

VISION

Frontline Revolution

The New Battleground for Asset Managers

An FT Remark and State Street Study

EXECUTIVE SUMMARY

WHAT ARE THE BIGGEST CHALLENGES FOR ASSET MANAGERS WHEN EXPANDING INTO NEW MARKETS?

57%
Building
Internal
Expertise

55%
Selecting
Distribution
Platforms

85%
Overcoming
Regulatory
Barriers



STATE STREET®

FT Remark
Research from the Financial Times Group

Frontline Revolution: The New Battleground for Asset Managers

Asset managers are rethinking their business models to capitalize on new trends in investor demand, according to a State Street survey of 300 senior executives at asset management firms, conducted by FT Remark.

Three-quarters of respondents (76 percent) say that changing client demands are causing a fundamental shift in their overall business strategy. Appetite for new types of investment solutions, combined with intense competition for the most profitable customer segments and markets, are reshaping the industry.

There are three areas where asset managers will compete to dominate the emerging investment landscape:

1. Product innovation will unlock a new wave of growth:

The greatest opportunities include delivering multi-asset solutions tailored around clients' investment objectives.

2. Growth strategies will target underserved segments and markets:

Asset managers must find ways to tap underserved investor groups in existing markets. In addition, while penetrating new markets remains challenging, the potential rewards are too great to ignore.

3. Asset managers need to upgrade their capabilities to thrive in a multi-asset world:

Asset managers will transform their operations to deliver new efficiencies and greater agility. They will invest in new tools, in particular risk and performance analytics, and acquire the talent required to master these new investment strategies.

1. PRODUCT INNOVATION WILL UNLOCK A NEW WAVE OF GROWTH

Growth opportunities abound, but only for asset managers that can adapt to the new investor demands that are reshaping the competitive landscape.

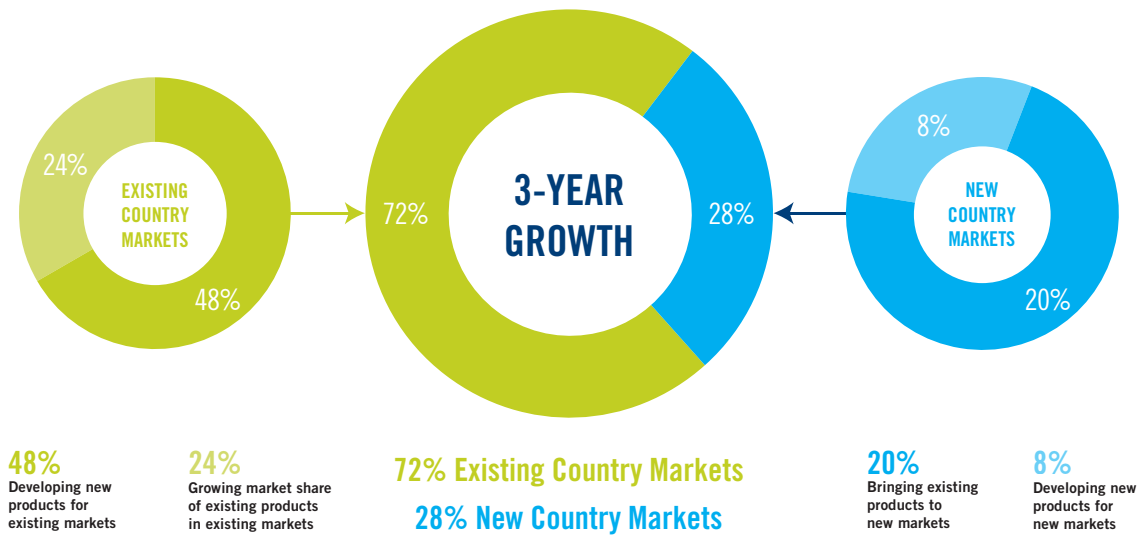
A strengthening global economy, combined with better prospects for most developed economies, has helped improve the outlook for growth in asset managers' established markets. Over the next 12 months, the greatest opportunities for growth will come from bringing new products to existing markets, according to 48 percent of respondents in the survey. An additional 24 percent of companies believe that increasing market share for existing products in their established markets is the most likely route to growth.

New markets are less of an immediate source of growth, with only one-quarter (28 percent) of asset managers citing this as their main opportunity. Geographic expansion remains a strategic goal, but new market investments typically take time to generate profitable growth.

76%

SAY NEW INVESTOR DEMANDS ARE
RESHAPING THE COMPETITIVE LANDSCAPE

Figure 1: Where will growth come from? What's the greatest opportunity for your business over the next three years?



Asset managers are prioritizing multi-asset solutions

Multi-asset solutions are cited by more than two-thirds (67 percent) of asset managers in the survey as the type of investment strategy most likely to drive growth. By comparison, only 17 percent of respondents cited traditional actively managed equity and even fewer (7 percent) cited traditionally managed fixed income.

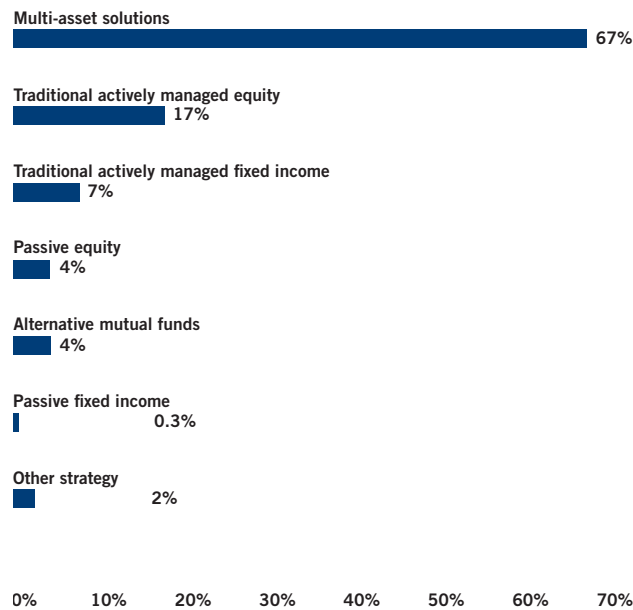
This shift from traditional products to multi-asset solutions represents a major inflection point for the industry — potentially creating huge opportunities for growth. It is also clear that many asset managers are struggling to adapt to the demands of this evolving investment landscape.

MANY ASSET MANAGERS ARE STRUGGLING TO ADAPT TO THE EVOLVING INVESTMENT LANDSCAPE

Table 1: Impact of multi-asset solutions

Investor trend	Industry impact
Focus on investment goals	Migrate from products to outcome-based solutions
Improve diversification	Find better ways to analyze risk and performance holistically across multi-asset portfolios
Reduce volatility	Ensure consistent risk-weighted performance over the long run
Create transparency	Achieve real-time ability to deliver granular insights into all aspects of performance and risk
Upgrade service	Differentiate by offering proactive account management to clients

Figure 2: Which one of these investment strategies do you think will contribute most to your business growth over the next three years? (Select one only)



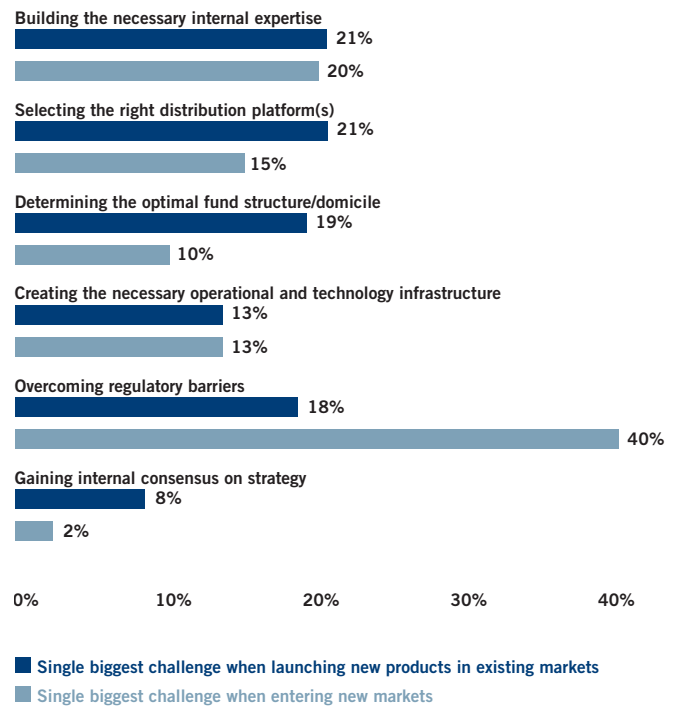
A “capability gap” may hinder many asset managers from effectively delivering multi-asset solutions

Multi-asset solutions are a key path to growth for active managers, but they are considerably more complex to deliver than traditional investment strategies (see Table 1).

The scale of this challenge becomes clear in the survey, where almost three-quarters (74 percent) of respondents believe that few asset managers are currently equipped to thrive when it comes to offering multi-asset class investment solutions.

Multi-asset solutions stretch asset managers’ capabilities on a number of fronts. The most frequently cited challenge when launching new products in existing markets is the need to build internal expertise (cited by 63 percent of survey respondents). This is not surprising — today’s diversified portfolios may require asset managers to deliver a range of investment strategies, often including alternative assets. In some cases, these may also be blended with innovative low-cost products such as smart beta or active ETFs. Challenges in managing risk and performance across these highly diverse portfolios also emerge as a major concern in the research.

Figure 3: Which is the single biggest challenge to your firm when launching new products in your existing markets or expanding to new markets?



2. GROWTH STRATEGIES WILL TARGET UNDERSERVED SEGMENTS AND MARKETS

Asset managers will need to learn how to attract and create value for new investor segments, as well as for the high-growth markets of the future.

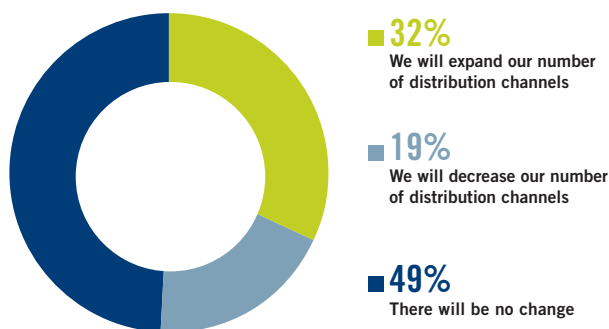
Asset managers need new strategies to attract tomorrow’s customers

New products are one of the pathways to growth. To be successful, however, asset managers must also develop relationships with new investor segments. Forty-two percent of asset managers in the survey say they will target growth primarily from new investor segments.

These new investor segments include demographic groups such as Generation X, Generation Y and — looking to the future — Millennials. These demographic groups have different investment requirements from the baby boomer generation that asset managers targeted with more traditional offerings. Generally speaking, the younger groups will live longer and have different ideas about

what retirement means. They are used to selecting and consuming services through online channels. To attract these new groups, asset managers need to rethink their brands and distribution channels, and must create products that are suited to these investors' long-term objectives.

Figure 4: Please indicate which of the following scenarios will be likely for your business over the next three years



Asset managers are trying to penetrate new growth markets, but it is a long-haul strategy

Asset managers are also keen to tap into high-growth markets. Almost half (47 percent) of asset managers in the survey will enter a new market in the next three years. Of those asset managers that plan to expand into new country markets, 60 percent are focused on opportunities in Asia Pacific (APAC).

Overcoming regulatory and distribution challenges will be key to successful market expansion

- More than four out of five (85 percent) respondents see regulatory barriers as a key challenge when expanding into new markets. North American-based asset managers in particular have difficulty here, with 96 percent mentioning regulatory barriers as a challenge. In short, regulation is currently seen as a major inhibitor to growth.
- Distribution issues represent another serious obstacle to market expansion for many asset managers. More than half (55 percent) of respondents agreed that distribution

challenges are preventing them from expanding into otherwise highly attractive markets. Approximately one-third (32 percent) of asset managers plan to expand the number of distribution channels they use — a figure that rises to almost half (47 percent) in APAC.

- Selecting the right distribution platform is seen as the biggest hurdle for Asian fund managers (31 percent) when launching new products in existing markets.

Regulatory risk is a key barrier to international expansion

Asset managers are sanguine about growth, but they also see a number of challenges on the horizon. Foremost among these is regulatory risk. Over three-quarters of respondents in the survey (76 percent) felt that regulatory risk will rise strongly for their business over the next 12 months. As noted above, regulatory barriers are also cited in the survey as the top challenge for asset managers when expanding into new markets. A wave of new regulations such as Dodd-Frank and the Foreign Account Tax Compliance Act (FACTA) are already imposing a heavy compliance burden on the industry.

Regulatory compliance becomes an even greater challenge when viewed from an international perspective. Establishing business in new markets requires asset managers to navigate a plethora of regulatory standards across multiple jurisdictions. The costs are significant: for example, reporting systems must be adapted to meet different regulatory requirements in each market. It is also a key talent issue, as asset managers are finding they need people on the ground that can provide excellent knowledge of the local regulatory environment.

3. ASSET MANAGERS NEED TO UPGRADE THEIR CAPABILITIES TO THRIVE IN A MULTI-ASSET WORLD

Leading asset managers are rebuilding their business to become smarter, more agile and more capable of satisfying evolving customer demands.

Transformation: Future-proofing the business

The shift to multi-asset investment solutions requires a major transformation of many aspects of an asset manager's operating model. Asset managers recognize the scale of the challenge that lies ahead. For example, over half (54 percent) see major opportunities to improve their operational efficiency.

Asset managers need to transform their operations so they can roll out and support new products rapidly. They must provide the talent, technology and processes required to deliver world-class investment performance and service. They also need the right distribution strategies to access a more diverse range of customer segments and markets.

Many asset managers will need to invest in building many of these capabilities internally. However, they may also eye opportunities to improve their market reach and capabilities through strategic acquisitions. One-quarter (28 percent) of asset managers in the survey see significant acquisition opportunities in the next 12 months.

As they overhaul their product offerings, asset managers will also need to redefine their core competencies. Many will seek to acquire cutting-edge capabilities to support the fastest-growing investment strategies. They will also look for help on support roles — for example, outsourcing administrative functions and regulatory reporting to specialist providers.

Tools: Unlocking the power of data and analytics

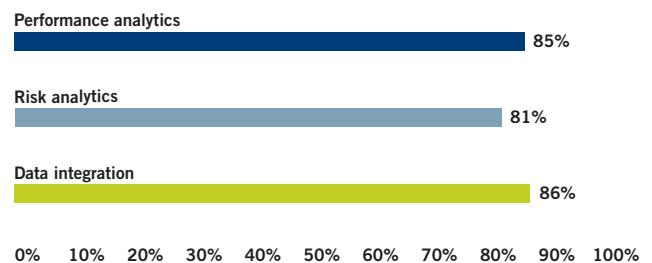
The shift to outcomes-based investment solutions requires asset managers to be able to analyze risk and performance more holistically across investment portfolios. This capability is particularly critical at a time when investors demand greater transparency over the way their portfolios are managed. In fact, 9 out of 10 asset managers surveyed (91 percent) believe that providing a high degree

of transparency to clients gives managers a competitive advantage when attracting new assets.

The asset manager that can use technology to deliver deep insights has a distinct advantage. Unfortunately, traditional risk and performance tools struggle to do this across multi-asset portfolios.

The industry is now investing heavily to address this challenge. As Figure 5 shows, the biggest priorities for technology spending in the front office are on performance analytics, risk analytics and data integration. Together, these tools and technologies are vital to ensure that asset managers can manage, optimize and report on highly complex multi-asset portfolios.

Figure 5: Investing in technology — % respondents that expect significant or moderate investments in the following over the next three years



Talent: Expanding the skill base

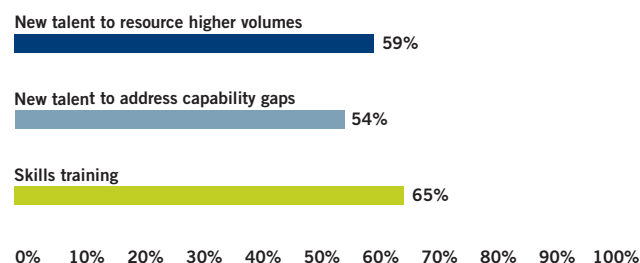
Asset managers also need to be able to bring in new skills to support a more diverse set of product offerings. The survey shows significant investments are now being made to acquire talent and upgrade capabilities (see Figure 6). Almost two-thirds of respondents (65 percent) say they will make moderate or significant investments in training over the next three years. In addition, 54 percent will make moderate or significant investments in new talent to address capability gaps.

Naturally this includes expertise in terms of planning and executing on strategy, but it also means developing the ability to deliver a more holistic style of account management.

An Investment Metrics survey conducted by Chatham Partners reveals that institutional investor satisfaction with investment managers is greatly influenced by client service, regardless of the economic climate or investment performance.¹ It suggests 40 percent of overall satisfaction can be attributed to client service delivered consistently. Moreover, two of the top-five client service factors are related to client reporting.

The implication is that investor satisfaction rests on a combination of consistent investment performance matched with a state-of-the-art servicing model. The current investment environment, with the investor and regulatory emphasis on transparency, only reinforces this focus.

Figure 6: Investing in talent — % respondents that expect significant or moderate investments in the following over the next three years



Conclusion: Closing the capability gap

The rise of the multi-asset portfolio as a mainstream investment strategy represents a watershed in the evolution of asset management. The opportunities are immense for asset managers that can make the shift from delivering traditional products to providing holistic solutions that consistently meet their clients' long-term objectives.

Leading asset managers are also positioning themselves for longer-term expansion. There is huge potential in emerging markets, but tapping into these opportunities will require a mastery of local investor demands, regulatory systems and distribution channels.

Ultimate success will require asset managers to transform every aspect of their business. The more forward-thinking firms are already on the move — investing in new talent, adopting advanced technology, and developing the flexible operating models required to thrive in a fast-changing world.

FORWARD-THINKING FIRMS ARE INVESTING
IN NEW TALENT, ADOPTING ADVANCED
TECHNOLOGY, AND DEVELOPING THE FLEXIBLE
OPERATING MODELS REQUIRED TO THRIVE
IN A FAST-CHANGING WORLD

¹ "How to keep clients happy despite a poor-performing portfolio," Chatham Partners and Investment Metrics, November 2010

About the Research

The research presented in this report is based on a global State Street survey of 300 senior executives at asset management firms. The State Street 2014 Asset Manager Survey was conducted by FT Remark in April and May 2014. Respondents were equally distributed across North America, Europe and Asia Pacific.

Investing involves risk including the risk of loss of principal.

The information provided does not constitute investment advice and it should not be relied on as such. It should not be considered a solicitation to buy or an offer to sell a security. It does not take into account any investor's particular investment objectives, strategies, tax status or investment horizon. You should consult your tax and financial advisor.

All material has been obtained from sources believed to be reliable. There is no representation or warranty as to the accuracy of the information and State Street shall have no liability for decisions based on such information.



STATE STREET

State Street Corporation
State Street Financial Center
One Lincoln Street
Boston, Massachusetts 02111-2900
+1 617 786 3000
www.statestreet.com

Contact Information

To receive a copy of the full report, featuring the findings of this research, please email: vision@statestreet.com

If you would like to discuss the results with a State Street expert, please contact:

Jane Mancini
+1 617 662 2476
jmmancini@statestreet.com

Paul Khoury
+61 2 9323 6444
paulkhoury@statestreet.com

Jörg Ambrosius
+49 89 55878 133
jambrosius@statestreet.com