McKinsey&Company

Financial Services Practice

New Heights Demand Increasing Agility: Global Asset Management Overview

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Introduction

The global asset management industry had another record year in 2014. Assets under management (AuM) and profits have both recovered from the global financial crisis and now surpass 2007 levels in all regions. This strong performance has been driven by a mix of long-term and cyclical trends, but firms will need to develop greater agility to chart a course that minimizes exposure to headwinds and takes advantage of the prevailing tailwinds, if they are to maintain leading positions through the next economic cycle.

This analysis is based on McKinsey Performance Lens Global Asset Management Survey, a global benchmarking effort with data collected from more than 300 firms worldwide representing 60% of global industry AuM, from the U.S., Europe, Asia and Latin America; as well as from McKinsey's Performance Lens Global Growth Cube, a global database that tracks asset pools and flows at the level of countries, channels and asset classes over time.

A Record Year for the Asset Management Industry

Assets under management reached record highs across regions

The industry's total AuM reached an all-time high of $69.2 trillion in 2014 up $6.1 trillion on the previous year, thanks to strong market performance and healthy net flows of 3.3% of total AuM (Exhibit 1).

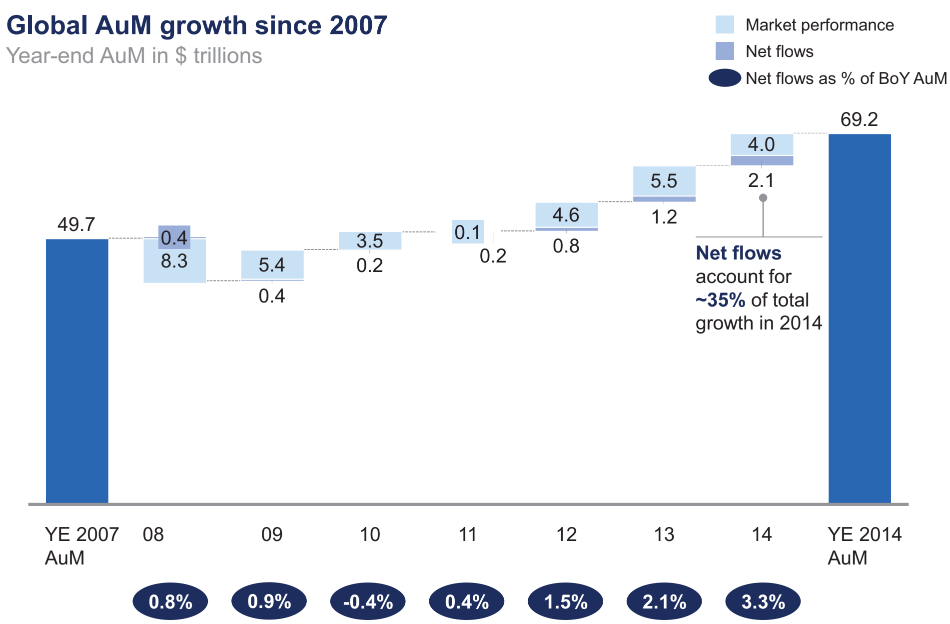
Profit pools hit historic highs in all regions

Total profits in both developed and emerging markets reached record levels, despite continued pressure on profit margins, especially in Europe. In North America, profits were 29% higher than they were before the crisis in 2007, reaching $36.7 billion. Western European players finally surpassed 2007 levels and reaped $13.6 billion in profits (5% higher vs. 2007), and emerging markets saw profits of $10.2 billion (79% higher vs. 2007). Across all regions, increases in industry profit came primarily from revenue growth as costs rose in line with revenues and in some cases ahead of them (Exhibit 2).

Exhibit 1

Global AuM growth since 2007

Year-end AuM in $ trillions

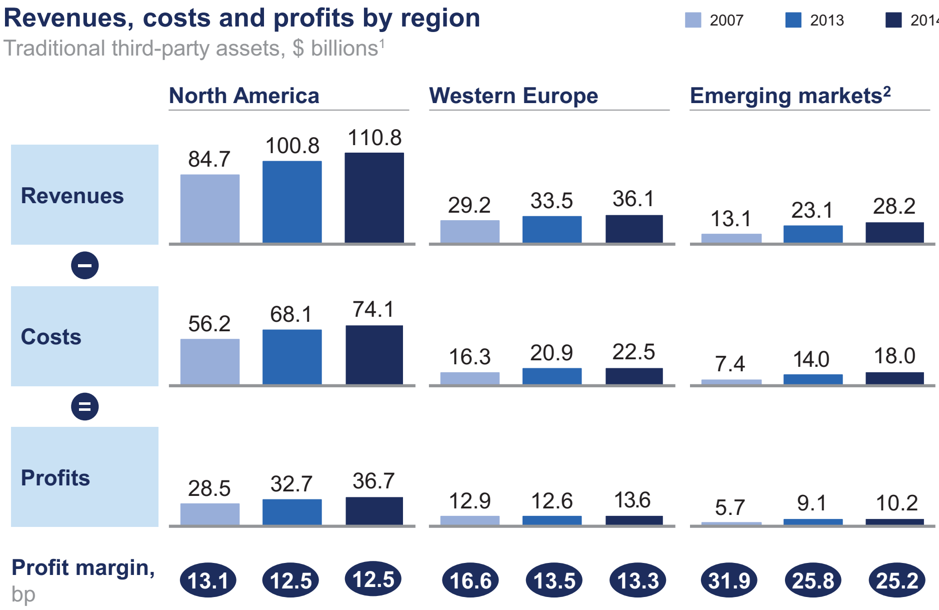


SOURCE: McKinsey Performance Lens Global Growth Cube

Exhibit 2

Revenues, costs and profits by region

Traditional third-party assets, $ billions[1]



1 Refers to the traditional assets only, excluding alternatives
2 Refers to Emerging Asia (Asia ex-Japan) and Latin America

SOURCE: McKinsey Performance Lens Global Growth Cube, McKinsey Performance Lens Global Asset Management Survey

Strong Flows and Rising Costs

Flows increased, with developed markets leading the charge

Over the past year, asset managers recorded the highest net inflows globally since the financial crisis. Developed markets bounced back as the major drivers of growth while momentum slowed in some emerging markets. Overall, global flows were split roughly evenly across North America, Europe and emerging markets (Exhibit 3). Although emerging markets continued to contribute a disproportionate share of flows relative to assets (32% of flows from only 11% of industry assets), the slowdown in their overall economic growth meant that there was a rebalancing of the overall share of flows towards mature markets.

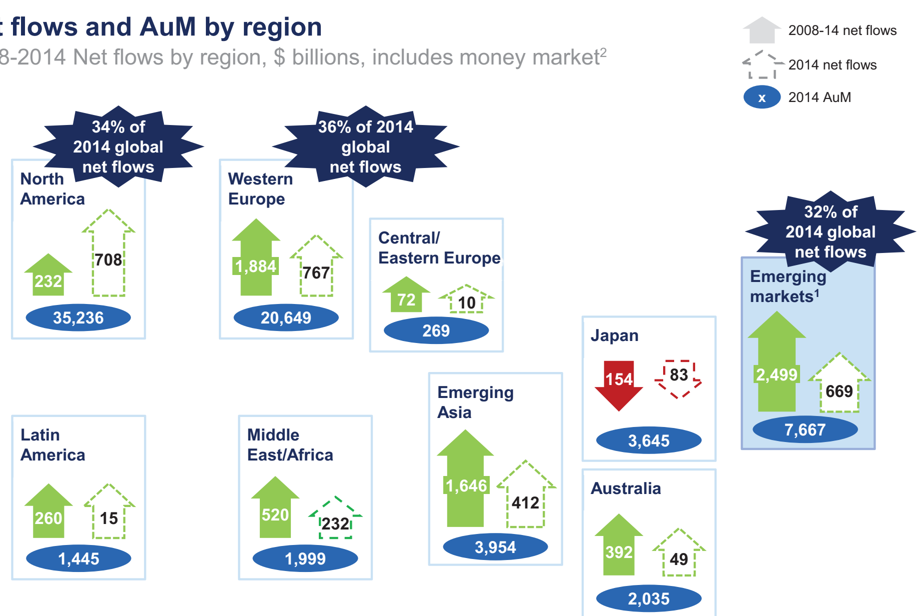
In North America, inflows were back, after six years averaging net outflows. Most of the money came from the retail segment, with institutional flows remaining negative and DC close to zero.

In Europe, net flows continued to recover, posting 4% growth for the year. Italy (11% overall, 15% in retail) and Spain (10% overall, 16% in retail) in particular continued to rebound from several years of dramatic outflows. Investors in both countries moved from deposits to fixed-income and balanced products in the hunt for better returns, and distributors, in particular banks, pushed hard to generate more commission-based fees.

Exhibit 3

Net flows and AuM by region

2008-2014 Net flows by region, $ billions, includes money market[2]



1 Includes CEE, Emerging Asia, Middle East and Africa and LatAM
2 Includes Tier 1 and Tier 2 countries
Note: Data includes Money Market funds, leading to the high inflows being witnessed in Emerging market, driven by China

SOURCE: McKinsey Performance Lens Global Growth Cube

Japan was the only major market to suffer outflows, with $128 billion flowing out of pension funds as the combination of decumulation and legislative changes more than offset gains in other client segments.

Within emerging markets, performance was once again varied. China spearheaded AuM growth, with flows heavily concentrated in money market funds ($300 billion of the $351 billion emerging market money market flows were in China). Online platforms, such as Alibaba and Tianhong, which offer direct distribution, were the main drivers of these flows. Formerly high-performing countries, such as Brazil, had a much more challenging year, with net flows of 0%.

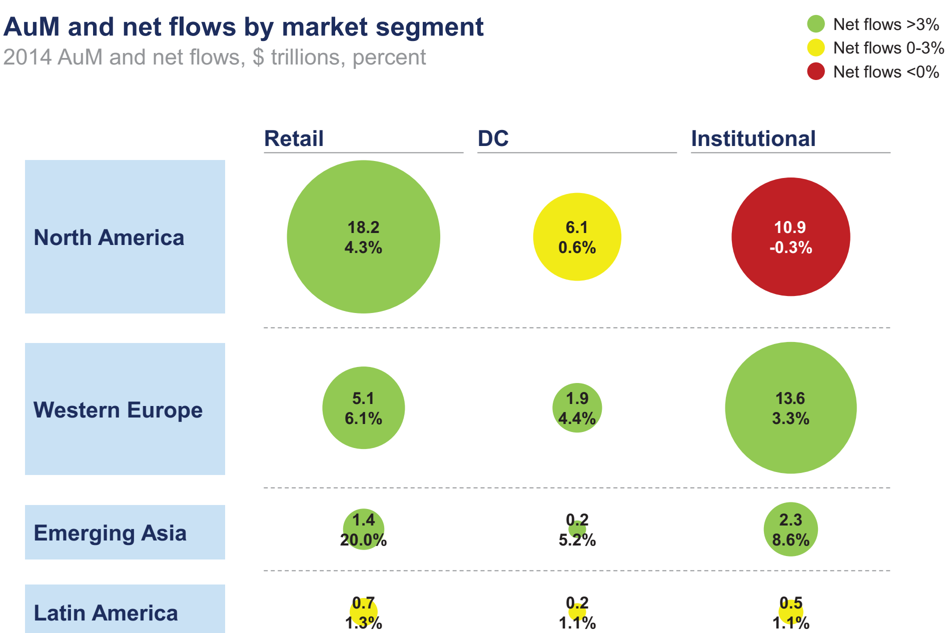
Retail benefited from strong flows globally

The retail sector in the US continues to be the largest segment in the world with robust growth and inflows of 4.3%. Flows in this segment have historically been strongly correlated with market performance and this past year was no exception. In Europe and emerging markets, both the institutional and retail businesses performed well. Defined contribution (DC) continued to grow around the world, but at a slower pace as baby boomers in the US – by far the largest DC market globally – began to retire (Exhibit 4).

Exhibit 4

AuM and net flows by market segment

2014 AuM and net flows, $ trillions, percent



SOURCE: McKinsey Performance Lens Global Growth Cube

Structural changes in product demand created significant "money in motion"

Traditional asset classes, such as active equities, continued to dominate overall AuM pools, but growth in flows was driven by other specific product categories. Since 2009, more than 100% of inflows have been driven by just three asset classes: active fixed income ($2.81 trillion), multi-asset ($1.73 trillion), and alternatives ($1.28 trillion). Passive funds – both fixed income and equity – continue to attract inflows, although these are predominantly in North America with emerging market activity less pronounced. Money market funds and active equity suffered net outflows ($0.82 trillion and $2.87 trillion, respectively), though active equity remains the largest single asset class in terms of AuM with $16.4 trillion in AuM, 26% of the total (Exhibit 5).

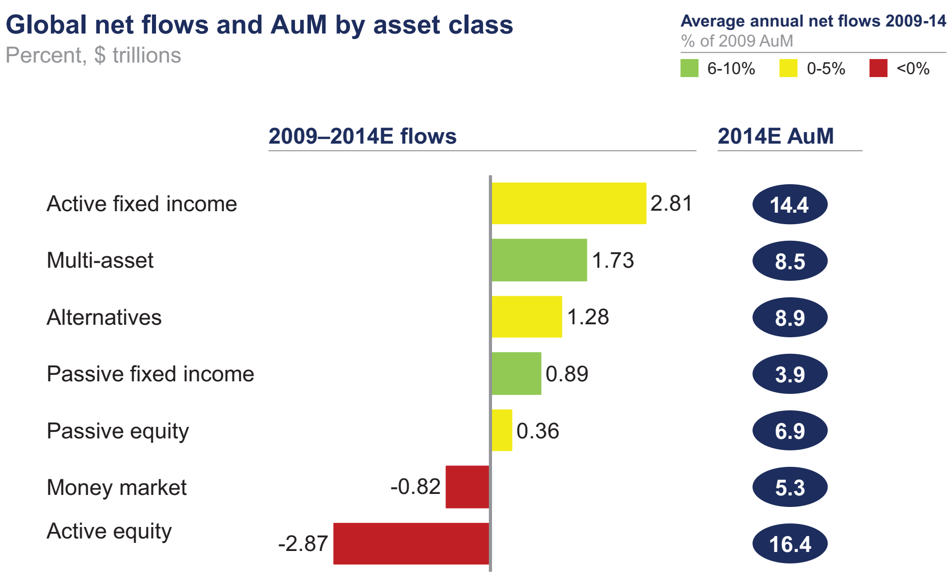
Costs continued to soar; operating leverage remains elusive

Although recent growth has been robust and revenues are up, asset managers have also materially increased their cost base (Exhibit 6), which is now 44% higher than in 2007. This persistent increase in costs, which affects every functional area, has meant that the industry has failed to benefit from the potential operating leverage that is in the asset management business model. It reflects a variety of forces, including an

Exhibit 5

Global net flows and AuM by asset class

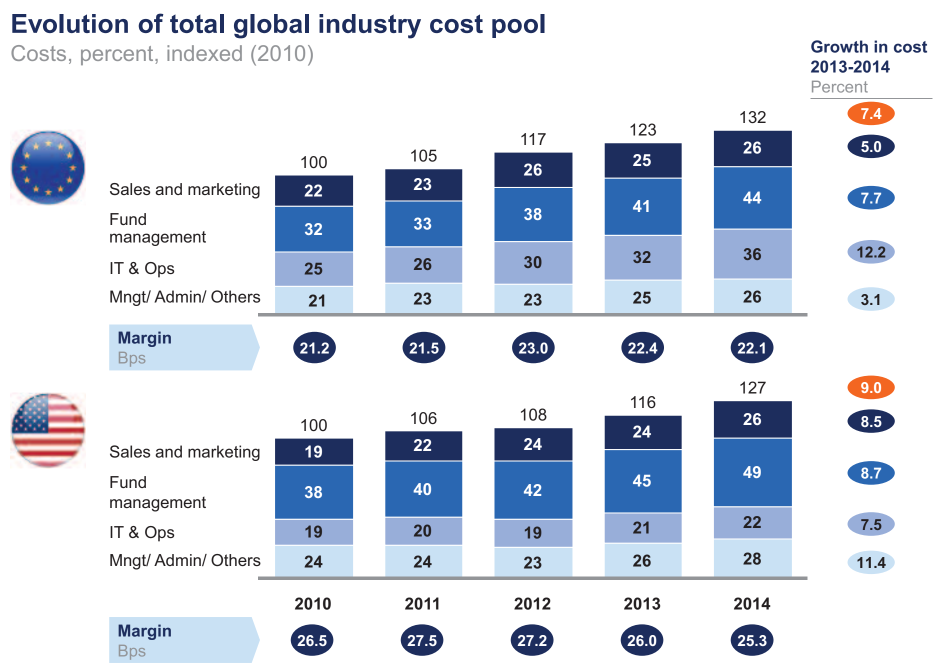
Percent, $ trillions



1 Includes only 20 largest asset management countries, accounting for ~95% of the AM market

SOURCE: McKinsey Performance Lens Global Growth Cube

Exhibit 6



SOURCE: McKinsey Performance Lens Global Asset Management Survey

ongoing distribution arms race in certain markets, increased product and operating model complexity, and the cost of regulation. A continued ratcheting up of costs could bring additional challenges to asset managers in an economic downturn where revenues fall.

Firms Must Be Agile to Perform Well Through Cycles

This year's results show that robust market performance, relatively strong inflows and shifting demand across asset classes are prevalent almost everywhere. However, despite an impressive recovery, it is clear that the asset management industry is exposed to significant uncertainties and challenges that could come into effect in the short-to-midterm. The end of cheap money as interest rate rises begin, regulatory changes in particular around consumer protection, as well as disruptions from new technologies and digital competitors may have a profound impact on the growth trajectory of asset management. In this context, it is absolutely critical that firms think about how to adapt their business models to ensure they can sustain the successes of the post-crisis years.

There are five specific themes that asset managers need to pursue decisively and urgently in this quest for agility:

1. **Be deliberate on where and how to compete** to take advantage of the geographies, asset classes and segments that will see the highest demand.
2. **Develop cost flexibility** to remain sustainable through cycles.
3. **Invest in digital and analytics capabilities** to create more operational agility and to increase value to clients.
4. **Anticipate the impact of new regulations** to be at the forefront of changes that will continue to re-shape segments of the industry.
5. **Upgrade talent processes and build more integrated organizations** to better address the needs of clients who demand more holistic solutions across asset classes and geographies.

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