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Reasons for cheer and for caution

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Is that it?

A year ago the asset management industry was quaking in its boots. A toxic combination of tumbling markets and fleeing investors saw assets under management slide 19 per cent in 2008, McKinsey has estimated. This is an uncomfortable statistic for an industry whose revenues are directly related to its assets, but whose cost base is relatively fixed.

With the atmosphere still febrile in the wake of **Lehman** collapse, the fund industry was battening down the hatches in anticipation of another bad year. Headcounts were cut, bonuses trimmed and there was even wild talk of the industry thinking about starting to prepare to consider whether the gross oversupply of funds, particularly in Europe, should finally be addressed.

Even if the storm clouds gathering menacingly over the global economy were to dissipate, it would surely take battle-scarred investors, particularly those of the retail kind, years to regain their nerve and return to the fray.

Yet what a difference a year makes. Thanks to the rally that set in in March, most major equity indices are up 20 per cent for the year. Corporate bonds have proved equally fruitful.

And the funds industry has been the prime beneficiary of this trend. EPFR Global, a data provider, says that, barring a dramatic late sell-off, bond funds will take more money this year than ever before, while equity funds are also in rude health. Higher margin areas such as emerging market equities and high yield bonds have seen record years.

Lipper FMI says European funds attracted a net €35bn (£31bn, $50bn) in October, the best showing since April 2006. This comes on top of a July-September quarter that was so strong even the fund-shy Italians and Greeks threw caution to the wind and returned to the marketplace. Fund sales in the UK have hit record levels.

Further, there are few signs investors have the clout to punish fund managers for their losses in 2007/08 by demanding lower fees. Even the lucrative “2 and 20” hedge fund structure looks likely to remain intact.

All in all, it is little surprise that the median listed asset manager saw its shares plunge 50 per cent in 2008, but rebound 46 per cent this year, with the likes of **Bluebay**, **Gottex**, Banca Generali, **Azimut**, **Henderson**, **Blackstone** and **Ashmore** seeing their stock more than double in value.

“From a negative position in the first quarter without exception, 99 per cent of them have come out with profits. They have been rescued,” says Ray Soudah, founder of Millenium Associates, a Swiss advisory firm. Mr Soudah believes industry cost/income ratios had leapt to around 100 per cent as of March, erasing profitability, but have since eased back to 70/80 per cent.

The oft-mooted wave of merger and acquisitions, in what is surely one of the world’s most fragmented of industries, has once again proved muted, with the deals that have taken place, such as **BlackRock** snapping up Barclays Global Investors and BNY Mellon snaffling Insight Investment, largely driven by the weakened banking sector’s desire for cash.

So can industry executives now remove their flak jackets and settle back into their customary, comfortable routines?

Perhaps not. One obvious concern is that the market rally has been built on a government and central bank-sponsored wall of liquidity, rather than sound economic foundations, and is thus prone to collapse when the tap is turned off.

Even setting aside such worries, a return to business as usual is far from guaranteed. Industry profitability rebounded sharply after the bursting of the dotcom bubble at the beginning of the decade but, as Mr Soudah notes, during that episode we did not have a banking crisis. Large asset managers were not owned by troubled institutions.

“The market has rescued [asset managers] in the short term but it has not rescued them in the long term because the parentage of these firms is in a mess,” he says, arguing change has merely been postponed. “It’s quite clear that a lot of asset management companies will be disposed of and a lot of wealth managers will become non core.”

As a rough rule of thumb, one knows one is in hostile waters when one’s parentage is being questioned, but Amin Rajan, chief executive of the Create Research consultancy is “cautiously optimistic” that genuine change is afoot.

“The industry has really started to clean itself up. They are having redundancies in the front, back and middle office of a scale that are the greatest in living memory,” he says, recounting 30 per cent plus headcount cuts in extreme cases as the industry gets to grips with its oft-bloated cost base.

Mr Rajan pins his hopes on a new “gene pool”, a new generation of chief executives who offer the “real chance of a revitalised industry emerging”.

The ramifications of the financial crisis are likely to reverberate for some time, but it would be churlish not to offer at least one cheer for the year that is about to expire.

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