Supply-Side Jitters

As the wealth management industry enters a new phase of uncertainty around markets and investor preferences, local industry participants will be flooded with a rising tide of homogeneous investment structures predominately from offshore product suppliers who are struggling to raise assets in their countries of origin. Whilst the vast majority of these will provide an unwanted distraction, there will no doubt be a handful of unique capabilities and ideas that will resonate with investors.

The underlying factor influencing the outlook for the funds management industry is the state of the local and global economy. The aftermath of COVID has left a meaningful mark on economic systems worldwide. More recently investors have been presented with favourable risk-free options whilst they await the return of predictability and consistency in investment markets. They may be waiting a while with arguments surfacing that current economic environments actually represent normality.

In recent times, a noteworthy shift in the funds management landscape has been the widespread acceptance and implementation of sustainability investing. Whilst the ESG movement has effectively established benchmarks for funds managers to mitigate risks, it seems that much of the heavy lifting is now complete with the majority of managers appropriately adapted. With this general industry alignment comes the inability for passionate ESG managers to justify any pricing premium for their sustainability principles, with the emphasis resuming on after-fees-risk-adjusted returns.

Whilst there has been plenty of noise surrounding the rapid advancement of technology in funds management, this appears to remain as 'work in progress' – albeit that it is coming. AI, and big data analytics are establishing themselves as integral tools for decision-making, rapidly enhancing funds managers' ability to analyse vast datasets and identify investment opportunities with unprecedented precision. Although this is driving down costs, these advancements also heighten new challenges, such as cybersecurity risks and the recruitment of talent equipped with cutting-edge skills. The growing demand for expertise in areas such as data analytics, AI, and sustainable investing has led to talent shortages. Funds managers are now competing against each other for talent acquisition, retention, and development strategies.

The combination of these factors continues to compel funds managers to discover the balance between embracing innovation and managing the associated risks to stay competitive in an increasingly digitalised world. Those with the deepest pockets appear to be well advanced of many of the local fledgling participants.

All of this innovation is occurring at a time where industry regulators are increasingly more active in shaping the future of funds management. Evolving regulatory frameworks, both on a global and local scale, are influencing how funds operate, report, and disclose information. Managers are increasingly burdened with stricter compliance requirements designed to enhance transparency and protect investors. Remaining aware of and adapting to regulatory changes has now become a significant ongoing expense for local funds managers to ensure compliance.

New Zealand's capital markets, while characterised by stability and a well-regulated environment, are relatively minute in comparison to larger global counterparts. The limited size poses challenges for domestic funds managers seeking diversity and growth opportunities. Consequently, there is an increasing attraction for offshore investment pursuing exposure to a broader array of industries, access to larger and more liquid markets, and a hedge against the inherent concentration risk in the smaller local market. As global interconnectedness continues to grow, New Zealand investors are being presented with greater offshore options that feed into the expansive and dynamic investment landscape abroad. This will continue to accelerate, with many local funds managers already exploring avenues to

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effectively compete or collaborate in this space.

Whilst the historically popular passive investing has been quick to adapt to the changing environment, it is not immune to future threats. The predicted gyrations and market downturns will continue to challenge most passive investment strategies that are inherently tied to the performance of the broader market indices. During periods of economic volatility or market corrections, passive investors will experience significant declines in portfolio value without the ability to actively adjust their holdings. The more recent concerns about market concentration and overvaluation in certain sectors also pose risks to passive investment portfolios, as they inherently mirror the market's composition. This extremely competitive space will be dominated by a blend of ever-decreasing price pressure and large global brands.

Of course – irrespective of whether the investment philosophy is active or passive – both share the looming threat of the 'democratisation of everything'.

The rise of low cost fintech platforms together with the growing enthusiasm of retail investors are starting to have a profound impact upon the dynamics of funds management. Accessibility and user-friendly interfaces are now considered basic components for funds managers looking to attract and retain a broader investor base. This disintermediation is well underway in the New Zealand market with technology making it less relevant as to the domesticity of the fund manager. Many established funds management brands are finding it difficult to compete amid weak performance and margin pressures.

The outlook for global funds management is characterised by a complex interplay of economic, technological, and societal factors. As the world undergoes unprecedented changes, local funds managers will need to be agile, adaptable, and forward-thinking to thrive. Limited in scale, these domestic funds managers may face hurdles in achieving the same economies of scale, operational efficiencies, and diverse investment opportunities that larger global players enjoy. The constrained size of the local market may also lead to challenges in generating substantial returns required to attract and retain investors.

In an era where global funds managers wield significant resources, technological prowess, and access to a vast array of assets, the small size of New Zealand funds managers could hinder their ability to negotiate favourable terms, offer competitive fees, or deploy cutting-edge technologies. Despite their intrinsic understanding of local markets, these smaller funds managers may find it challenging to compete on a global stage, emphasising the importance of strategic partnerships, innovative approaches, and niche specialisation to carve a space in the fiercely competitive funds management landscape.