the market. Delivering alpha is expected as an active manager, and there is much serious discussion (and light-hearted banter) in the industry surrounding top decile, top quartile, beating benchmarks, and not being beta in disguise or hugging an index.