SOUTH AFRICAN DFMs, MULTI-MANAGERS & WEALTH MANAGERS

INSIGHTS INTO INVESTMENT BOUTIQUES

August 2018

RMI | INVESTMENT MANAGERS

IDENTIFY. PARTNER. GROW

FOREWORD

JB Beckett is a veteran fund selector and strategist with over 20 years' industry experience. He is the UK Director for the Association of Professional Fund Investors.

Globally, the struggle between boutiques and super-tanker funds continues and professional fund investors find themselves at the centre of it; a fight between asset aggregators and specialists, between broad waterfront and high conviction. South Africa in particular faces significant concentration issues based on available data. Such concentration is rarely conducive to good competition, without which innovation and excellence cannot thrive. The risk is the Retail Distribution Review, which exacerbated asset concentration in other markets and a rise of indexation. This then is the most enlightening buyer study I've seen in context of the South African market and asks reaching questions around the buying behaviours of advisors, discretionary fund managers (DFMs) and multi-managers.

What can fund buyers do? To break out of what I call the *core-satellite conundrum* that buyers find themselves in, we must reconsider past as well as new allocation decisions to challenge our bias towards big brands and reassess those 'safe' choices. Simply allocating small satellite allocations to boutiques will not change your market. As the study notes, no single approach to fund investing works, certainly not by focusing on past performance alone. It requires the use of a wider range of techniques, new questions, multiple factors and technologies. As markets become ever more complex, buyers must shift from a rear-view approach to a forward-looking one. It is imperative that we move from short-termism to long-term outcomes. Our sense of the economic value of those in the value chain has never been greater but remains unrecognisable to where we are heading. We need to invest towards a more sustainable economy and it is boutiques, with high levels of focus and engagement, that will bring the most innovative solutions.

JB Beckett

INTRO

Leading insights into what retail gatekeepers require of investment boutiques.

RMI Investment Managers recently conducted a survey amongst various types of retail financial service providers (FSPs). These FSPs are all authorised to allocate funds to investment managers with a fully discretionary or non-discretionary mandate.

These FSPs included the following:

1 WEALTH MANAGERS

This included IFAs, tied agents and bank financial advisors and/or independent wealth managers (financial advisors that focus largely on advising on investments).

2 MULTI-MANAGERS

This included both corporate (owned largely by large listed companies) and financial adviser fund-of-funds.

3 DISCRETIONARY FUND MANAGERS

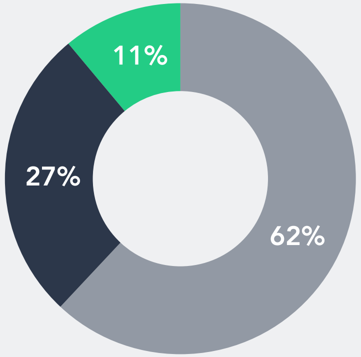
Also referred to as discretionary investment managers (DIMs). For the purpose of this paper, we will refer to them as DFMs.

The purpose of this survey was to glean insights into how these allocators of capital view boutique investment managers in South Africa and specifically what factors they consider when screening and awarding investment mandates to these boutiques.

STATS

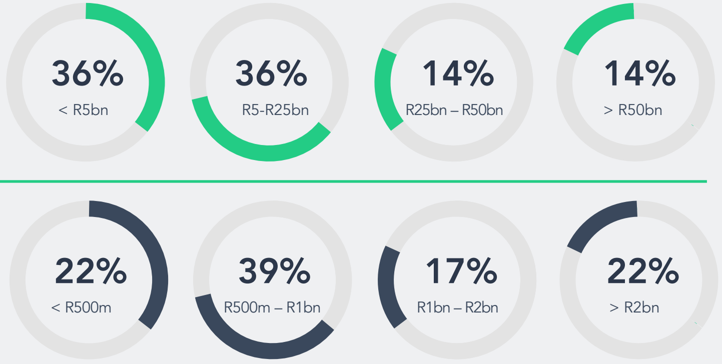
Key highlights from the survey

1 SURVEY PARTICIPANTS BY CLIENT TYPE



- IFAs and Wealth Managers (of these respondents 65% have appointed a DFM)
- DFMs
- Multi-managers

2 ASSETS UNDER ADVICE



3 MOST IMPORTANT FACTORS THAT INFLUENCE INVESTMENT MANAGER SELECTION

IFAs/Wealth Managers
- Trusted brand
- Investment manager tenure
- Long term track record (greater than 5 years)

DFMs/Multi-managers
- Investment manager tenure
- Long term track record (greater than 5 years)
- Ownership structure

6 TOP ADVICE FOR BOUTIQUES WHEN PITCHING FOR BUSINESS

IFAs/Wealth Managers
- Platform access
- Articulate key differentiators

DFMs/Multi-managers
- Articulate key differentiators

4 % OF ASSETS UNDER ADVICE INVESTED WITH BOUTIQUES

IFAs and Wealth Managers

48% hold less than 10%

DFMs and Multi-managers

50% hold 10-25%

5 REASONS FOR NOT ALLOCATING TO BOUTIQUES

IFAs/Wealth Managers	DFMs/Multi-managers
Brand and investment team unknown	Key investment manager risk and not available on platforms

7 TOP FACTORS WHEN SELECTING A BOUTIQUE MANAGER

IFAs/Wealth Managers
- Niche investment strategies
- Portfolio managers have a stake in the business
- Investment performance track record

DFMs/Multi-managers
- Portfolio managers have a stake in the business
- Investment performance track record
- Robust investment process

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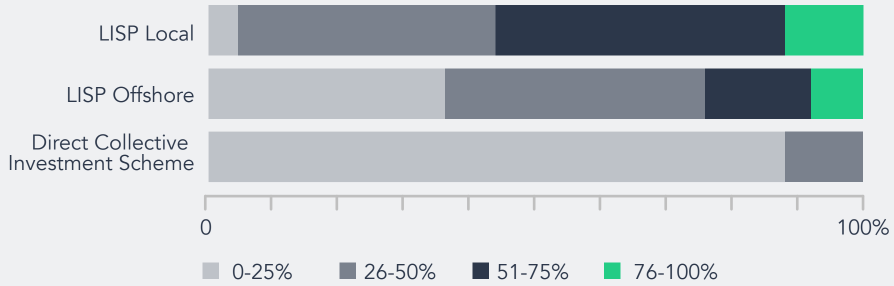
01 OVERVIEW OF INDUSTRY ASSET SPLITS

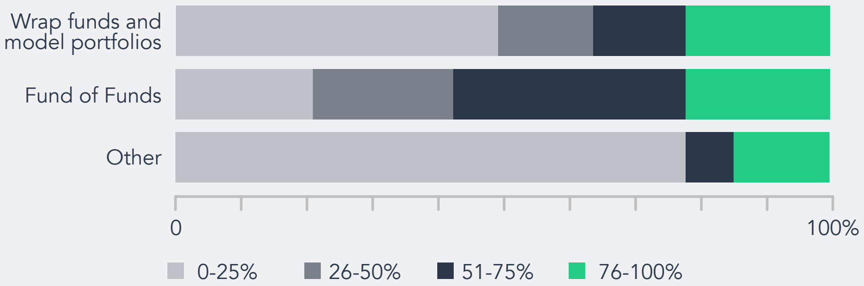
IFAs/Wealth Managers

80% of IFAs and Wealth Managers have between 26% to 75% of their assets held via a local LISP with almost 75% of the survey respondents holding between 0-50% of their assets via an international LISP. Interestingly, almost 90% of the survey respondents hold between 0-25% of their assets directly with a unit trust and not via a platform/LISP.

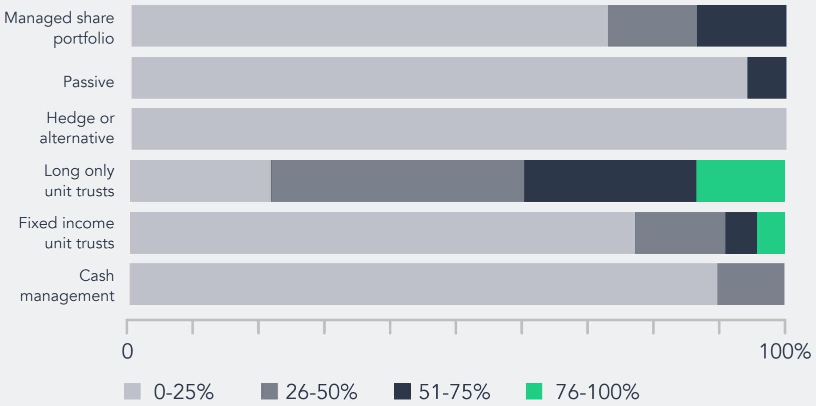


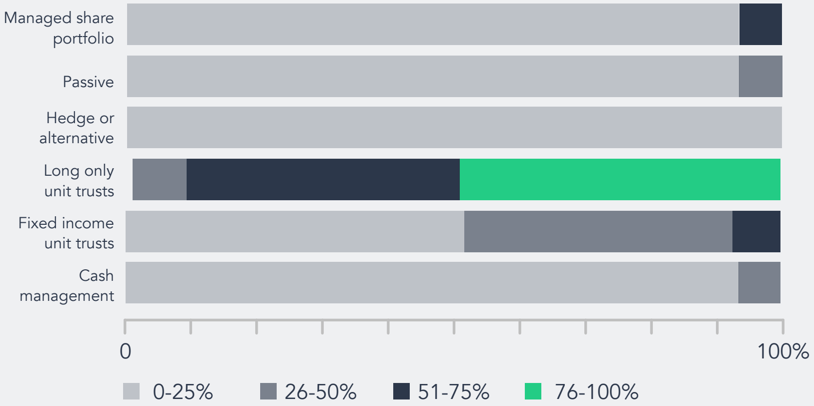
DFMs/Multi-managers

Almost 60% of the DFMs/Multi-managers have more than 50% of their assets invested in a fund of funds.



92% of DFMs/Multi-managers and almost 40% IFAs/Wealth Managers allocating more than 50% of their total assets to long only unit trust funds. Hedge and Alternatives together with Passive and Cash management receiving less than 25% of total allocations across the board.





02 THE RELATIONSHIP BETWEEN ADVISORS AND DFMS

It is becoming increasingly common in South Africa for financial advisors and wealth managers to use DFMs as investment partners against the backdrop of a highly complex market and ever tighter regulation. Partnering with a DFM can bring benefits such as cost efficiency through scale as well as enable financial advisors to focus purely on advice, rather than embarking on a robust investment allocation diligence process.

Our survey results show that this is indeed a popular strategy as **65%** of the wealth manager respondents have appointed a DFM. The majority use DFMs to advise on asset allocation, portfolio construction and investment manager selection.

03

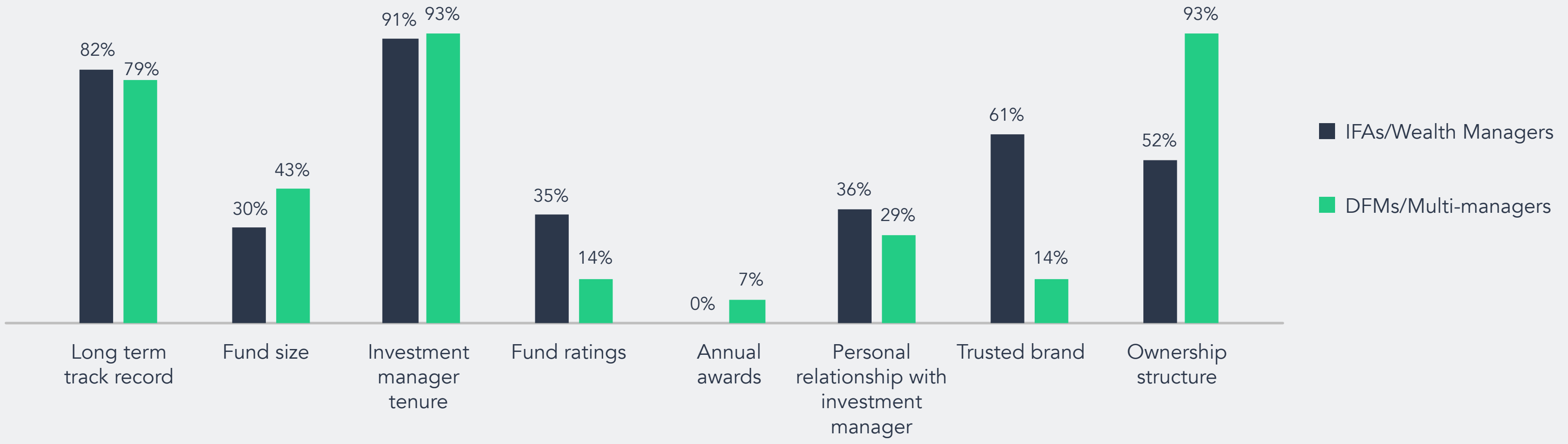
THE INVESTMENT MANAGER SELECTION PROCESS

There are a rising number of boutique entrants into the investment management industry in South Africa that are attracting an increasing portion of new business flows. One of the consequences of this is that there are a number of factors that can influence a capital allocator's decision in the investment manager and/or underlying fund selection process.

Our survey found that for the majority of respondents, **investment manager tenure** is the most important factor, across financial advisors and DFMs/multi-manager participants. **A long-term track record of greater than 5 years** and **ownership structure** was also deemed integral to the decision-making process across respondents.

03 CONTINUED

FACTORS CONSIDERED IN THE MANAGER SELECTION PROCESS



Interestingly, there was a significant divergence between the importance of a trusted brand between financial advisors and DFMs/multi-managers. For more than 60% of the former, a **trusted brand** ranked high in terms of importance whereas amongst the latter, it did not. This discrepancy makes sense given advisors deal directly with the end client, so it would be difficult for them to recommend a brand with which the client is not entirely familiar or comfortable.

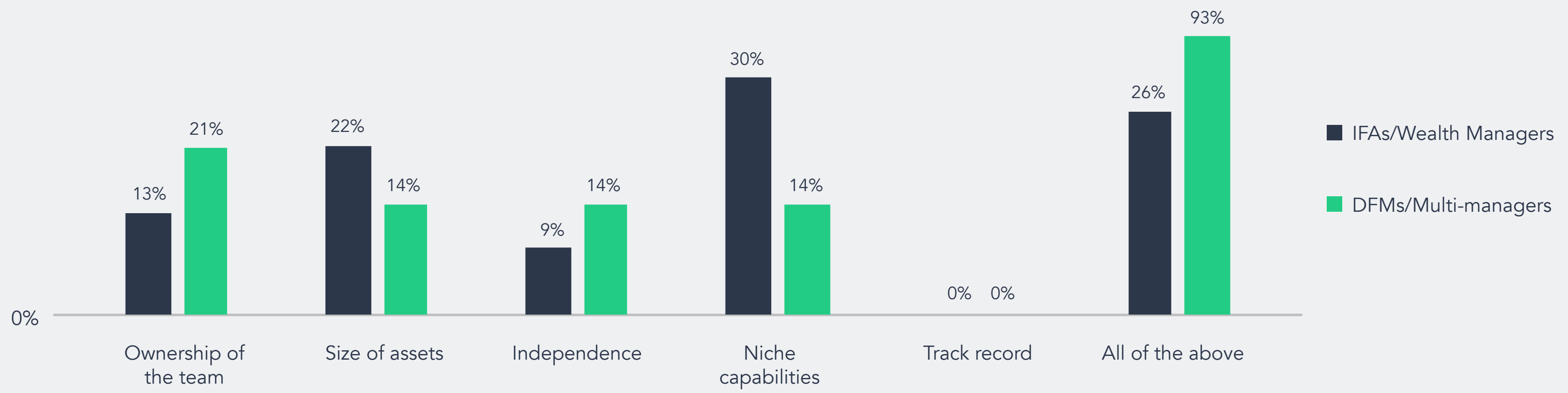
The **least important factor**, for both the adviser and manager groups, was whether the manager had received any annual industry awards.

04

SELECTING A BOUTIQUE INVESTMENT MANAGER

At RMI Investment Managers, we define a boutique as an independently owned firm that specialises in a specific investment capability. Typically they manage a finite number of portfolios that make the most of the investment team's niche skill set, are often independent and owned by the day-to-day "decision-makers".

FACTORS CONSIDERED WHEN SELECTING A BOUTIQUE INVESTMENT MANAGER



04 CONTINUED

For the purposes of our survey, we provided our respondents with a choice of five characteristics that could define what a boutique investment manager means to them:

SIZE OF ASSETS	OWNERSHIP STRUCTURE	NICHE CAPABILITIES
INDEPENDENCE	TRACK RECORD	

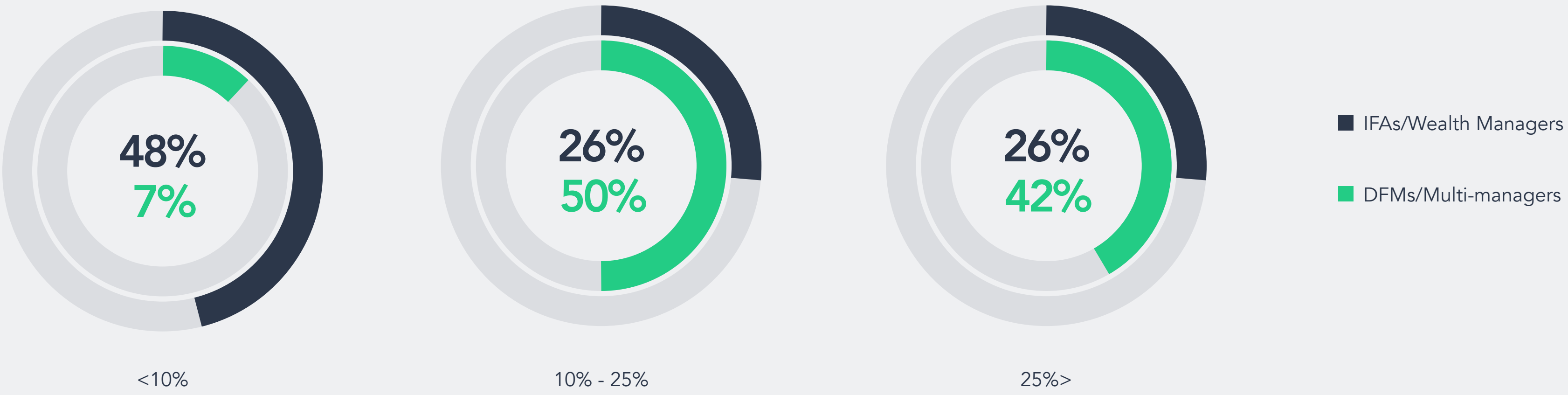
Across all categories of respondents, all five of these are key to what differentiates a boutique investment manager. Interestingly, the most popular choice for the advisor group was **niche capabilities**. It is therefore vital that boutiques articulate these niche capabilities clearly when pitching for business.

05

SMALL ALLOCATION TO BOUTIQUES

The results of the survey indicate that only a few participants actually allocate to boutique managers. The majority of advisors and wealth managers (more than 75%) hold less than 25% of their assets under advice with boutiques. DFMs apportion a far higher percentage of their assets under advice to boutiques compared to the advisor group; encouragingly, just over 40% of DFM respondents hold more than 25% of their assets under advice with boutiques.

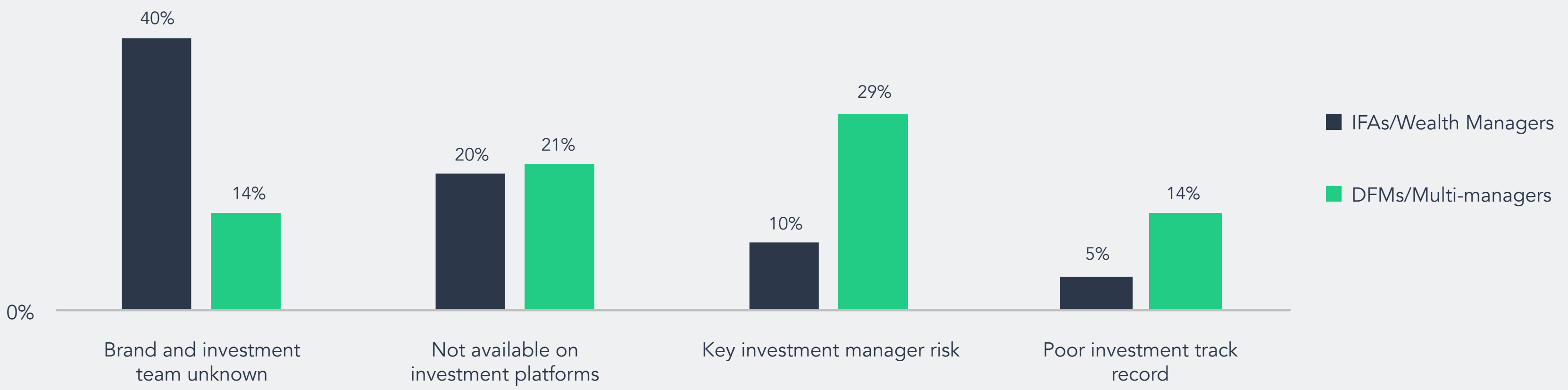
ASSETS ALLOCATION TO BOUTIQUES



05 CONTINUED

Respondents cited **unknown brand and investment team** as the reason for the low allocation. For DFMs and multi-managers however, this was the least important factor. For them, concerns about **key investment manager risk** was rated highest as a reason for not allocating assets to boutiques.

REASONS FOR NOT ALLOCATING TO BOUTIQUES



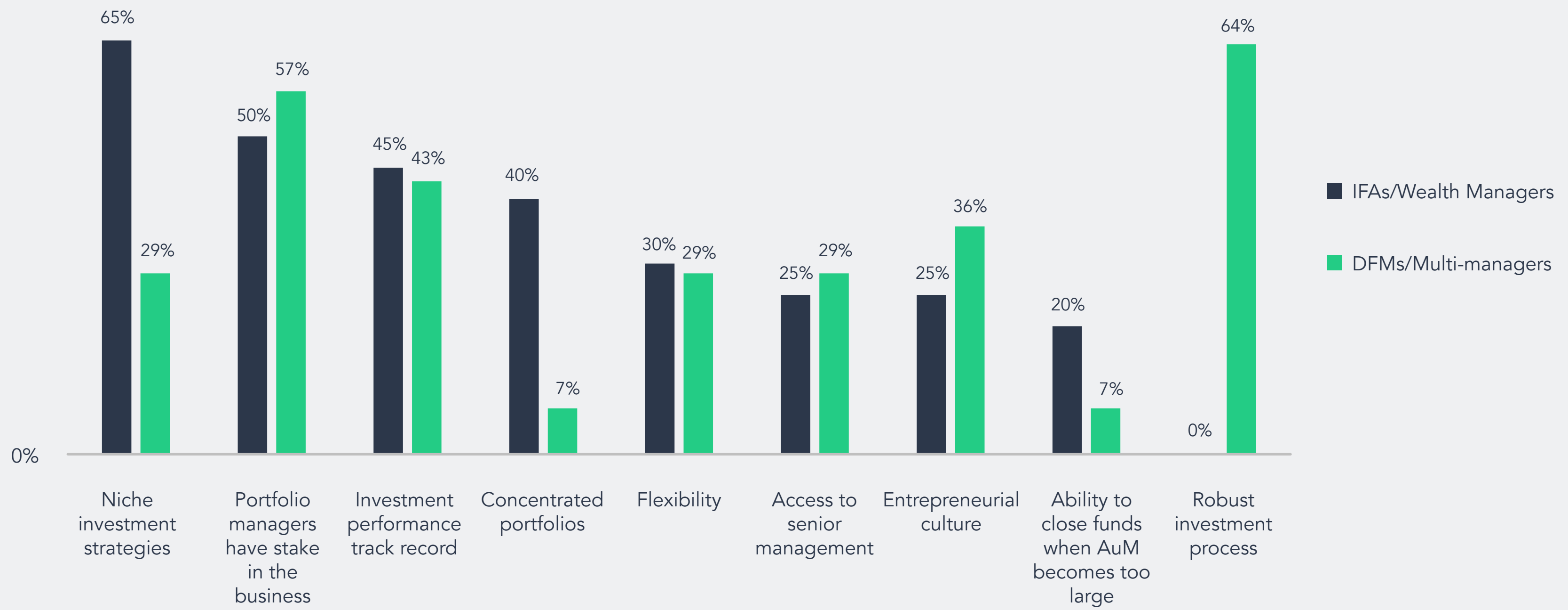
06 OWNERSHIP IMPORTANT IN BOUTIQUE SELECTION

For financial advisors, DFMs and multi-managers, ownership structure matters when it comes to selecting a boutique manager. Portfolio managers **owning a stake in the business** was cited as the second most important selection factor across categories. This is a key differentiating feature of boutiques compared to big fund houses: boutique managers generally have significant **skin in the game**, so their goals are often considered more closely aligned with those of their clients. **Track record** is also important to all respondents, with this being the third choice for both groups.

The groups differed in their choice of the top influences affecting their investment manager selection decision. The DFMs and multi-managers selected a **robust investment process** while, in line with their preferred definition of a boutique manager (discussed above), the advisors selected a boutique manager based on their ability to offer **niche investment strategies**. This speaks to the industry-wide trend that we are seeing: advisors are increasingly looking to distinguish themselves from the market by offering solutions that are slightly differentiated from the more traditional options available from larger players.

06 CONTINUED

CRITICAL SUCCESS FACTORS FOR BOUTIQUES



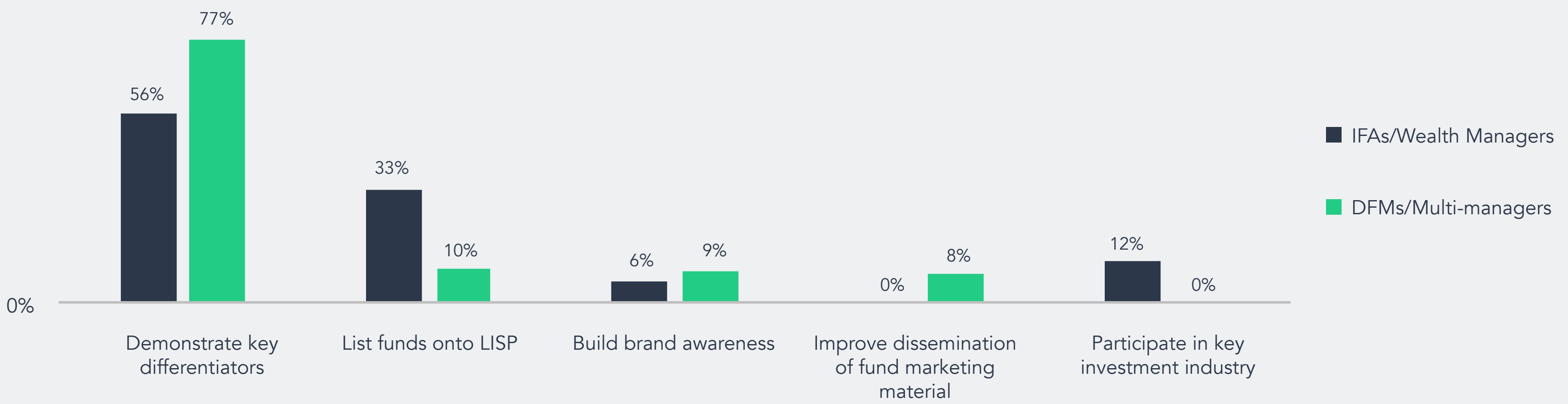
07 MOST IMPORTANT FOCUS AREAS FOR BOUTIQUE MANAGERS

The survey respondents were requested to rank, in order of importance, five points of advice to boutiques who pitch for a share of their business. **Demonstrating key differentiators** ranked the **most important** for IFAs, DFMs and multi-managers. Clearly, a boutique has to stand out from the crowd and articulate how it can offer a superior solution to its peers. Against an increasingly competitive backdrop, this is no mean feat but one that evidently has to become a priority.

Listing funds on a LISP was the next most important advice from wealth managers to boutiques (although for DFMs and multi-managers, this turned out to be less important). This outcome is no surprise, as most IFAs and wealth managers place investment businesses onto LISPs for easier and better administration purposes. For the DFMs and multi-managers, participation in industry events and improving the dissemination of marketing material ranked lowest.

07 CONTINUED

TOP ADVICE FOR BOUTIQUES PITCHING FOR BUSINESS



On a positive note, 50% of advisor participants responded that they are looking to **increase their allocation** to boutiques in the next 12 months. But this should be viewed in the wider context; 65% of this group use a DFM or multi-manager, so the adjusted percentage is much smaller. Out of the DFM and multi-manager sample, there was an even split between those looking to **remain as is** and those looking to **increase their allocation**. Encouragingly, none of the participants indicated that they would be decreasing their allocation.

08

BENCHMARKS INAPPROPRIATE

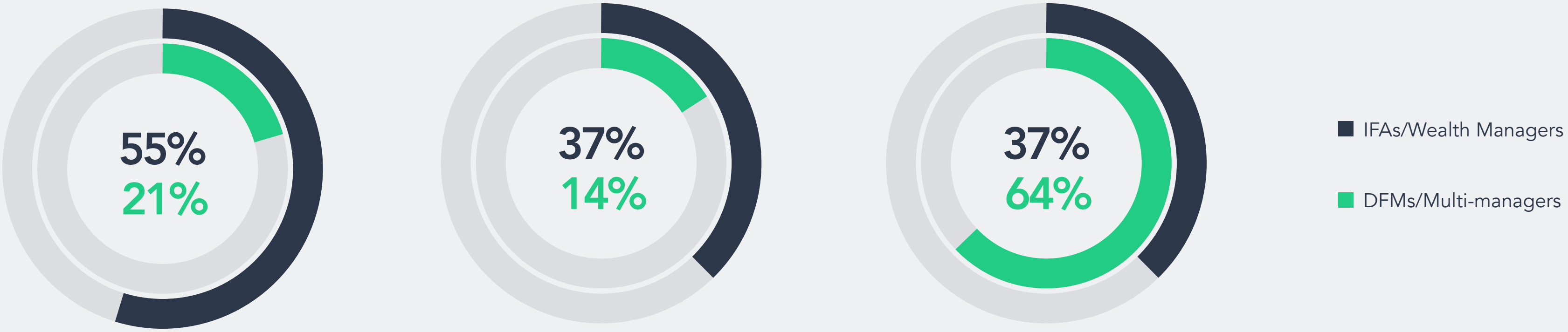
When it comes to fees, it seems that DFMs and multi-managers are more realistic in setting pricing benchmarks. Their view is that **local fixed interest mandates** should charge **15-50bps** while **offshore mandates** should charge **25-50bps**. All other mandates ranged between **50-75bps.**

On the IFA and wealth manager side, approximately 80% of respondents felt that the fees to be charged for **fixed interest mandates** (both local and offshore) should range between **10-25bps**, whereas both **local and offshore balanced and equity funds** should charge in the region of **50-75bps**.

A majority (55%) of IFAs and wealth managers believe **performance fees should not exist at all**. Interestingly, 64% of the DFMs and multi-managers were neutral on the existence of performance fees, but they were more concerned about how the performance fees are actually charged; 64% of the DFMs and multi-managers agree that **benchmarks are entirely inappropriate.**

08 CONTINUED

VIEW ON PERFORMANCE FEES



Agree that performance fees should NOT exist

Agree that performance fees incentivise appropriate performance

Agree that benchmarks are entirely inappropriate for performance fees

09

WHAT MATTERS IN MANAGER SELECTION

Based on our survey results we can conclude the following:

- **Differentiating features** and **niche capabilities** matter to all FSPs.
- A **trusted brand** is particularly important for the advisor market.
- **Track records** influence the manager selection process.
- **More assets are likely to be allocated** to the boutique market in the coming year.

With the continued growth in the entrance of boutique investment managers into the industry, it is clear that this is an area advisors and allocators need to take notice of, as investing with boutiques can offer many advantages in complementing large manager allocations.

10

DIVIDED BUT CONQUERING? A DEEP DIVE INTO THE DFM MARKET

In February 2018, the UK's MoneyMarketing publication interviewed more than **400** advisors and paraplanners and compiled a write-up on their key findings.

While the survey did not highlight the inclusion or exclusion of boutiques in manager selection, there were many interesting observations that we believe complement the RMI Investment Managers retail client survey.

KEY HIGHLIGHTS

For a full review of the article, please click **here**

8.7

The advisor feedback was overwhelmingly positive: when asked for a rating out of 10, the average advisor rated their DFM 8.7.

46%

The average advisor held 46% of their assets with DFMs and rated performance as the top priority in choosing where to place their client assets.

While the structure of the advisor-DFM relationship came through in many of the comments from advisors, **performance** was still ranked as the most important factor when choosing where to invest a client's money.

Concerns over how to benchmark DFMs against one another were raised in the survey responses suggesting a **whole of market performance benchmarking would be easier** and not the DFMs preferred benchmark over their preferred time frame implying it was hard to measure how the different DFM solutions performed against one another.

There were many points that covered costs suggesting that advisor sentiment towards DFMs may change if markets continue to deliver flat or negative performance in the face of a bear market or increased volatility. The approximate average charge to access a DFM was **0.66%,** with the larger proportion of respondents (44.4%) paying between **0.7% and 0.8%.**

Advisors indicated that they were happy with DFMs at the moment, but continued interest in **reducing costs through passives** could change that. Asset allocation could be done cheaper via passives rather than a DFM

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DISCLOSURE

This survey and its findings were neither intended to be qualitative nor quantitative, but rather “dip stick” research conducted via SurveyMonkey via willing participants. In so doing, we believe that these findings cannot be deemed as fully representative of all types of intermediaries in South Africa but are confident that these results could be used to observe certain high-level key market indicators.