J.P. Morgan Insights The World Is Not So Flat

The 2016 J.P. Morgan Asset Manager Survey

The World Is Not So Flat

Findings from the Feb. 3, 2016, webinar on global distribution and product trends

In 2005, Thomas Friedman's *The World Is Flat* painted the picture of a global economy where geographical distinctions would become increasingly irrelevant. As asset managers enter yet another year of change, many probably wish it were only that simple.

In early 2016, J.P. Morgan partnered with Dechert and the financial consulting firm Dechert LLP to survey our largest asset management clients for their views on the trends that will shape their business in 2016 and beyond. Eighty representatives from client firms participated in a webinar, including chief operating officers and heads of marketing, product development and operations from U.S., European and Asian-based asset managers.

The findings, based on in-depth qualitative interviews and interactive webinar polling in addition to Dechert and FUSE's own proprietary research, showed a number of revealing patterns. The asset management industry of tomorrow is likely to be both more global and more localized than it is today. The winners will be those that can amass the scale, efficiencies and nimbleness to respond to the particular demands of distinct client bases spread across dozens of regional markets and regulatory jurisdictions.

Technological and demographic upheavals, too, are creating new challenges for the world's largest asset managers, as well as opportunities for growth. As managers weigh their commitments to new product and mobile platforms, they grapple with which side of these historic shifts their firms will fall on. Will they follow the example of companies in other industries that embraced the digitalization of their goods and services...or those that were rendered obsolete by it?

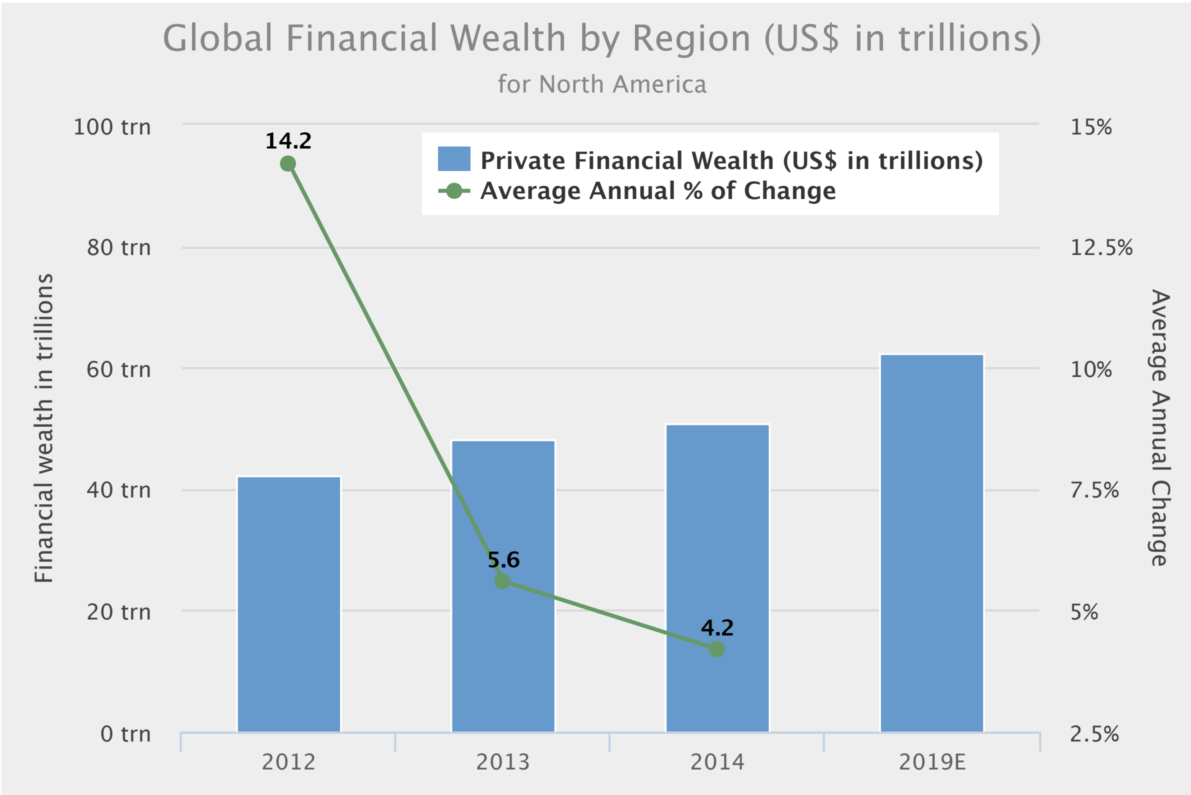
The ways that global asset managers are answering that and other questions make for a telling snapshot of the industry and potentially a roadmap for the future.

Top five potential distribution and product trends for 2016 identified at the webinar

1. The growth potential and considerable barriers to entry in Asia

- Although the U.S. and Europe remain the primary focus, asset managers are increasingly drawn to the potential growth in Asia. Projections through 2019 from a survey conducted by the Boston Consulting Group (BCG) call for assets under management (AUM) in Asia to grow at 10% annually, more than twice the rate in the U.S.[1]
- The age demographics are also compelling. It took 65 years (1950 to 2015) for seniors in Europe to increase to 24% from 12% of the population. Asia, where seniors currently represent 12%, is projected to make the same shift in just 33 years.[2]
- But the upfront costs will likely be considerable, particularly in China, which is viewed as the market in Asia with the greatest upside. Based on our survey, many managers are concerned that restrictions on the ability to sell non-local product in China and Hong Kong will continue to restrain access to China's $1 trillion fund market. A more likely path, suggest our survey results, is that managers will need to establish (and win Chinese recognition for) Hong Kong-domiciled funds or cultivate a presence in China itself via joint ventures. Our panel noted it could take managers 10 to 15 years to build out a large footprint.
- Dechert's clients are looking at asset-gathering opportunities in geographic markets that may be easier to penetrate—like Latin America (LATAM). While smaller in absolute terms, the LATAM market is growing significantly. Moreover, given the right product offerings, capital can be accessed relatively quickly through the privatized pension systems. As a result, managers may be able to introduce new products across multiple jurisdictions with (relatively) smaller investments in new infrastructure.

While **50.9%** of managers say Asia represents the best asset-gathering potential over the next three to five years, **65.3%** think they will need to establish a Hong Kong-domiciled fund to access Chinese retail investors, the largest single opportunity in the region.



Source: BCG Global Wealth Market-Sizing Database, 2015

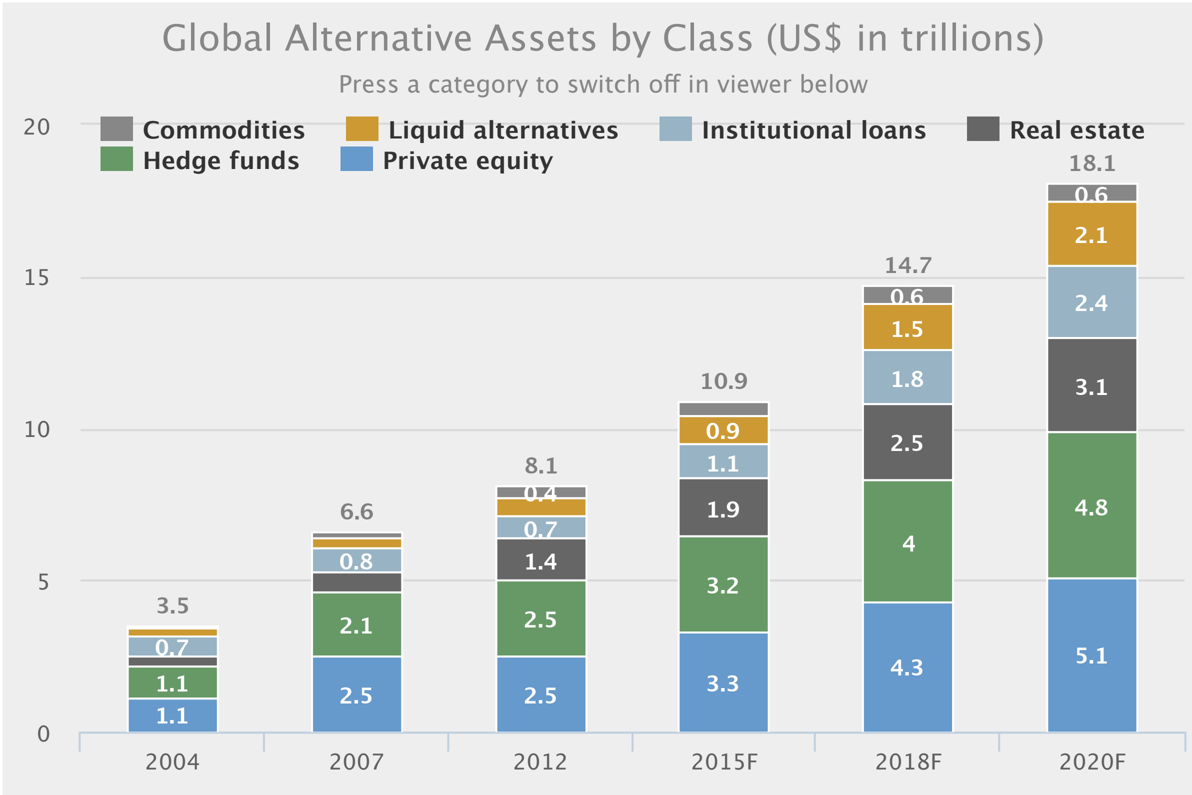
Press a button to compare regions

Asia-Pacific (ex Japan) | Latin America | North America | Europe

2. The convergence of asset classes, investment approaches and types of managers

- The growth in exchange traded funds (ETFs), at 22% from 2013 through 2014 versus 10% for mutual funds[3], and alternatives (35% since 2012[4]) continue to dominate asset managers' product development strategies.
- But as FUSE pointed out, the real trend is the continued emergence of more nuanced solutions that blur the lines between active and passive (see: the tripling in smart beta U.S. AUM since 2010 to $586 billion[5]) and alternative and conventional products.
- This is partly a byproduct of regulatory reform, as new controls on broker dealers have opened up opportunities for asset managers. The disintermediation of traditional bank credit structures and the related surge in direct lending products is a prime example.
- Each new hybrid product type can create its own complications behind the scenes. That is why some argue that the more often managers keep functions like clearing and settling, reporting and prime brokerage under one roof, the easier it may be to find ways to streamline.

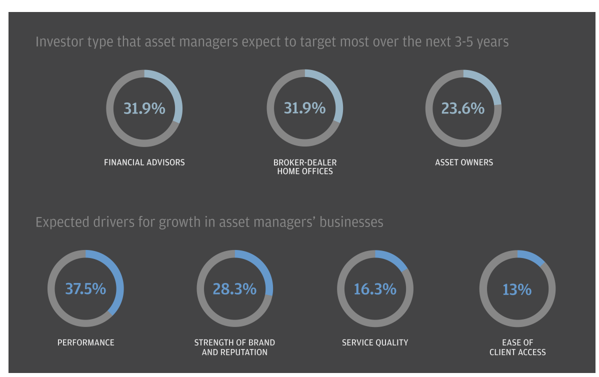
42.6% of managers think multi-asset solutions will experience the strongest growth over the next five years, followed by **35.2%** who anticipate the biggest growth will be in passive and smart-beta strategies, **14.8%** in liquid alts and just **3.7%** each in active and"other."



Source: Alternative Investments, "It's Time to Pay Attention," Strategy & PwC, 2015

3. The increasing mass and class of the US financial advisor market

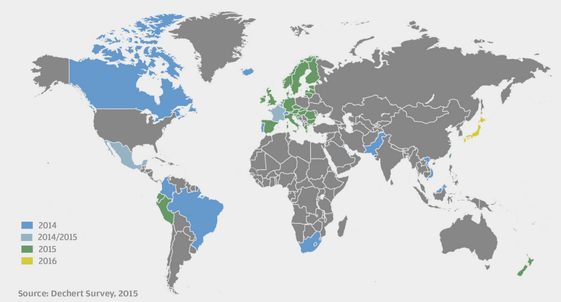
- In the U.S., the primary retail distribution channel is branching off in two directions: At one end, there is the rise of the registered investment advisor (RIA), the high-touch practice essentially running its own money; and, at the other, the increasing importance of the home office “menu,” as more mainstream brokers look to leverage efficiencies that can help them build their own businesses and compete more aggressively on price.
- Both trends make for more discriminating customers. For RIAs, the choice of providers increasingly comes down to more sophisticated product offerings (See trend No. 2). For the broker dealers, it is often about more sophisticated service.
- Automation and its potential for disintermediation are also playing a role. More advisors seem to accept they can’t compete with the new wave of ETF “robo advice” portals on fees and so are starting to incorporate these sites into their practices as a way to help service their smaller accounts. They are getting out in front of the trend, in other words, and expect the wholesalers to do the same.



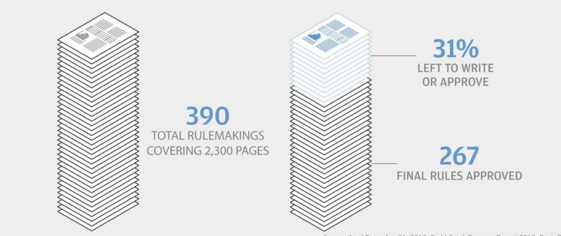
4. The redrawing of the global regulatory map

- It is not just all of the new regulations that have been introduced, but the volume of *additional* regulations and finalized rules likely still to come that have many managers overwhelmed by the potential costs and compliance requirements of the post-crisis environment.
- Compounding the difficulties is the mosaic effect that has resulted from different jurisdictions coming at the reforms from different perspectives and timelines. It has become more difficult to create one-size-fits-all distribution platforms when managers have to comply with the Markets in Financial Instruments Directive (MiFID) in Europe, Retail Distribution Review (RDR) in the UK, excessive fee lawsuits in the U.S. and the Securities and Exchange Commission's increased scrutiny of the use of derivatives by liquid alternatives and other types of mutual funds. Firms with the scale and flexibility to develop local product and service operations and strategically work with local distribution partners increasingly have the edge.
- The jury is still out on the final impact of some of the regulations. For example, Dechert clients are concerned that certain aspects of MiFID could threaten their ability to run a "soft dollar" program globally. The proposed rules on the use of dealing commissions could force the managers to unbundle their programs and either charge European clients for research or internalize the costs and pass them on to all their clients (which might not sit so well with the U.S.-based ones). U.S.-based managers also worry about the impact the remuneration rules in UCITS V could have on their retail mutual fund business. On that front, Dechert believes that the UCITS V regulations will ultimately be interpreted and enacted in a way U.S. managers can live with.

Countries around the world that have instituted new financial reforms since 2014



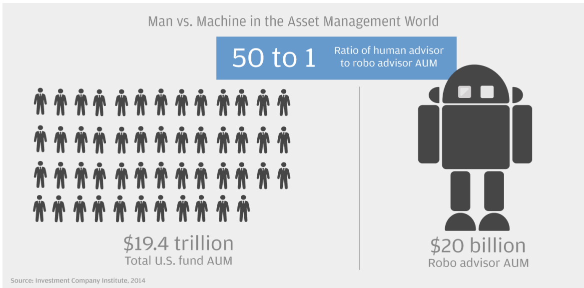
Charting the progress in implementing the 2010 Dodd-Frank U.S. financial reform bill

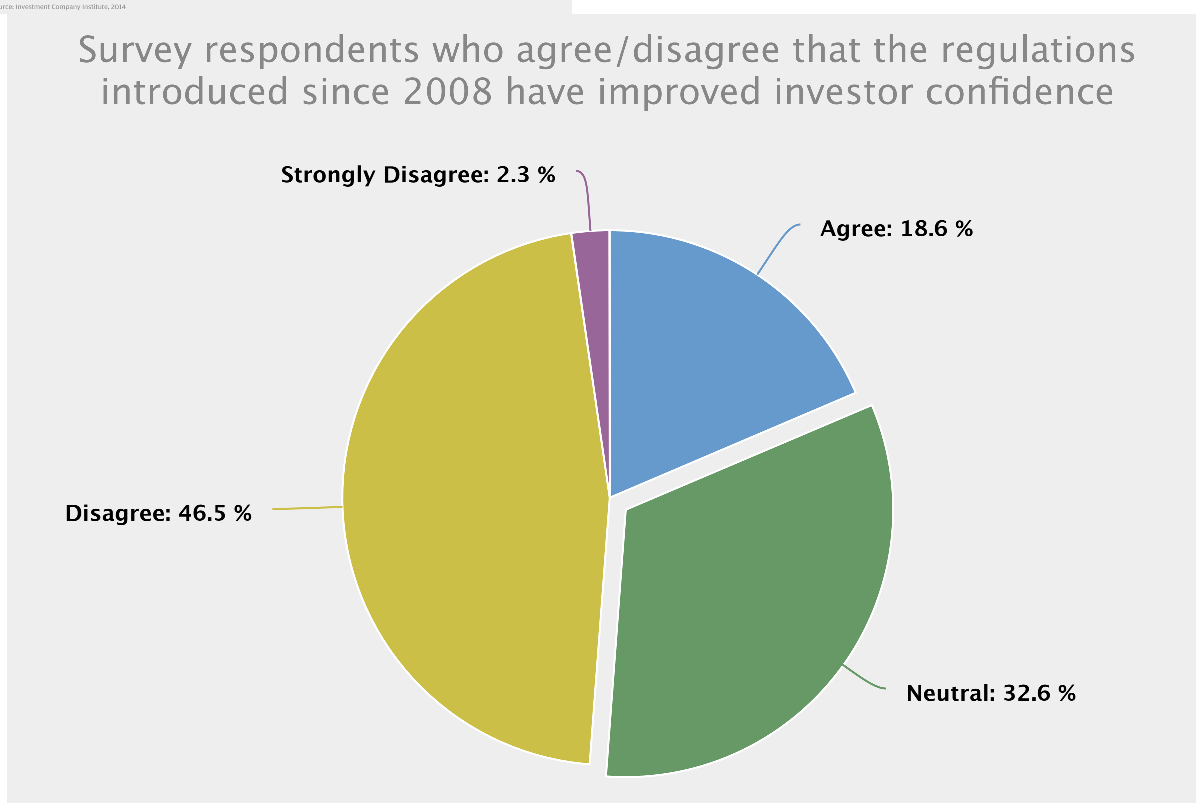


Asset managers are divided on whether new regulations are helping to facilitate access to offshore funds in local markets—**44%** say they are helping, while **56%** say they are posing additional hurdles.

5. The regulation-Fintech amplifier effect

- Many asset managers today see increased regulation and the possible disintermediating effects of developments like robo advice and blockchain as twin challenges.
- But some also see opportunity in the convergence of regulation and Fintech. In the UK, the introduction of RDR and the overhaul of the commission structure for financial advisors mean that many advisors no longer accept accounts smaller than £100,000. A number of managers have seized on the opening, partnering with or building out their own robo platforms to serve the increasing number of smaller retail clients being shut out from traditional sources of advice. In the U.S., too, large asset managers have begun to pick off some of the smaller robo players.
- As impactful as developments like robo advice could be over the long term, it is important to remember they still represent a tiny portion of AUM. Their more immediate relevance may be in what they signify about the evolving nature of clients' expectations. Over the next five years, our panelists don't necessarily think asset managers are at great risk of disintermediation. But they do think that robo advice and blockchain are a reflection of the kind of service customers are coming to expect in an era where so much of everything else is available on their phones.





J.P. Morgan Global Distribution & Product Trends Webinar Survey, Feb. 3, 2016

Key takeaways

- In an increasingly diverse global regulatory environment, asset managers will need both the international reach and local presence to fully tap the greatest opportunities for growth. While Asia features most prominently on most managers' future radars, Latin America may actually present lower barriers to entry.
- As the convergence of alternative and traditional, passive and active strategies continues, there could be efficiencies gained in more closely synching up back-office operations such as custody and prime brokerage.
- The added costs and complexity of heightened regulation have been overwhelming, but some new rules are also creating opportunity. Note the opening for asset managers in Europe to grab a share of the growing robo advice market created by RDR-type reforms.
- When it comes to Fintech, asset managers need to be prepared to embrace and even anticipate the trends, as their customers increasingly turn to their phones for all types of sensitive information.

Learn More

Please contact your J.P. Morgan representative

[1] BCG Global Wealth Market Sizing Database, 2015

[2] United Nations, Department of Economic and Social Affairs, Population Division (2015). World Population Prospects: The 2015 Revision

[3] ETF Landscape, BlackRock, December 2014, International Quarterly Statistical Release, EFAMA

[4] Alternative Investments, It's Time to Pay Attention, Strategy & PwC, 2015

[5] FUSE, Morningstar, as of December 31, 2015