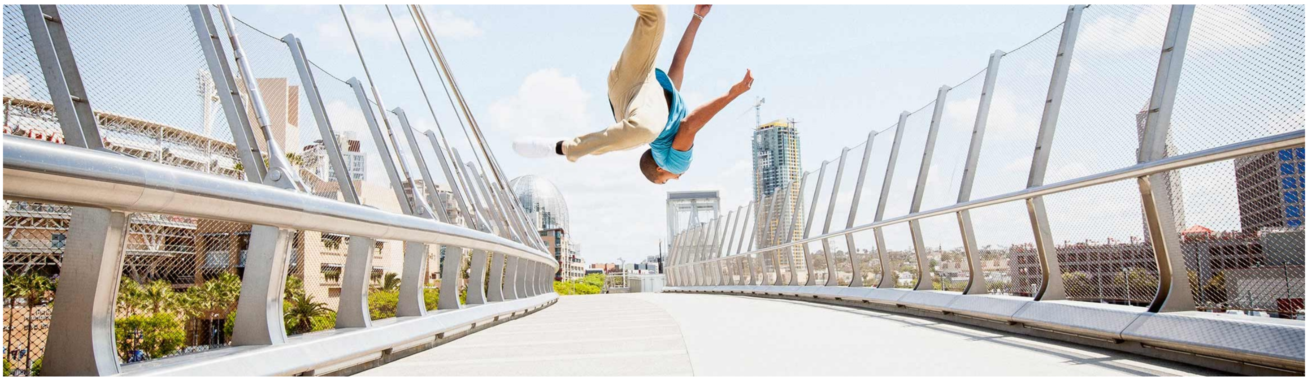
Four industry trends are arguments in favour of active asset management

by Tobias C. Pross | 25/09/2018



Summary

Firm believers in active asset management do not always have it easy in the public debate. Yet they have also had it tougher. This is because, in the long-standing controversy about active versus passive fund management, the debate is gradually becoming objective – and thankfully so. Each of these approaches has its raison d'être; neither is the only true path. Nonetheless, there are good reasons for asset managers to adopt a clear position. We have done so and remain committed: Allianz Global Investors (AllianzGI) is an active manager. We refer to four globally observable trends in the industry to illustrate this.

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1 Divergence has advantages

The first trend – to take the bull by the horns, so to speak: the popularity of passive strategies provides an opportunity for real active management. In the bond sector, the advantages of a deliberate deviation from the index are obvious, as the largest borrower (not always the most solid one) holds the largest weighting in the index. This applies to German equities, too: since the low point in the spring of 2009, investors have been able to make up a lot of ground against the DAX just by underweighting utilities and banks. The prices of these two sectors are still below the level of March 2009, while over the same period the DAX has more than tripled. Even more opportunities are provided by multiasset strategies, which have held first place by a wide margin in European sales statistics over the last 15 years: an analysis by AllianzGI indicates that European private investors have entrusted around EUR 870 billion to this asset class since 2002. The built-in diversification and flexibility, i.e. the opportunity for active reallocation, are the trump cards that the asset class can use to its best advantage.

All this shows that even in a world in which the market return – beta – can be achieved cheaply via passive products, there is an opportunity for active strategies and active management. Even in the implementation of an investment strategy consisting entirely of passive instruments, most customers need "active" support. In addition, it is a myth that investors always receive exactly the performance of the associated index with an ETF. The DAX, for example, is a performance index, which includes the dividends that are paid out. Since taxes are payable on dividends, however, a DAX ETF is systematically lower than the index. In the case of ETFs on less liquid market segments, such as high-yield bonds, index and ETF perform differently in difficult market situations, because some of the securities included in the index are no longer tradable. We last saw this situation in February, and as the ECB exits the corporate bond market, we may experience it more often. This suggests at least a more complex balance between active and passive management than we usually find.

2 Myth of exact tracking

A second globally observable trend is the increasing importance of alternative investments. When the expected yield for supposedly "safe" investments (government bonds with the highest credit ratings) is almost zero or is negative, not least with serious repercussions for the portfolios of pension institutions, more depends on additional income – alpha. The charm of alternatives is not only that they have return potential, but that this is also uncorrelated with other asset classes. In addition, the market for illiquid alternatives such as infrastructure or private financing is growing strong: capital supply has its counterpart in fastgrowing capital demand. As an example, this is reflected in the growth of Alternative Investments at AllianzGI. Between 2013 and 2018, the assets under management in that sector have increased thirty-fold through organic and inorganic growth – from the original EUR 2 billion to more than EUR 60 billion now. Actually, the term “alternatives”, as a catch-all for strategies that are not plain vanilla equity, bond or multi-asset investments, has not lived up to the importance of this asset class for quite a long time. It is often overlooked that the assets managed within this strategy have, according to the Boston Consulting Group, grown just as strongly as the more passive investment strategies in the last 15 years. This trend may continue. And alternatives are pure active management.

3 Sustainability becoming more important

The third global trend is the increasing importance of ESG aspects when making capital investments. The Global Sustainable Investment Alliance (GSIA), a worldwide association of organisations for promoting sustainable investing, reports that the total volume of responsibly managed investments rose by a quarter between 2014 and 2016 alone, to nearly USD 23 trillion. More than half of this amount (USD 12 trillion) is managed in Europe. An important note in this context is that investing while taking into account environmental (E), social (S) or governance (G) aspects does not automatically mean exclusion criteria and investment bans. A number of clients are looking for exactly this, or are interested in impact investing, i.e. investments that explicitly promote well-defined ecological or social causes. For some other clients, on the other hand, this is not what they are looking for. So precisely for these clients, there is a third way: integrated ESG research. This is AllianzGI’s alternative for those who are not seeking direct SRI products, but who would like to make sure that the main ESG risks are taken into account in the investment process. The objective in doing so is to identify and avoid “ESG torpedoes” in the research process, i.e. ESG risks that may seriously threaten the share price. At the same time, however, investment opportunities should also be used actively, resulting from the fact that companies redefine their strategy on the basis of dialogue with critical analysts and portfolio managers. In the US especially, integrated ESG research already plays a major role, according to GSIA figures. This alternative approach still has some potential for catching up in Europe.

4 Client focus put into practice

Lastly, the fourth trend is based on the recognition that the justification for the existence of active asset management is not based solely in achieving an outperformance of any type. It is based rather more on a trusting and added value-creating client relationship. This starts with advisory services, but can go much further. As the highest level of the cooperation known from fiduciary management (this would include the preparation of strategic asset allocation, the development of the investment strategy, selection of portfolio managers, risk management, reporting), the investment value chain is fully outsourced to delegated/ outsourced CIO services. This means that both the decisionmaking authority and responsibility are delegated to the asset manager. This requires a very special close relationship of trust between client and asset manager. The partnership is raised to a new level. Common values can only emerge over the long term if they are shared, i.e. “Shared Value”. Consequently, critical factors in the success of an asset manager are, above all, genuine client focus put into practice, in addition to extensive expertise (both geographical and asset class-related) and time-tested risk management qualities.

Active advice essential

Our many discussions with clients reveal that these four trends, observable worldwide, are on investors’ minds. Many appreciate comprehensive and active asset management, not least because experience shows that investment objectives are primarily missed due to investment strategies that have been established or implemented inadequately. As a result, we believe active advice and active management will continue to be essential in the future, in order to create value together with clients and on their behalf.

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About the author

Tobias C. Pross

CEO

Tobias C. Pross is Chief Executive Officer (CEO) of Allianz Global Investors and is chairing the firm's Executive Committee.

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ESG – "plus" for sustainability, "plus" for performance?

by Hans-Jörg Naumer | 25/09/2018

Summary

This article illustrates the considerable growth in the importance of CSR[1] and ESG for companies and investors. The added value consists not only of a "plus" for sustainability, but may also result in a "plus" for performance, as documented by academic studies.