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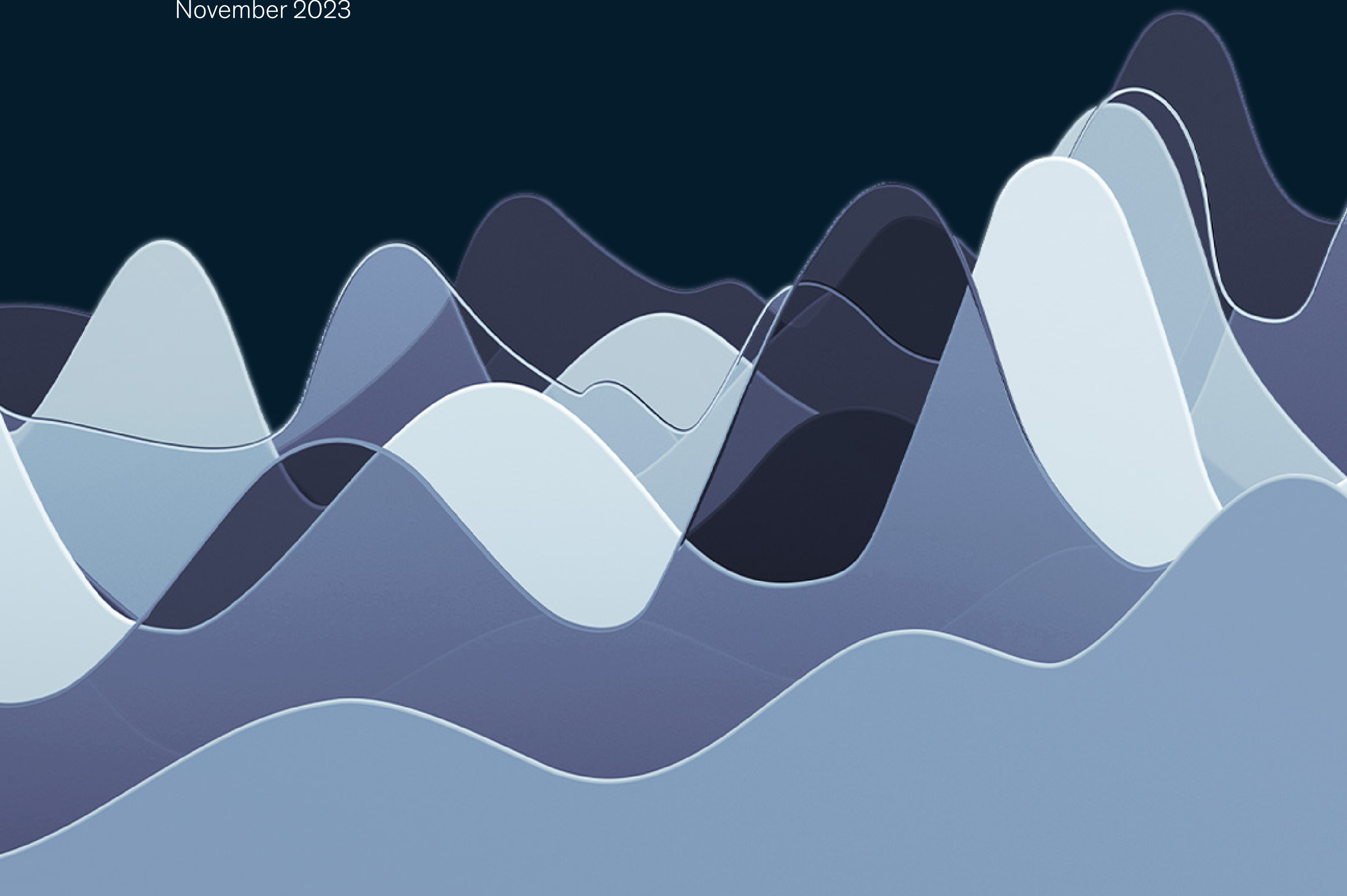
Everything everywhere all at once: North American asset management 2023

November 2023



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Introduction

The asset management industry has been hit by a series of shocks over the past 18 months. Surging inflation and interest rates were the defining disruptions, compounded by a market downturn, banking turmoil, and geopolitical upheaval.

Inflation reached a peak not seen in four decades, accompanied by the swiftest escalation of interest rates in over half a century, marking a sharp departure from the expectations of lower-for-longer rates that had become embedded in the operating assumptions of many market participants. Equity and bond markets suffered simultaneous declines in 2022, with the S&P 500 down nearly 20 percent and the Bloomberg US Aggregate Bond Index experiencing the worst year of performance since its inception in 1976. This market downturn, unmatched since the financial crisis of 2008, erased close to 50 percent of the cumulative market appreciation from the preceding five years. Even today, markets continue to wobble as investors place bets on whether the United States is headed for a recession or a soft landing.

This market backdrop was further clouded by instability in the banking system, with repercussions in both the US and Europe. The global landscape was also roiled by geopolitical disruptions including the war in Ukraine, conflict in the Middle East, intensifying tech rivalries, and the disentanglement of highly connected supply chains. Asset managers have had to parse this complex mosaic of mixed signals.

Our 2023 review of the North American asset management industry, including traditional and alternative asset managers, explores five major themes in this challenging environment:

1. The industry is down but not quite out, with aggregate industry economics holding up relatively well despite the challenging environment, particularly when compared with prior crises.

2. Market stresses have accelerated long-term shifts in industry structure (such as active versus passive, the rise of platform business models, and the adoption of new investment vehicles), widening the gap in performance between leading and laggard firms and narrowing the path to success for industry leadership.

3. The industry faces a period of structural adjustment to the new reality of a higher-for-longer interest rate environment, which is upending business models that feature high leverage, complex liabilities, or significant liquidity and duration mismatches.

4. This structural adjustment creates an unprecedented money-in-motion opportunity for asset managers to expand their roles as financial intermediaries: assets and liabilities are gravitating beyond the balance sheet into the world of capital markets and professionally managed assets.

5. Asset managers need a trifocal agenda of growth, operating effectiveness, and productivity, simultaneously repositioning their firms to capture the tailwinds of new growth while retooling their operating models to deliver capabilities with customization and scale.

This report delves into detailed industry data and analysis illustrating and illuminating key aspects of these five themes. We start by reviewing the asset management sector's performance in 2022, then explore what has changed in 2023. Next, we document the increasing performance gap between the industry's leaders and laggards. In the following section, we detail the drivers of this widening gap. Then we explore the once-in-a-generation opportunities presented by the significant structural changes the industry has experienced. Finally, we present our agenda for navigating this challenging new environment.

State of the industry: Down … but not quite out

In an industry that had enjoyed a decade of nearly unbroken growth, 2022 marked an unusual year of significant contraction. Global assets under management (AUM) declined by 10 percent as markets surrendered a substantial portion of their pandemic-era gains. Net flows slowed to a crawl and clocked in at near zero in every region apart from Asia–Pacific. Total global net flows registered 1.1 percent, in stark contrast to the norm of 3 to 4 percent during the past decade (Exhibit 1).

Exhibit 1

The global asset management industry had a challenging year in 2022.

[1]Includes 42 countries from Africa, Asia–Pacific, Europe, Latin America, Middle East, and North America.
Source: McKinsey Performance Lens Global Growth Cube

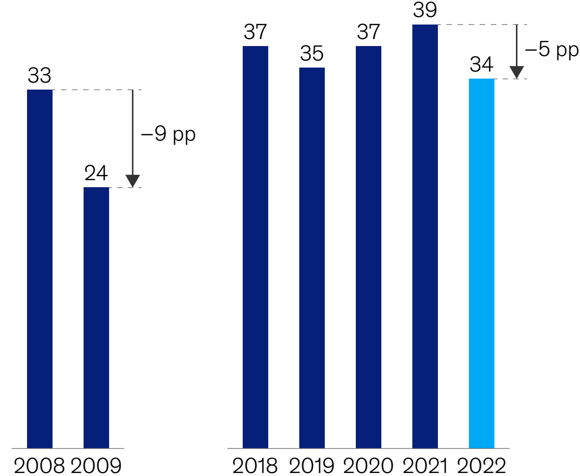
A hit to revenues

The economic impact of this contraction was significant, with industry revenues for asset managers based in North America experiencing an 11 percent decline. Profitability also suffered, with a five-percentage-point fall in operating margins (Exhibit 2).

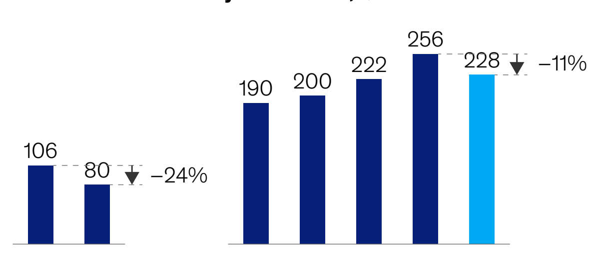
Exhibit 2

Industry profit margins fell in 2022, mainly because of declining revenue, though the hit was less severe than during the 2008 financial crisis.

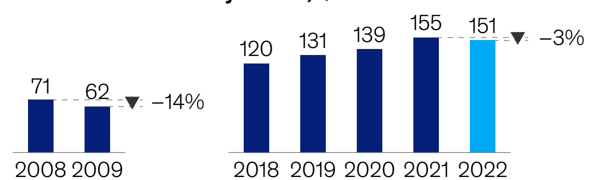
Estimated pretax operating profit margin,[1]
% of net revenue



Estimated industry revenues, $ billion



Estimated industry costs, $ billion



[1]Weighted average of pretax operating profit margins by revenues of firms in survey sample.
Source: McKinsey Performance Lens Global Asset Management Survey; public filings

However, this hit to industry profitability was only about half the wallop that the industry took during the 2008 global financial crisis, and the resulting industry operating margins of 34 percent were a return to pre-pandemic (that is, 2019) levels. Taking this longer-term view, the declines of 2022 were more akin to a reversion to the mean than a wholesale restructuring of industry profitability.

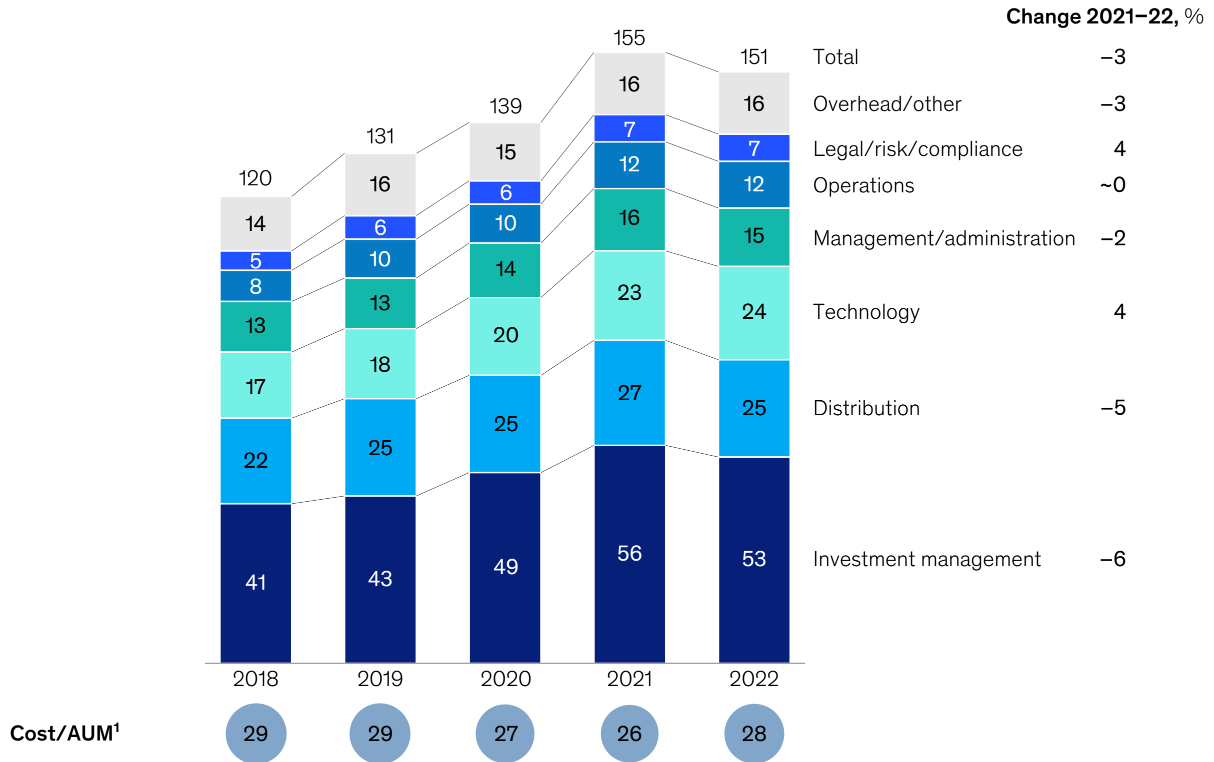
Inflexible costs

Profit-margin declines reflected an inflexible cost structure in the face of falling revenue. In the pandemic era of 2019–21, the asset management industry's cost base grew by $24 billion, or 19 percent. Yet in the face of a significant revenue shock in 2022, that cost base contracted by just $4 billion, or 3 percent, attributable mainly to the automatic stabilizers of lower variable compensation for investment management and distribution professionals (Exhibit 3). The industry's cost-cutting measures announced in the first half of 2023 are expected to result in additional savings of a few billion dollars—modest when compared with the industry's $151 billion cost base in 2022.

Exhibit 3

Industry costs fell modestly in 2022, helped by lower investment management and distribution expenses.

Estimated total North American asset manager spending by function, $ billion



[1]Total annual costs divided by average assets under management during the year, in basis points.
Source: McKinsey Performance Lens Global Asset Management Survey

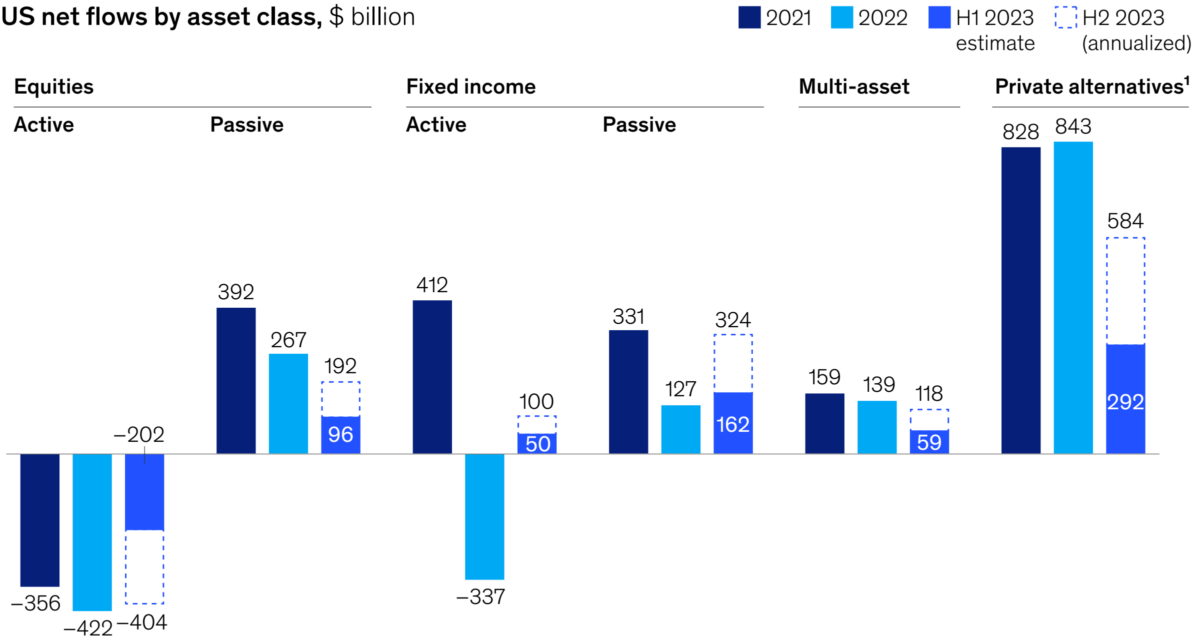
A low-margin recovery

While the first half of 2023 showed some signs of optimism, with positive net flows across many asset classes, what has emerged so far is a lower-margin recovery. Clients have been reentering the market in lower-fee passive and fixed-income strategies, while higher-fee active equity strategies are again in outflows, and private markets fundraising has pulled back (Exhibit 4). Notably, active equity had estimated outflows of $202 billion during the first half of 2023, representing a 2 percent decline of assets under management since the beginning of the year. Private markets fundraising is on track to fall by nearly $300 billion, or about 30 percent, from a 2021 peak.[1]

[1]Comparing annualized first-half 2023 fundraising with 2021.

Exhibit 4

Some asset classes showed signs of a muted recovery in the first half of 2023.



[1]Private alternatives annual fundraising for North America.
Source: McKinsey Performance Lens Global Growth Cube; Preqin

This somewhat tentative view of a recovery is reflected in market valuations for asset managers. The industry's forward price-to-earnings (P/E) ratios remain subdued relative to the broader equity market's recovery. Traditional asset managers have recorded a decline of more than 25 percent in their P/E ratios, from an average of 16 times in 2015–18 to 12 times in 2022–23. The valuations of high-flying alternatives managers have experienced a similar trend, with P/E ratios dropping from an average of 15 times in 2015–18 to 13 times in 2022–23, a decrease of more than 10 percent.

An increasing wedge between the industry's haves and have-nots

Market volatility has also had an impact on industry structure. This is reflected in a growing gap between the industry's best and the rest in terms of organic growth and profitability.

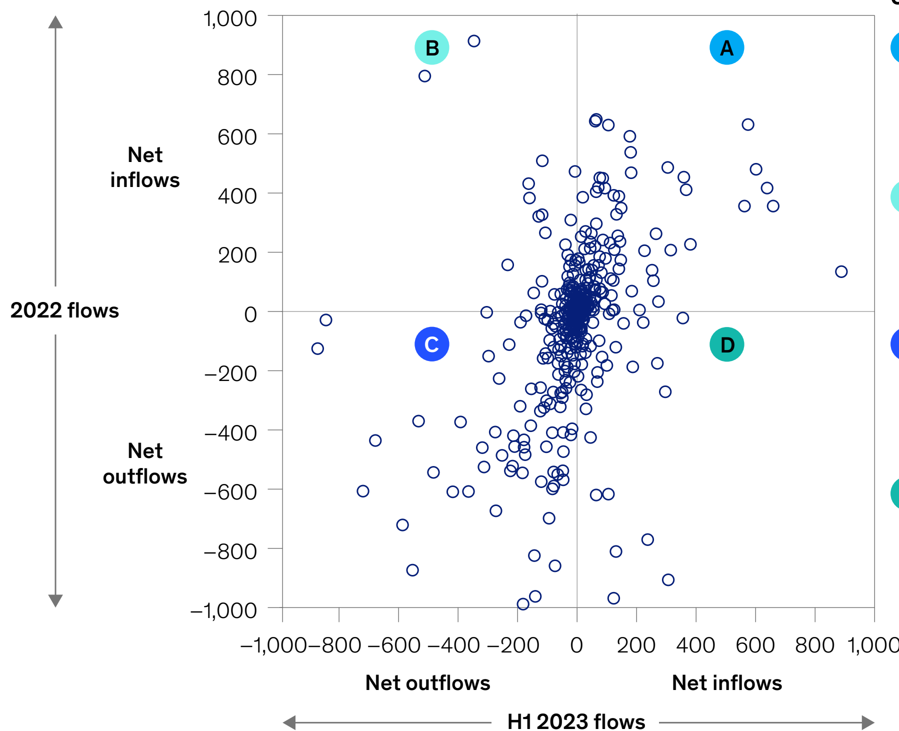
Fewer strong performers

To compare the performance of US asset managers in terms of organic growth, we measured each firm's net flows in 2022 and the first half of 2023, then compared these results with corresponding measures taken one year earlier (Exhibit 5). Of the asset managers measured this time, 29 percent were in the quadrant of consistent winners—firms that generated positive net flows during both 2022 and the first half of 2023. This share represents a decline from 34 percent one year earlier. The latest crop of consistent winners collectively contributed $600 billion in long-term net flows over the 18-month period ended in June 2023. Firms in this category tended on average to be larger, to have a full breadth of passive and active asset management capabilities, and to have some form of privileged access to distribution channels.

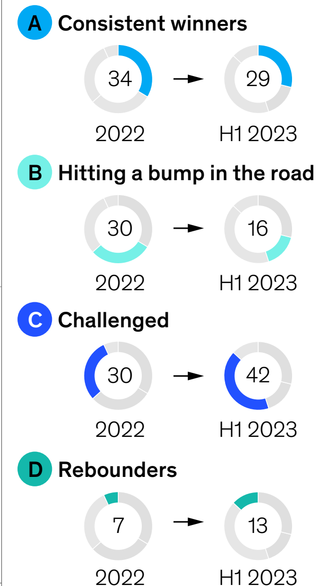
Exhibit 5

Evolving industry dynamics are resulting in fewer winners and more challenged firms.

US asset managers by net flow performance category,[1] $ million



Share by performance category,[2] %



[1]Includes mutual funds and exchange-traded funds. Excludes money market funds and funds of funds. Sample of about 700 fund families listed on Morningstar.
[2]Categories based on flows over time; for example, 2023 consistent winners had inflows in both 2022 and H1 2023, while 2022 consistent winners had inflows in both 2021 and 2022. Numbers may not sum to 100% due to rounding.
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In contrast, the share of challenged firms—those that experienced net outflows in both 2022 and the first half of 2023—increased to 42 percent from 30 percent in 2021–22. Firms in this segment tended to be smaller and concentrated in investment strategies grappling with pronounced multiyear outflows—notably, active equities. Collectively, these firms have witnessed outflows amounting to around $800 billion over the 18 months ended in June 2023.

We also saw an upsurge in the number of firms we call rebounders, which transitioned from net outflows to net inflows. This resurgence has been driven by performance improvements among fixed-income-focused firms that faced net outflows in 2022. Meanwhile, the fourth subset of firms, which we describe as hitting a bump in the road, experienced the inverse journey—shifting from positive to negative net flows. This often came in response to performance challenges encountered by a subset of firms, especially value-oriented active equity managers.

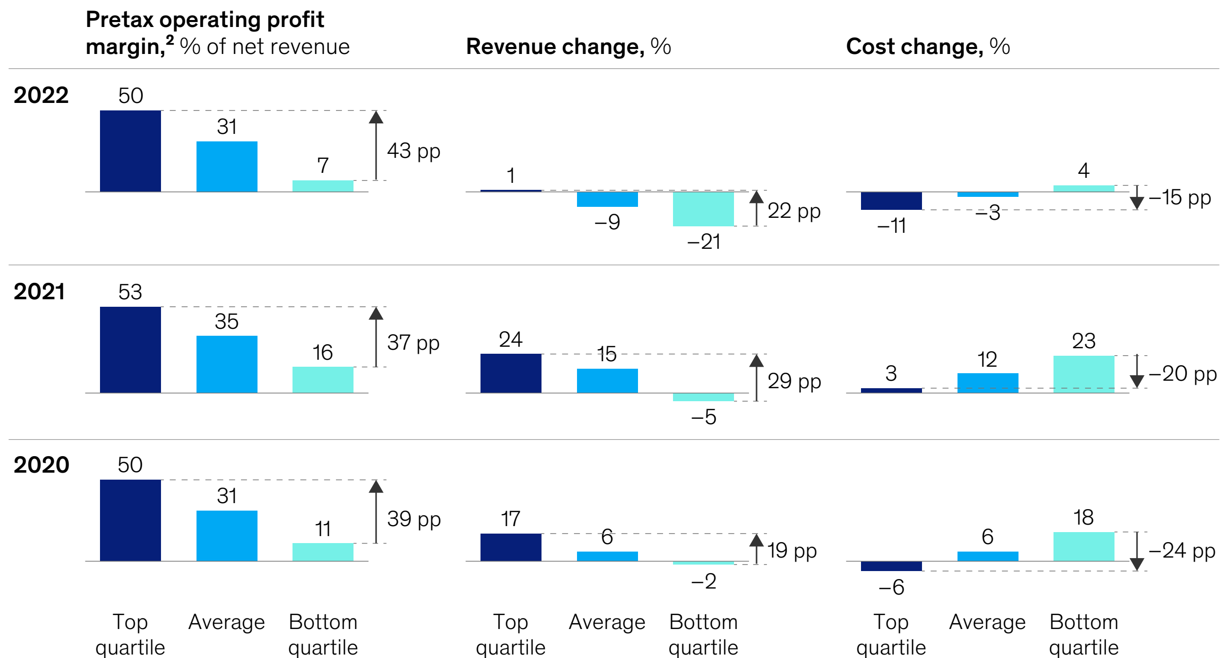
A widening gap in profitability

In terms of profitability, the gap between the margins of top- and bottom-quartile performers in our Global Asset Management Survey has grown from 37 percentage points in 2021 to 43 percentage points in 2022 (Exhibit 6). Top performers were able to hold their ground in a stressed environment, while those at the bottom faced significant revenue contractions and had difficulty reducing costs.

Exhibit 6

The profitability gap between top and bottom performers has grown.

Performance of North American asset managers by quartile[1]



[1]Differences indicated in each graph compare the top-quartile asset managers against those in the bottom quartile, measured in percentage points (pp).
[2]Arithmetic average of pretax operating profit margins of firms in the survey sample.
Source: McKinsey Performance Lens Global Asset Management Survey

Drivers of the widening performance gap

The market stresses experienced by asset managers have contributed to widening the performance gap between leaders and laggards over the past 18 months. What explains this trend? Our research suggests four major drivers: a difficult environment for active management, customer adoption of new investment vehicles, growth of platform-based business models, and differences in the effectiveness of firms' operating models.

Continued challenges in active management

Structural outflows in active management offerings, particularly in equities, have exerted a drag on growth for many firms focused on these strategies. While there was talk of a "new age for active" in a higher-volatility environment, the uptick in performance of active value strategies in 2022 has thus far been relatively short lived; many active strategies have been underperforming in 2023 (Exhibit 7). In terms of flows, although some growth-oriented active equity strategies experienced improving performance in the first half of 2023, open-end funds recorded outflows of $140 billion in active equities during that period. Over that same period, active fixed-income funds had inflows of $18 billion (0.1 percent of beginning-of-year assets), while passive fixed-income funds had inflows of $136 billion (7 percent of beginning-of-year assets).

Exhibit 7

Active equity and fixed-income funds' performance has returned to more familiar patterns after a departure in 2022.

AUM in each investment style category outperforming primary prospectus benchmark,[1] %

Legend: 0–24, 25–49, 50–74, ≥75

		2020	2021	2022	2023 August
Active equity	Blend	26	36	81	33
	Growth	77	22	20	64
	Value	44	63	88	36
Active fixed income	Long	90	74	59	97
	Intermediate	87	88	43	82
	Short	70	87	36	81
	Municipal	44	79	21	81
	High yield	19	69	47	43

[1]Results aggregated at the investment-style level; 2023 data through Aug 31.
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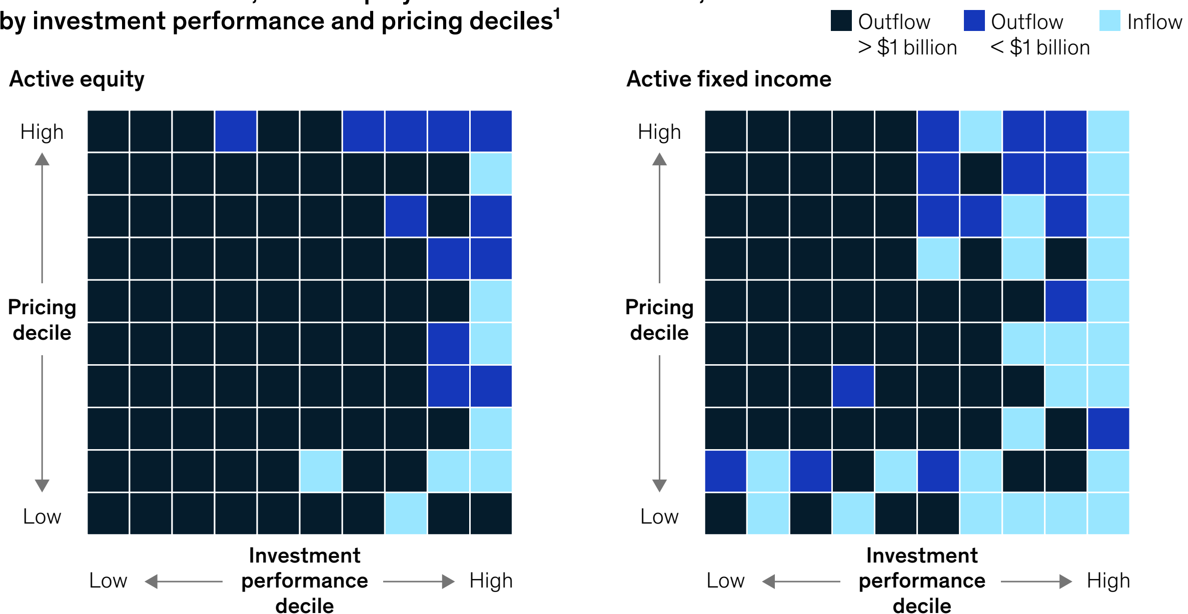
Over the past decade, as active managers have faced challenges in attracting inflows for their funds, some have been comforted by the belief that above average performance and/or low fees could still garner positive net flows. However, in our latest review of active strategies by investment performance and pricing deciles from January 2021 to June 2023, we found that only a small share of active equity funds were able to achieve positive net flows (Exhibit 8). These tended to be funds with top-decile performance, and even in that category, not all experienced positive net flows, suggesting an increasingly narrow path to success. Active fixed-income funds performed better overall than active equity funds, but to attract positive net flows, they generally needed to have investment performance in the top three deciles and/or fees in the bottom two deciles.

Exhibit 8

Positive net flows have been difficult to achieve in active management, though somewhat easier in fixed income than in equity.

US mutual fund flows, active equity and active fixed income, by investment performance and pricing deciles[1]



[1]Investment performance deciles based on 3-year return performance as of year-end 2022. Pricing deciles calculated using year-end 2022 total expense ratio. Cumulative flows from Jan 1, 2021, to June 30, 2023. Performance and pricing compared with peers in the same Morningstar category, excluding funds with insufficient data (n = ~10,100 equity funds + ~6,000 fixed-income funds).
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Accelerating adoption of new vehicles

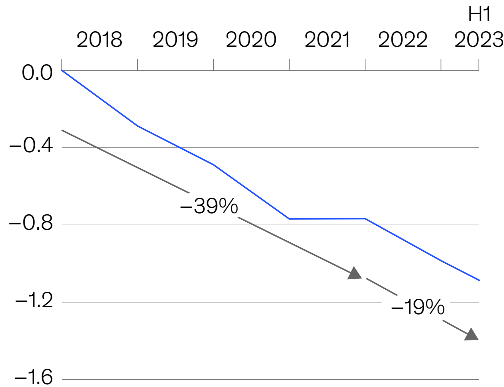
The industry's accelerating adoption of new vehicles that deliver strategies in more efficient and flexible ways has created a new lane for growth for active strategies, at the expense of other types of vehicles. Between 2018 and the first half of 2023, actively managed US exchange-traded funds (ETFs), collective investment trusts (CITs), and separately managed accounts (SMAs) together garnered positive net flows of $500 billion (Exhibit 9).

Exhibit 9

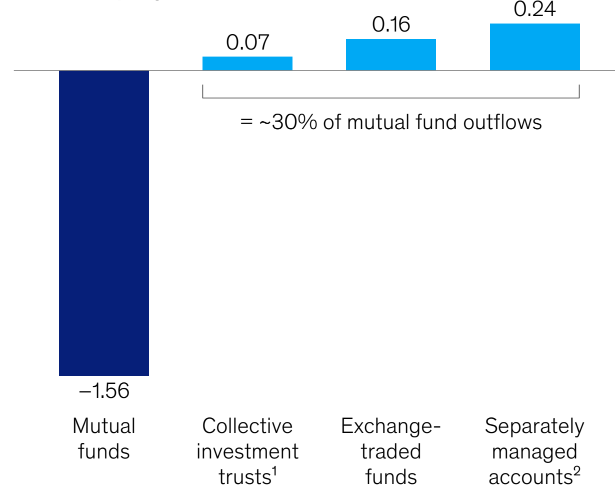
North American active equities have experienced big outflows, though certain types of vehicles have fared better.

Cumulative flows, $ trillion

Total active equity, 2018–H1 2023



Active equity vehicles, 2018–H1 2023



[1]Excludes passively managed funds based on "index" keywords in fund names.
[2]Includes direct index separate account strategies.
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Each type of vehicle has different factors influencing demand. Tax and liquidity benefits have long made ETFs an attractive vehicle for various investing strategies, both active and passive. Over the past few years, active ETFs have also reached critical mass as large, established active managers have embraced the category either through mutual-fund-to-ETF conversions or new-product launches. The number of active ETFs in the US increased 40 percent over the 18 months ended in June 2023.

In the case of SMAs, flows have been propelled by a desire for tax efficiency and, to a certain extent, customization—particularly prevalent among high-net-worth clients. This momentum has spurred growth in municipal bond strategies and, notably, within equities through the surge of direct indexing strategies. For CITs, growth has been driven by cost-sensitive defined-contribution retirement plans.

In aggregate, the growth of these alternative vehicles has had a material impact on flows for North American active equity as a whole. Between 2018 and the first half of 2023, the $500 billion in flows into actively managed ETFs, SMAs, and CITs made up for about a third of the $1.6 trillion in mutual fund outflows over that same period.

Platform-based business models

Platform-based business models, long established in the technology sector, have started to take root in the world of asset management and now account for a disproportionate share of growth in the industry. Platform business models allow asset managers to create deeper (and in some cases direct) relationships with clients, often by extending reach into different parts of the investment management value chain, moving beyond simply creating investment products.

Within the asset management ecosystem, we see three distinct types of platforms emerging:

1. *Client platforms* are often firms affiliated with banks, brokerages, or retirement-focused businesses that have proprietary access to large and growing groups of clients, as opposed to stand-alone asset managers that need to gain access to clients through an intermediary. These platforms can offer existing clients additional services such as wealth management.

2. *Enablement platforms* include firms that combine more traditional asset management with technology, operations support, and access to outsourced portfolio construction and manager selection capabilities. These platforms serve a broad range of clients across the investment management ecosystem, including smaller wealth managers and other asset managers.

3. *Asset origination platforms* are firms with a unique ability to both originate and manage assets at significant scale across multiple asset classes, often by tapping sources of "permanent capital" such as pension or insurance liability assets.

Collectively, firms using these models are growing faster than average, registering growth rates ranging from three percentage points to 16 percentage points above the industry-wide AUM growth of 6 percent recorded from 2018 to 2022.

Differences in effectiveness of asset manager operating models

Asset managers' operating models also played an important role in driving differences in operating performance, particularly in profitability. Operating models vary widely in scalability and flexibility, and both play a role in effectiveness.

Over the years, our review of asset managers' performance has highlighted that the most important factors correlated with top-quartile profit margins are not absolute size or scale, but rather the size or scale of an investment strategy. Firms that created highly scalable operating platforms with built-in operating leverage generally proved to be more resilient in their ability to remain profitable in a highly volatile year.

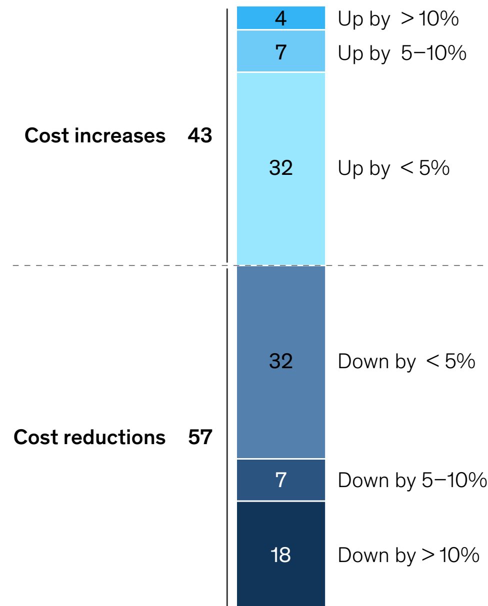
Similarly, firms with greater organizational agility were able to pivot and reallocate resources toward areas of growth. Of the firms polled in our North American Asset Management Survey that reported declining revenues in 2022, only about 60 percent were able to reduce costs, and of these companies, a majority made cuts of 5 percent or less (Exhibit 10).

Asset managers' relative positioning vis-à-vis each of these dimensions has led to significant differences in performance in terms of growth and profitability.

Exhibit 10

Almost 60 percent of firms we surveyed cut costs as revenue fell, though a majority of reductions were modest.

Cost changes at North American asset managers with declining revenue, 2022, % of respondents



Source: McKinsey Performance Lens Global Asset Management Survey

Structural adjustments and once-in-a-generation opportunities

While the stresses of the past year and a half are real, the current period is also creating opportunities for asset managers. The present tumultuous conditions have ushered in not just market volatility, but also significant changes to the foundations of the industry. After a decade or so of easy money, the sector confronts the reality of a sustained higher-for-longer interest rate environment, the long-term consequences of interest rate shocks, and greater market volatility. These conditions create stress on nodes of the financial ecosystem that rely on high leverage, wholesale funding, illiquidity, and duration mismatches.

As with any crisis, these stresses can also lead to new ways of doing business. Certain segments of investors are looking for new alternatives as midsize US banks cope with bond market losses, deposit flight, a decrease in lending activity, the preemptive restructuring of potentially impaired assets, and the potential of increased regulation. Where some banks pull back from parts of the market, opportunities arise for asset managers to play the role of alternative lenders or havens for investors looking for yield.

We highlight four opportunities for asset managers arising in this new environment: the increasing attractiveness of cash as an asset class, a repositioning of fixed income, an evolution in private markets, and a reset in commercial real estate.

Dash for cash

The radical shift in interest rates has made the old quip of “cash is trash” appear outdated. Cash isn’t just a safe haven anymore; it is an asset class with a respectable return—investors are now quite literally being paid to wait. These factors have triggered record inflows of more than $600 billion into money market funds in the first half of 2023 (Exhibit 11). This surge was driven by a combination of the banking deposit crises and higher yields and was fueled by historically elevated levels of accumulated cash on individual and corporate balance sheets during the pandemic ($8 trillion and $3.2 trillion, respectively, as of the first quarter of 2023).

Beyond inflows, the business of liquidity has become far more commercially attractive as asset managers have been removing fee waivers on money market funds, which were commonplace during periods of low interest rates to keep investors’ yields from dropping below zero. As a result, we estimate that the revenue pool for money market funds in the United States has more than doubled over the first eight months of 2023 to about $13 billion,[2] not far behind the revenue represented by other large asset classes such as multi-asset funds, estimated at $15 billion.[3]

Amid the growth in cash as an asset class, the key challenge for asset managers is retaining shorter-term assets that have migrated into the industry from the depository system. To broaden their structural role in the liquidity ecosystem, asset managers should consider these steps:

— Provide cash segmentation services that optimize balances by investment horizon and liquidity needs, as well as laddering across different investment instruments (for example, short-duration fixed income) to deliver customized liquidity with superior yields.

— Offer liquidity solutions tailored to the needs of larger corporate clients (for example, dynamic portfolio management in SMAs) and smaller clients (for example, liquidity-driven bond ladders).

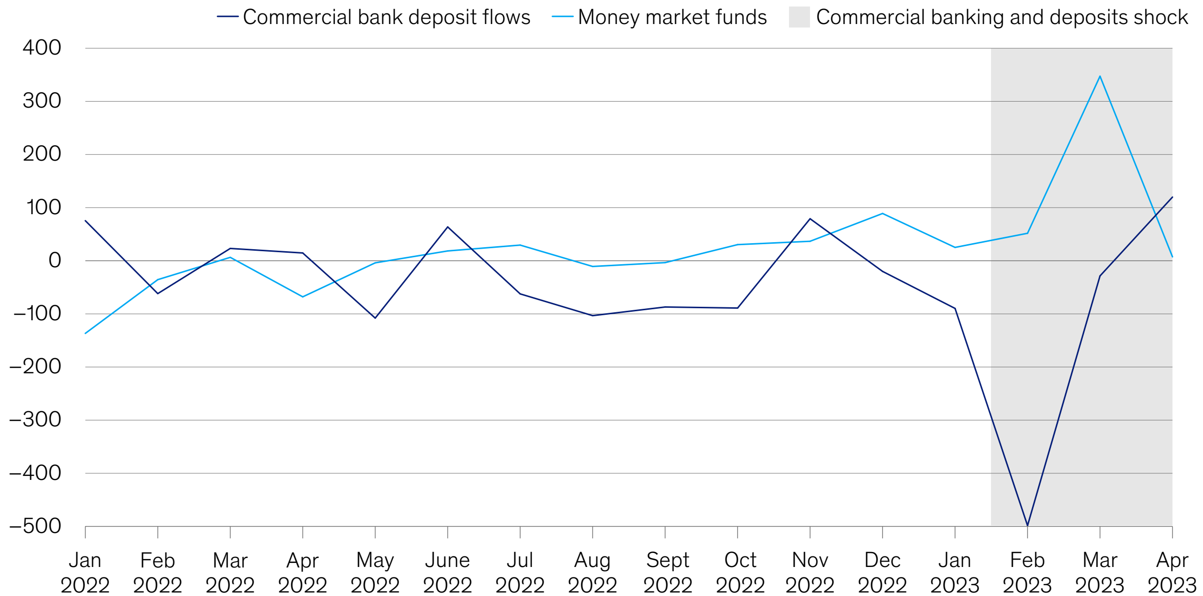
[2] Estimate based on comparing US money market funds’ annual net revenues as of December 31, 2022, and August 31, 2023, excluding amounts waived because of fee waivers.
[3] Active and passive multi-asset funds in the US.

— Deepen investments in technology (and integrations with client-facing cash management technology platforms) to increase the stickiness of their liquidity services.

Exhibit 11

Money market funds experienced record inflows in the first half of 2023, helped in part by worries over banks.

Monthly flows, money market funds and commercial bank deposits, $ billion



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A new future for fixed income

Higher interest rates have led to a recalibration of the role of fixed income in asset allocation. What was once viewed primarily as a low-risk diversifier has become an increasingly attractive source of income, now that risk-free yields sit at roughly 5 percent (Exhibit 12). When combined with long-term trends (for example, the retirement needs of an aging population, default asset allocation shifts in target date funds), demand for fixed income is expected to be robust in the coming years. However, fixed income has been changing in three important ways: more use of ETFs, more illiquid credit, and a bigger role for insurance balance sheets and reinsurance-oriented entities.

Greater use of the ETF wrapper

The 2023 recovery of fixed-income flows in the wake of 2022 disruptions mirrors a pattern seen in the past with equities: a macro shock triggers outflows from actively managed strategies, a period of stabilization encourages investors back into the markets, but money that was previously on the sidelines flows back into the asset class through passive strategies. Despite the bond market turmoil in 2022, fixed-income ETFs captured $198 billion in new money. Notably, active ETFs within fixed income also surged, growing into a $150 billion AUM segment by mid-2023. Demand for fixed-income ETF usage will likely keep growing as institutional clients seek the tactical flexibility and cost efficiency of the vehicle and as retail intermediaries continue to embrace the tax efficiency involved and the use of model portfolios (which typically include ETFs).

Exhibit 12

Rising interest rates have made fixed-income assets increasingly attractive.

Yields on US instruments,[1] %

Fixed-income assets

	Dec 2021	Sept 2023	Change,[3] basis points
Money market funds[2]	0.02	5.1	510
T-bills (1–3 months)	0.04	5.4	540
Treasuries (1–3 years)	0.9	5.4	450
Municipal bonds	1.1	4.3	320
Mortgage-backed securities	2.0	5.6	360
Investment-grade bonds	2.4	6.0	370
Asset-backed securities	1.1	5.8	460
Commercial mortgage-backed securities	1.9	6.1	420
High-yield bonds	4.9	8.9	400
S&P 500	4.2	4.1	–14

[1]Data as of Dec 31, 2021, and Sept 29, 2023.
[2]Calculated as weighted average of money market funds (prime, tax-exempt, government, and Treasury) as of Sept 30.
[3]Numbers may not sum due to rounding.
Source: Bloomberg; Nasdaq; SEC money market fund statistics; US Treasury; McKinsey analysis

More illiquid credit

Private credit is likely to be a major beneficiary of recent disruptions. The private credit industry as we know it came of age after the 2008 global financial crisis, when banks pulled back from certain types of lending in response to a new wave of regulation. In a similar way, recent pressure on bank lending activity is likely to set up private credit for the next stage of growth as private direct lenders continue to take market share from broadly syndicated loans that involve a group of lenders. As an example, the share of leveraged buyout transactions financed by private credit increased from about 60 percent in 2019 to about 80 percent in 2022. Private lenders have also started to attract larger borrowers, cutting out intermediaries like banks and brokers, with the number of direct lending deals of $1 billion or more totaling about $70 billion in 2022, up from about $5 billion in 2019.[4]

Meanwhile, client demand remains robust for private credit strategies, which can achieve higher yields than traditional fixed-income strategies. The floating-rate features of many private credit strategies have provided comfort to clients allocating in a rising-interest-rate environment. As a result, more large institutions have begun to structurally embed illiquid credit within their asset allocations (that is, via dedicated portfolio allocations to private credit and, in some cases, even with accompanying private credit teams). Large allocators are also seeking to blend private credit allocations with public fixed income, and private credit investments with private equity, as they fine-tune the positioning of their portfolios.

[4]Data from Refinitiv and Pitchbook.

A bigger role for insurance balance sheets and reinsurance entities
The higher-for-longer interest rate environment is precipitating a transformation in the funded status of liabilities. In the world of corporate pensions, higher rates have led to marked improvements in how well funded plans are, driving up interest in pension risk transfers and the freezing and annuitization of liabilities. Pension risk transfer volume has nearly doubled, from $27 billion in 2020 to $52 billion in 2022. This has been accompanied by the rise of multiple private-capital-backed insurance entities that have been created to aggregate liabilities (through acquisition and new origination) and provide a sizable pool of permanent capital to feed adjacent asset management businesses. As of 2022, insurance entities backed by private capital controlled about 11 percent of US life and annuities reserves, up from about 2 percent in 2012.[5]

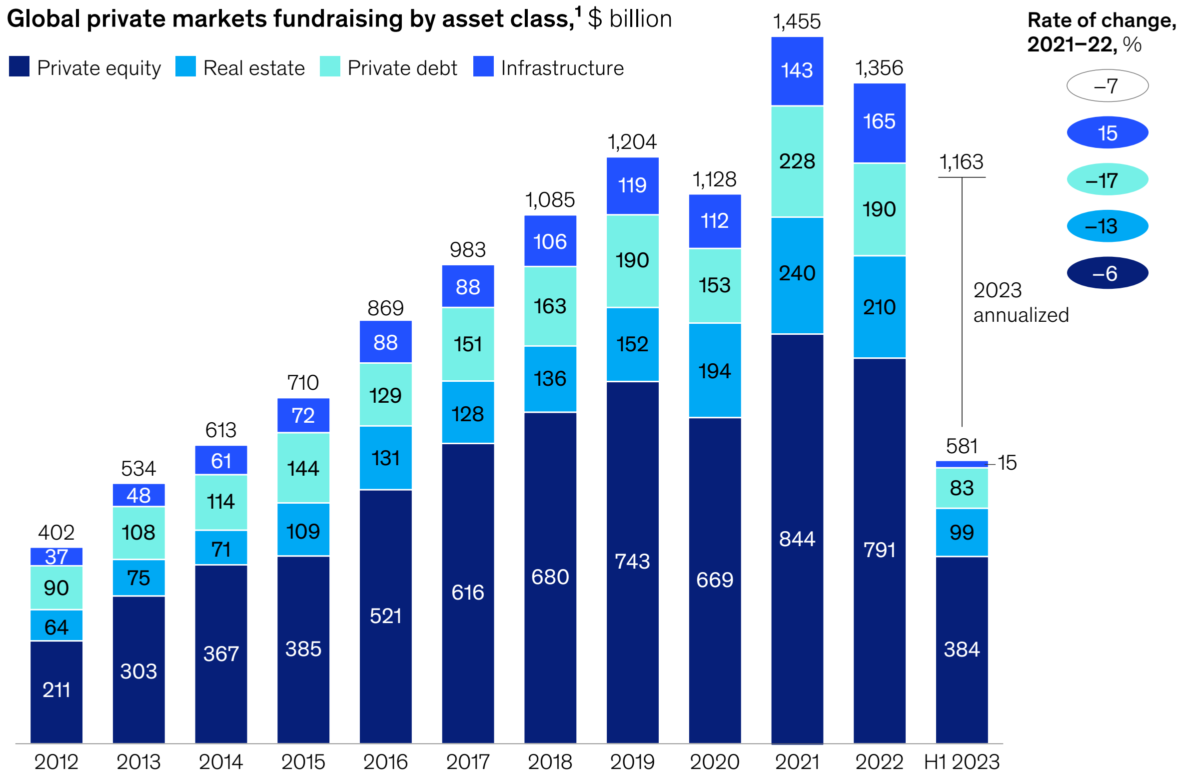
An evolution in private markets

The relentless growth of private markets alternatives has undoubtedly been one of the most important trends reshaping the asset management industry over the past decade. However, macro and market conditions have created a fundraising drought, at least in relative terms. Annualizing first-half fundraising for the remainder of 2023 would result in fundraising figures closer to the roughly $1.1 trillion raised in 2020 than to the fundraising peak of $1.5 trillion reached in 2021 (Exhibit 13). This pause in momentum can be attributed to at least three factors, including disruptions to M&A

[5] McKinsey analysis of insurance regulatory data from AM Best.

Exhibit 13

Private markets fundraising is down from a 2021 peak.



[1]All closed-end funds. Private markets refers to infrastructure, private debt, private equity, real estate private equity and debt, and natural resources. Secondaries and funds of funds are excluded to avoid double counting of capital raised.
Source: Preqin data compiled as of July 2023; McKinsey analysis

and IPO markets that have hampered exits and reduced distributions available for reinvestment; the impact of the denominator effect, where sharp markdowns of public asset valuations have created relative overallocation to private markets in the short term; and valuation uncertainties in key sub-asset classes such as venture capital that have spurred investors to take a wait-and-see approach.

The fundraising drought has had a disproportionate impact on smaller private managers as megafunds have been increasing their share of fundraising. In the first half of 2023, the top ten private markets funds globally represented 2 percent of vehicles but accounted for 35 percent of total capital raised. In contrast, larger firms have been weathering the fundraising drought with greater resilience.

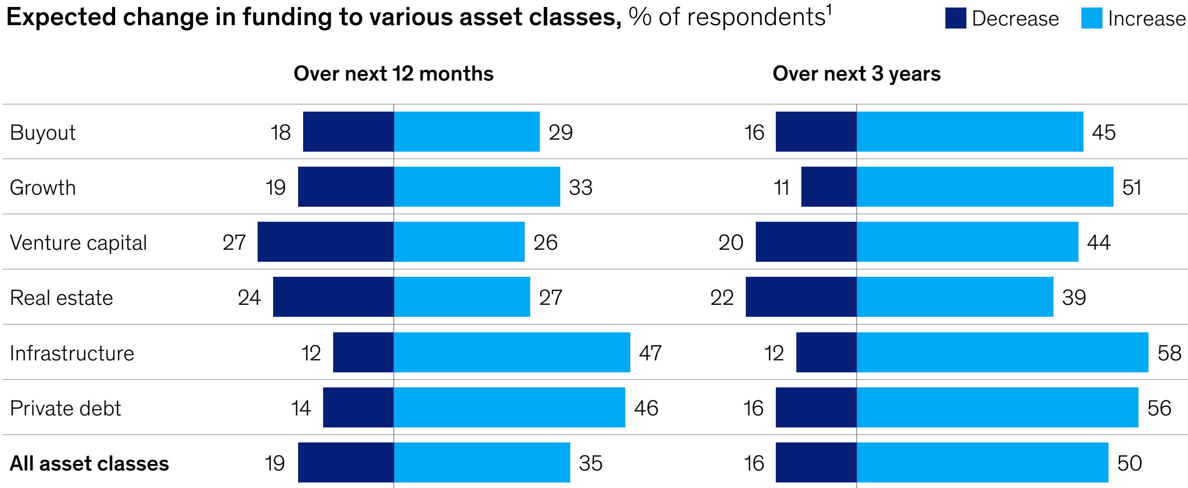
Amid these challenges, the private markets have continued to innovate. Private markets secondaries, for example, have stepped in to meet a growing need for liquidity in the market. Global secondary transaction volumes have more than doubled since 2020, to $108 billion in 2022, as limited partners seek to rebalance their portfolios and general partners aim to extend the hold periods for their best assets through continuation vehicles. In the current liquidity-constrained environment, the secondaries asset class is coming of age, with approximately $110 billion in transaction volumes in 2022, up from $40 billion in 2015, and eight megafunds with AUM of more than $15 billion each.

In addition, the longer-term outlook for private markets demand remains robust. A recent McKinsey survey of about 300 institutional investors showed that half aim to allocate more to private markets asset classes over a three-year horizon, as opposed to the 35 percent who plan to do so over the next 12 months (Exhibit 14). This optimistic demand projection is bolstered by the burgeoning high-net-worth segment. A recent McKinsey survey of financial advisors serving high-net-worth individuals indicated that over half intended to allocate more than 10 percent of their eligible client portfolios to private alternatives over the next five years.

Exhibit 14

Institutional investors expect to allocate more funds to private markets asset classes over the next few years.

Expected change in funding to various asset classes, % of respondents[1]



[1]Excludes respondents who selected "No change" or "Don't know."
Source: McKinsey Limited Partner Survey March 2023 (n = 276)

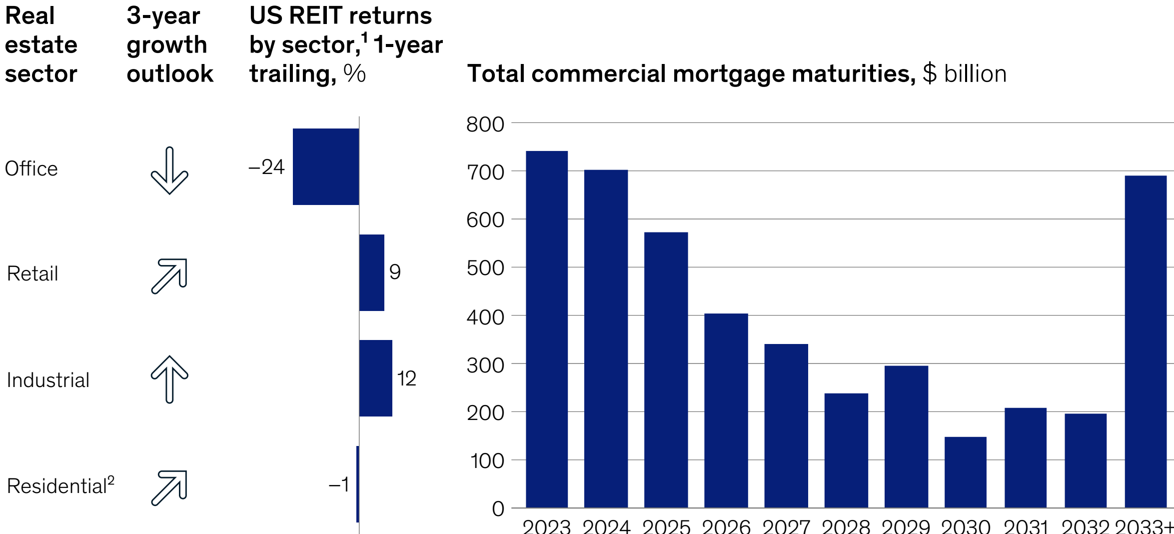
This combination of nearer-term challenges and a positive long-term outlook creates a unique window of opportunity for traditional asset managers seeking to enter or expand their presence in private markets investing. Some leading firms are doing this through team lift outs (hiring an entire team from another company), partnerships, or corporate acquisitions.

A reset in real estate

Commercial real estate (CRE) has quickly emerged as one of the most talked-about sub-asset classes in the industry, given the intersection of massive shifts in usage patterns post–COVID-19 and financial tightening on highly leveraged assets—a combination that has put pressure on owners and investors alike. Nowhere is this more evident than in the office segment, where valuations have fallen 24 percent in the year ended in July 2023 (Exhibit 15).[6] The situation is further exacerbated by the looming refinancing cliff of more than $1.2 trillion in commercial mortgages scheduled for renewal over the next few years, necessitating refinancing at markedly elevated interest rates.

Exhibit 15

Some commercial real estate sectors are under pressure, likely to be compounded by the amount of debt maturing in the next few years.



[1]US real estate investment trust returns for year ended July 31, 2023.
[2]Residential returns for multifamily only.
Source: Greenstreet; Mortgage Bankers Association; McKinsey analysis

However, not every real estate sector is cast from the same mold. Macro trends are affecting different sub-asset classes within real estate in very different ways. For instance, industrial real estate continued to perform robustly, in line with long-standing trends around e-commerce and positive developments including data center growth due to generative AI.

Amid these cross-currents, a restructuring is coming for the collective $13.5 trillion US CRE balance sheet. Potential hot spots include regional and community banks (which account for more than 20 percent of real estate lending) that are seeking to moderate their exposure to CRE, and semiliquid fund products that have exposure to impaired asset classes (for example, the $400 billion of assets in open-end core real estate funds, some of which have redemption queues

[6] Based on July 2023 trailing 12-month performance of public real estate investment trusts.

of investors waiting to cash out). This restructuring will create opportunities for providers of patient, or long-term, capital. Specific opportunities for asset managers include the recapitalizing of high-quality assets as banks reduce their exposure to the real estate sector, the scaling of real estate lending as an investable asset class, and the building of next-generation real estate investment franchises (such as sustainable buildings and digital infrastructure) while incumbents are on the defense.

We estimate that collectively, these four disruptions represent a potential $5 trillion money-in-motion opportunity over the next five years, with the prospect of shifting significant pools of assets into the world of third-party investment management. If asset managers are able to capture these opportunities, they stand to assume a far more expansive role within the capital markets ecosystem. Emerging roles for asset managers include liquidity managers, providers of long-term financing (via alternative credit), creators of new capital market instruments (for example, ETFs but in the future also tokenized assets) that democratize access to the markets, and scaled providers of liability-centric investment management services, such as for corporate defined benefit plans, in concert with insurance-linked permanent capital.

An agenda for navigating this new environment

The past 18 months have ushered in a new normal for asset managers—a sharp departure from the decade that came before. Adjusting to this new structural reality will require a trifocal agenda: coming up with new strategic positioning, reengineering operating models, and upgrading firms' execution engines. While the specific actions for each firm will vary, here are some common strategic themes firms should keep in mind.

New strategic positioning

For leaders of asset management firms, this is an opportune time for repositioning the firm and future-proofing their investment and product platforms.

Repositioning the firm

Asset managers will need to pressure-test their business strategies against long-term growth trends and a fundamentally different market environment. Firms with substantial exposure to areas that are challenged in the new environment will need to grapple with how to maximize the value of their legacy business while identifying the best ways to tap into new pockets of growth. As in prior crises, firms that can take advantage of transformative opportunities—including acquisitions, recruiting, and partnerships in the financial ecosystem—will have the opportunity to reposition themselves for outsize growth.

Future-proofing the investment and product platform

Firms should reexamine their existing product and vehicle strategies in light of a different market environment. In some cases, this will mean significantly accelerating the pace of product and go-to-market innovation, while in others it will mean more aggressive product rationalization. Firms should also be exploring the unprecedented opportunities created by new technologies such as generative AI to boost effectiveness and efficiency in investment processes including research, portfolio construction, security selection, trading, and risk management. All firms will have opportunities to improve scale, collaboration, and quality across what are often disparate investment centers. Firms that seize the moment to modernize their investment platforms can unlock competitive advantages that improve their legacy businesses in ways that preserve meaningful growth.

New operating model choices

With new choices in operating models, asset managers can design for flexibility and scale, as well as make bold moves to reallocate resources.

Designing for flexibility and scale

Firms will need to adapt to the volatility of the new environment by reengineering their operating models to create greater flexiblility and agility. This will require fundamental shifts to the operating spine of the firm to make costs more malleable so the firm can adapt quickly to changing market conditions. It will also require more fundamental shifts in the way teams are organized and the way work gets done. For example, some firms will find that there are cross-functional teams or tools that can work across asset classes or client segments to drive greater scale and/or to rapidly direct resources toward high-potential commercial opportunities.

Bold resource reallocation

Firms will also need to take advantage of this moment of uncertainty to cut back on internal complexity by shifting more resources toward true drivers of growth and taking a long, hard look at less crucial initiatives. This effort benefits from a recognition that incentives and key performance indicators need to differ for businesses operating at different

speeds. For example, a declining, mature book of legacy mutual funds will need different KPIs than a fast-growing but resource-intensive private markets build-out. In some cases, effective resource allocation also involves courageous choices to say no to long-standing businesses in order to make significant investments in new ones.

Well-tuned execution engine

As in any initiative, the execution must be as careful as the planning. Two elements where execution is particularly critical for asset managers are distribution and strategic partnerships.

Distribution alpha

Asset managers will need to modernize the engines that allow them to multiply the impact of their distribution resources and operations. This includes making sales and marketing a competitive differentiator by using non-traditional data, digital tools, and generative AI for tasks like targeting potential customers more effectively and tailoring marketing outreach to signal how a firm meets the distinct needs of different client segments. In the post-pandemic new normal, distribution professionals also need to recalibrate their model for customer interaction to make the most of fewer opportunities for in-person engagement. Leading firms are building digital distribution capabilities as well as refreshing client coverage to optimize across traditional, hybrid, expertise-driven, and team-based models. Firms that get this new distribution model right stand to win. For example, our annual Financial Advisor Client Experience Survey of more than 3,000 financial advisors shows that firms effectively using virtual channels to share expertise from portfolio managers and product specialists have meaningfully higher customer satisfaction scores.

Strategic partner engagement

Firms that win in this new environment will find ways to be strategic partners—rather than pure product providers—to their best clients. Strategic partnerships will also extend to a broader set of financial market participants, including some of the influential platform businesses we mentioned earlier, along with players in adjacent spaces (such as permanent-capital-oriented partnerships with insurance companies and distribution partnerships with private markets firms). Firms interested in pursuing these types of opportunities will need dedicated resources focused on strategic partnerships, including time and attention from the C-suite.

Beneath the challenges that asset managers experienced this year lies significant opportunity. As the financial markets ecosystem undergoes a once-in-a-generation transformation, asset managers have the potential to play a bigger role in the world of finance while helping meet clients' needs in an increasingly uncertain environment.

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