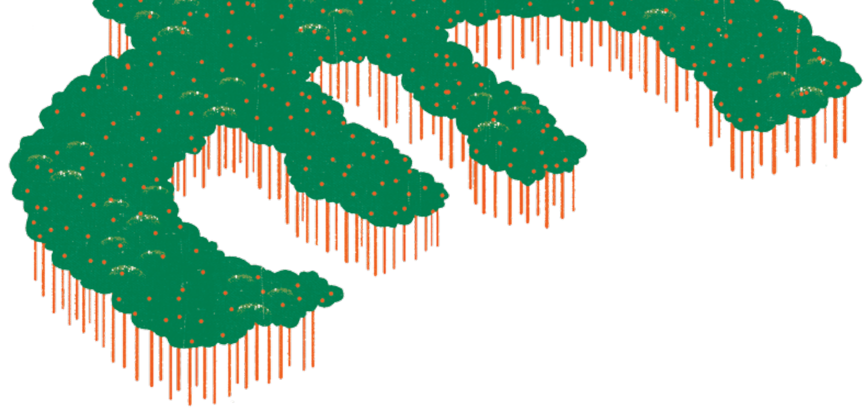

A new era for asset management:
A conversation with Edward Bonham Carter

A leading manager shares his views on an industry undergoing profound change.

Martin Huber

Edward Bonham Carter, vice chairman of Jupiter Asset Management, a fund-management group based in the United Kingdom, has spent his entire career in asset management. Recently, he spoke with McKinsey's Martin Huber about the industry's future direction.

McKinsey on Investing: *You've spoken of a new era in asset management. What do you see as the fundamental differences between this era and the past?*

Edward Bonham Carter: It depends in part on which past you are talking about. In my career, there have been two major periods. The first was in the 1980s and 1990s, a period of falling inflation, falling interest rates, and rising profits. Industry in the West was deregulated. These were perfect tailwinds for equity markets. The second era began in the late 1990s, the period of irrational exuberance, as Alan Greenspan called it; the effect on equities was a long sideways move.

Today, people are trying to work off the debt accumulated during that second period. The big question for the new era is how we will deal with that debt. I see three possibilities: we grow our way out of it; we get inflation, which, as we know, is a transfer of value from the saver to the borrower; or there's some sort of default.

The challenges to growth are numerous. Big parts of the world are aging. I suspect there is overcapacity in the fund-management industry as a whole, though clearly there are pockets of excellence. The implication for the industry, especially at current valuations, is that it's probably prudent to assume relatively low returns from major asset classes in the medium term.

McKinsey on Investing: *Some aspects of the financial system have delevered; are we making adequate progress overall?*

Edward Bonham Carter: I don't think so. There has just been a reallocation of debt among the major players. Household debt has shrunk, but governments have added debt. Corporations are a mixed story. On the one hand, you hear stories of cash-rich corporations in Europe and the United States, but I think you have to be careful with that analysis. Some sectors are still quite leveraged, and some sectors are leveraging up to buy their shares back. And within the household sector, you have to do a cohort analysis among households because there are big differences. In June 2014, a new report found that the poorest 20 percent in the UK are just as badly off as the poorest in Eastern Europe; meanwhile, by many measures, the wealthy are better off than ever.

McKinsey on Investing: *You suggested that there is excess capacity in the asset-management industry, just as there is in other industries—is that right?*

Edward Bonham Carter: Yes, I think so. In some areas you are already seeing it, as in the Ignis Asset Management–Standard Life merger in UK insurance, for example. I suspect we'll see more of that, as both a reflection of the economics and the trend to separate the insurance and asset-management businesses. We might also see consolidation on the retail side; we're already seeing concentration of flows by sector. If we say that there are 90 funds in the UK equity-income sector, I suspect only 5 to 10 funds are getting significant net inflows. That's probably replicated across lots of other major product categories. Now, asset managers are quite profitable businesses, but if they're in outflow and the costs of doing business—regulations, technology, and compliance, for example—are going up, then that's going to squeeze the sector.

McKinsey on Investing: *That raises the question of scale. But scale in asset management has challenges and causes complexity. Big asset managers now often have manufacturing in many countries and sales in many others. How do you see the trade-offs of larger size changing?*

Edward Bonham Carter: I'll give you an example. We have agreed to sell our private-client business. It's a good business with "sticky" clients; if managed well, it can be an attractive business, both for the owner and for clients. The problem is getting it to scale. Today, it has £2 billion under management, which I would say is smaller than many competitors. We looked at the investment needed to grow it to, say, £4 billion, out of £30 billion we manage overall. We thought about both organic growth and inorganic, and decided the costs and the risks of a transaction were too high. In our view, it's better off being owned by someone else, letting us focus on a more streamlined business.

McKinsey on Investing: *Does digital change that and allow you to add assets faster than in the past?*

Edward Bonham Carter: Even firms with a brand name and a platform still have to work out the costs of acquiring and servicing new clients. They have to decide what kind of relationship they want. Do you want them coming straight through to your administration desk? If you subcontract that, what issues of brand and quality does that raise? The client will come to you in multiple and complex ways; companies need to analyze the servicing requirements carefully. Take advisory, for example. Companies need to reach the end customer and get the word out and help their distribution partners, the financial advisers. At the same time, they also sell through their own channel and need to be careful not to compete. It's one of the paradoxes of this industry: unlike

Edward Bonham Carter

Vital statistics

Born May 24, 1960, in London, England

Married, with 3 children

Education

Holds a degree in politics and economics from Manchester University

Career highlights

Jupiter Asset Management (1994–present)

Vice chairman (2014–present)

CEO (2010–14)

Chief investment officer (1999–2010)

Manager, Jupiter Undervalued Assets Fund (2001–09)

Manager, Jupiter UK Growth Fund (1994–2001)

Electra Investment Trust (1986–94)

Schroders (1982–86)

Fast facts

Nonexecutive board director of Land Securities Group

Member of the investment committees of the Esmée Fairbairn Foundation and the Harrow School Foundation

Led successful management buyout at Jupiter in 2007 and IPO in 2010

Named *Financial News*'s CEO of the year, 2010

Received *Investment Week*'s Outstanding Industry Contribution Award, 2014

Commutes to work on a bicycle

other businesses, buying the product direct from the manufacturer is actually more expensive. To return to the question of the new era, I think that is changing. There is a whole new air of transparency into pricing, and I think we'll see some significant changes.

McKinsey on Investing: *You're an active asset manager. Is it harder today than in the past to convince your customer and your distribution channels of the value that you bring?*

Edward Bonham Carter: Yes, because people are colored by experience and are much more cynical now about the claims of the industry. That's partly because returns, in general, have not been that exciting, and they've been more volatile. We've had two bear markets since 2000, and people are scarred by that experience. They conflate the fact that market returns haven't been that good with the fact that a lot of active fund managers haven't delivered. Clients also say they want consistent outperformance, which is just not possible. All you can do over time is make sure that your good years more than offset your bad years and that you have active bets against the index—and that in so doing you justify your fees.

McKinsey on Investing: *In the United States, some investors now are suing what they call "closet indexers." What's your view on that?*

Edward Bonham Carter: Funnily enough, I think it's an opportunity. It makes our value clearer to investors who think all asset managers are the same. This story will make some people wary, but others will still want to have a part of their fund invested in an active way, with fund managers they believe in. It will add to the pressure on the industry for greater transparency on their investments and their fees. What it brings to mind is the contrast with hedge funds. Here, I think the long-only industry could learn something from hedge funds about pricing capacity. In the short term, asset managers are very sensitive to earning revenues; there's a tendency for people to keep their strategies open. But in the longer term, in certain strategies, mangers could be sharper at analyzing the capacity of the strategy, pricing the remaining capacity accordingly, and then closing it. In the 1990s, no one did that; recently, we've started to see it.

To relieve the pricing pressure, managers need to think about what's in the best interest of the client in the longer term. I suspect that in the institutional market, pricing for good institutional strategy has found a level and probably hasn't moved much in the past decade. In retail, the issue today is the split between the distributor and the manufacturer. My inclination is that the balance is going to tilt toward distributors.

McKinsey on Investing: *Do you think that the system is also going to change how people invest?*

Edward Bonham Carter: That's a hard one. In a sense, the answer is path dependent; if we had a deflationary scenario, you'd see an accelerated move out of equities, for example. But within that, I think some trends are here to stay: the move to products that are more solution based, the desire by clients for managers to allocate assets for them, the shift to absolute-return products.

McKinsey on Investing: *Who benefits from those trends—asset managers or the distribution channels?*

Edward Bonham Carter: Both can benefit, depending on their skill sets. If asset managers have good skills in-house for generating alpha in their space, they will get some of it, and some will absolutely go to wealth managers.

McKinsey on Investing: *Let me shift gears a little bit. We have heard a lot about wealth shifting into emerging markets; growth is dramatically faster than in developed markets. What impact do you think asset managers in these countries will have on the global market?*

Edward Bonham Carter: At the moment, there are still not that many home-sourced asset managers in emerging markets. So the technology, for want of a better word, is coming from the developed world, as people sell services and products into the emerging markets. On a ten-year view, as the emerging markets grow and add wealth, you would expect them to buy some of this expertise and technology. It might be like the way that Japanese companies bought some asset managers back in the 1980s and 1990s, though of course they then fell victim to their own economic cycle. We've seen Chinese firms try to buy various asset managers in the past few years. The questions are how fast will it happen, and will regulators encourage it or get in the way. You would also expect these countries would want to have their own indigenous asset managers. Maybe it's too early in their economic development, but there's no reason it won't happen.

McKinsey on Investing: *One more question on digital technology. Is it an opportunity? Is it a threat?*

Edward Bonham Carter: A part of me believes that human beings still like to deal with other human beings. I think some of the commentary today overemphasizes the pace of digital change, and one shouldn't forget that people want to meet and learn from other people face to face because of all the psychological benefits of that. I'm sure there are going to be huge changes in how managers access customers, how they use data to analyze markets, and how customers look through expert systems to help with decisions they need to make. Digital will hopefully improve the level of knowledge on both sides.

The danger is that we become drowned in an excessive load of information. That's not what we want in life; we want significant insights and analysis, things that add value to our knowledge and behaviors, not just more and more information. That's the challenge with digitization. It will be interesting to see how the next generations of investors respond to this. Are people going to stay cynical about advice, or will some say, "I pay my doctor and my accountant in this way; my financial adviser is a professional, and if he's good, I will pay him the same way"?

McKinsey on Investing: *Some say that another danger of digitization is that, if used to analyze a firm's decision-making algorithms, especially in the long-only business, it will simply replicate the firm's position. What could be counterstrategies to get around that?*

Edward Bonham Carter: The world of fund management is just beginning to understand some of these threats and the linked issues of flash trading and algorithmic trading. The questions of how shares are traded and monitored, and the kind of information that is made available, are critical because people need to know if certain types of investors are being favored or not. Is the quest for superior speed a healthy kind of arms race? We need to see more evidence that the market is working to the benefit of all participants.

Martin Huber (Martin_Huber@McKinsey.com) is a director in McKinsey's Cologne office.