OUTLOOK

2021

Managing Assets in a Post-Corona World: 10 Trends for 2021

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Editorial

2020 has been an exceptional year for asset and wealth managers. In March, the pandemic sent thousands of traders, analysts and portfolio managers out of the office at a time when markets were in a tailspin. This shift out of the office was managed well. Not only did business get done, but liquidity has kept flowing, giving the industry more opportunities to fulfill its role as a transformer of savings into investments.

Looking ahead into 2021, we believe the effects of the pandemic on the industry will only exacerbate a number of important structural changes with executives in Swiss banking anticipating an accelerated development going forward. For example, new digital-only platforms are commoditizing large parts of the value chain, forcing incumbents to rethink and sharpen their value propositions. Moreover, clients are basing their remote-only experiences during the pandemic to advance new demands with respect to the immediacy, connectivity and ubiquity with which they interact with their providers.

Although the industry still enjoys growth in assets under management (mainly due to asset price inflation), the future is likely to become increasingly turbulent to players ignoring the structural changes taking place in the market while margins continue to fall. We expect the implications of the crisis to have a lasting impact on the industry, accelerate existing trends, and compel managers to take strategic decisions faster than anticipated. The structural changes are being driven by ten key trends that are already challenging the industry. These ten developments build the foundation of this report.

We hope you enjoy reading this contribution to the dialogue on Redesigning Financial Services, and invite you to share your thoughts with us.

Yours faithfully,

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We identified ten trends in managing assets in a post-corona world

Rising pressure on active managers

1

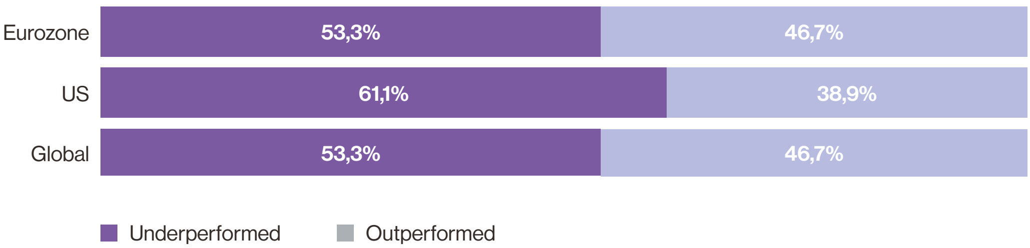
The premise of active investment is that managers with enough skill are able to outperform the market average.

In 2021, active managers are set to remain under pressure to deliver alpha. The premise of active investment is that managers with enough skill are able to outperform the market average. However, this view was challenged decades ago and has since sparked a longstanding debate about the ability of active managers to outperform the market on average. This debate could even become more contentious in 2021, after most active managers failed to outperform the market in a volatile environment that should have been conducive to do so.

The coronavirus-triggered disruption of 2020 would have been the perfect opportunity to outperform. And many believed that with volatility returning the case of active management would increase strongly. However, active fund managers failed to outperform their benchmarks despite the heightened volatility this year. In the first half of 2020, only 46.7% of global and 38.9% of US active managers outperformed their benchmarks before costs were even subtracted **(chart 1)**. Taking a longer view over five years and fifteen years, the data offers an even grimmer picture. Globally, only 24% of active equity managers outperformed over five years, and only 18% outperformed consistently over 15 years **(chart 2)**.

This difficulty for most active managers to outperform their benchmarks is also reflected in the stock price performance of most large, publicly listed invested managers - with the only exception being Blackrock, the world's biggest ETF provider **(chart 3)**. Looking ahead, pressure on active managers to deliver on their aim of outperforming their benchmarks is likely to rise in 2021, which could push underperformers out of the market, leaving more opportunities for the more successful managers. In this sense, the gap between performance leaders and laggards is set to intensify.

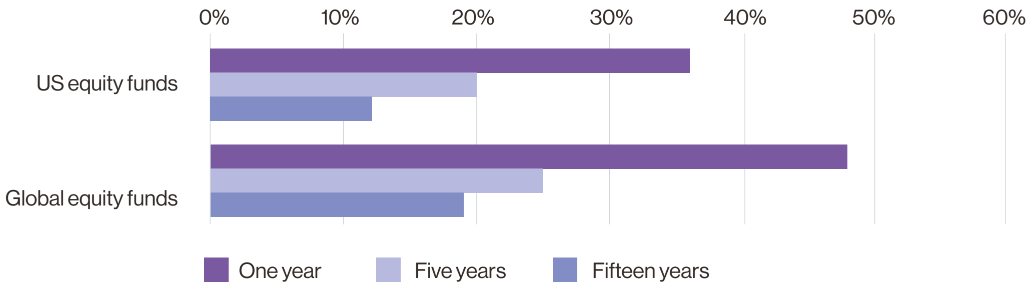
Chart 1. Most active managers still underperform their benchmarks



Source: S&P Dow Jones, RFS.

Chart 2. Equity funds struggle to beat their benchmark

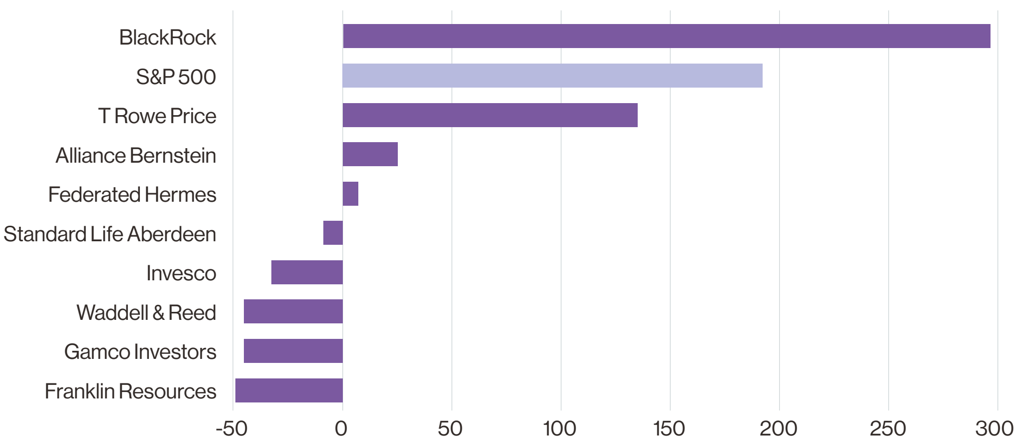
% of funds that outperformed their index over one, five and fifteen years



Source: S&P Dow Jones, RFS.

Chart 3. Most asset managment stocks have struggled to keep pace with broader market

Change in share price since Nov 10, 2010 (%)



Source: Refinitiv, RFS.

Passive attack set to intensify

Low and falling costs have led to a tectonic shift from active strategies to passively-managed index funds.

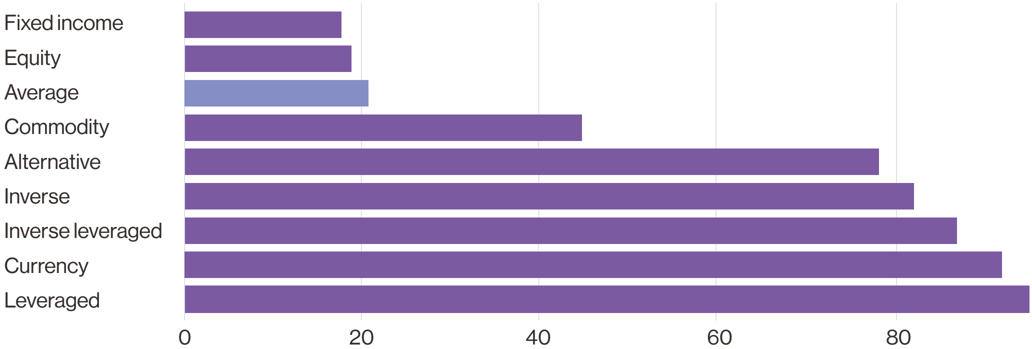
Technology today allows access to stock markets at vanishingly low costs. An investor can now buy exposure to the market return via passive products for an average of 20 basis points **(chart 4)**. These low and falling costs - along with the difficulty active managers have had in beating their benchmarks - have led to a tectonic shift from active strategies to passively-managed index funds.

Indeed, in just the last 10 years, passive equity funds have enjoyed inflows of more than USD 2 trillion, even as traditional active managers have suffered outflows of over USD 1.5 trillion, according to data provider EPFR **(chart 5)**. Moreover, this trend from active to passive has not slowed in 2020. According to EPFR, another USD 375 billion flowed into passive vehicles in 2020. In absolute terms, these flows have subsequently increased the stock of funds invested passively to over USD 12 trillion, with no sign of this trend losing steam **(chart 6)**.

The drivers of this flight to passive products are threefold: first is the difficulty active managers have in exceeding their benchmark returns. The second reason is significantly lower fees passive products cost relative to their more expensive active counterparts. The third main driver for the flight into passive products is regulation. Directives like the Retail Distribution Review (RDR) in the UK or the Markets in Financial Instruments Directive (MiFID II) in the EU have already incentivized greater price transparency, thus reinforcing the demand for simpler, more cost-effective passive products. Together, these three drivers are likely to keep the demand for passive products robust in a post-Corona world. The implication for Swiss asset and wealth managers means that passive products offer them an opportunity to build advisory services around more simpler, more transparent product offerings.

Chart 4. **Low as they can go?**

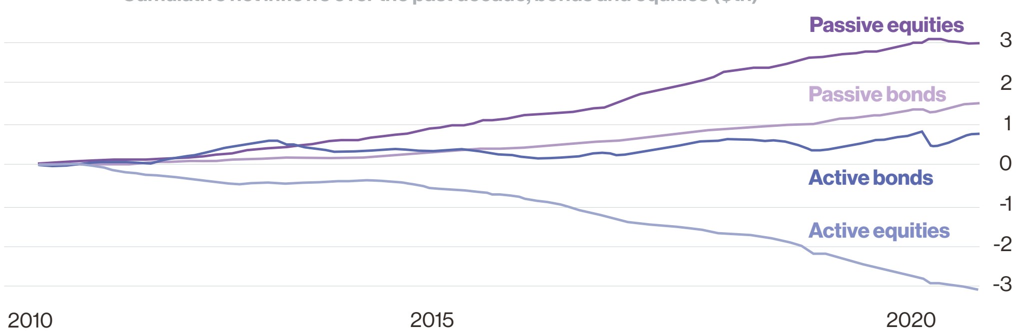
Global ETF asset-weighted annual expense ratio (bp)



Source: ETFGI, RFS.

Chart 5. **Passive aggressive**

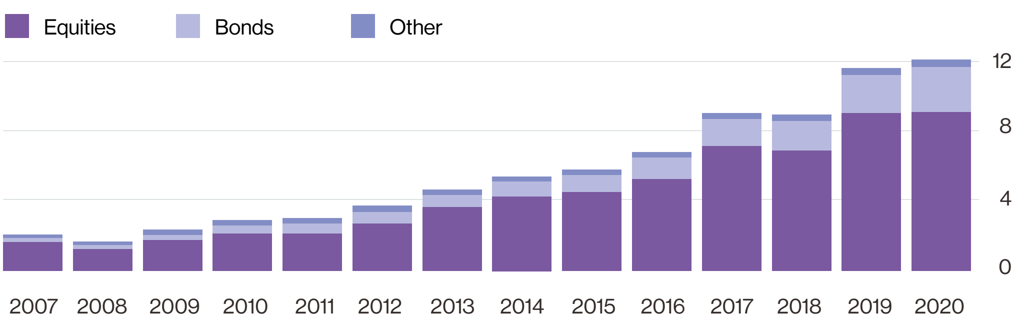
Cumulative net inflows over the past decade, bonds and equities ($tn)



Source: Morningstar, EPFRI, RFS.

Chart 6. **Index fund universe has vaulted past $12tn mark**

Total net assets, sorted by asset class ($tn)



Source: Morningstar, EPFRI, RFS.

Price war likely to escalate

The implication of the shift to passive products is that investors have become increasingly cost-conscious.

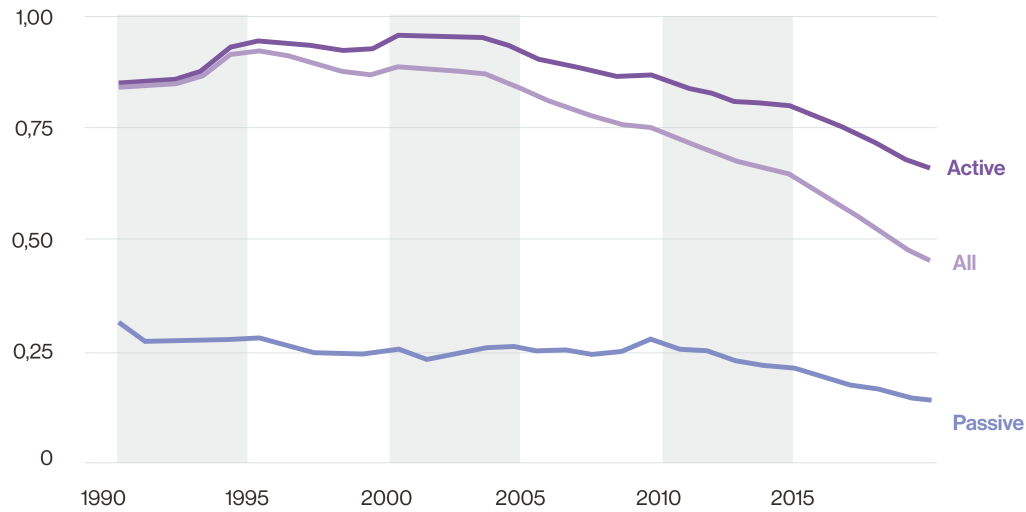
Costs seem to matter more than ever. The implication of the shift to passive products - which tend to be cheaper than actively managed alternatives - is that investors have become increasingly cost-conscious. This new cost-consciousness and desire for more cost transparency among investors continues to force (active) managers to lower their costs **(Chart 7)**, lest they risk suffering further outflows. Indeed, Chart 6 shows that passive product fees are still about 6 times cheaper than active products on average (0.11% vs. 0.69%).

The trend toward fee compression across all strategies has largely been driven by a price war between mainstream exchange traded funds (ETFs), which have seen fees fall by half since 2010 to unprecedented lows **(Chart 8)**. Average expense ratios for passive equity ETFs come in at 0.18% (down from 0.34% in 2013) while bond ETFs are even cheaper at 0.14% (down from 0.26% in 2013). Anecdotal evidence is even more compelling: some equity funds managed by the likes of Fidelity are now even free.

These developments put wealth and asset managers into unchartered territory in a post-pandemic world. Looking into 2021, many clients may question the value for money they receive from their providers and as such demand more price transparency. In fact, a Capgemini report showed that 33% of large clients disliked the fees they paid in 2019, and that 20% of the 2'500 clients interviewed planned to switch their money managers in 2021. The key takeaway here is that money managers need to sharpen the value propositions they offer their clients by offering more specialized (and more holistic) advisory services so as to complement the product pricing.

Chart 7. Falling fees raise asset management consolidation pressures

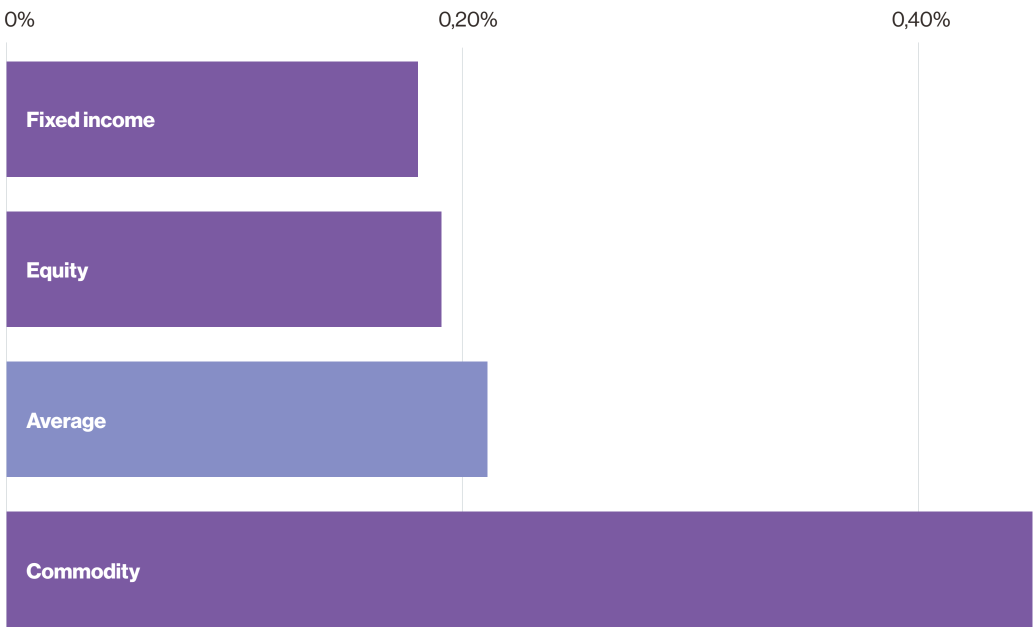
Per cent



Source: Morningstar, RFS .

Chart 8. Low as they can go?

Global ETF asset-weighted annual expense ratio (bp)



Source: EPFRI, RFS .

The quest for scale

4

Increased competition on price and performance is widening the gap between leading and lagging firms, paving the way for a winner-take-all scenario.

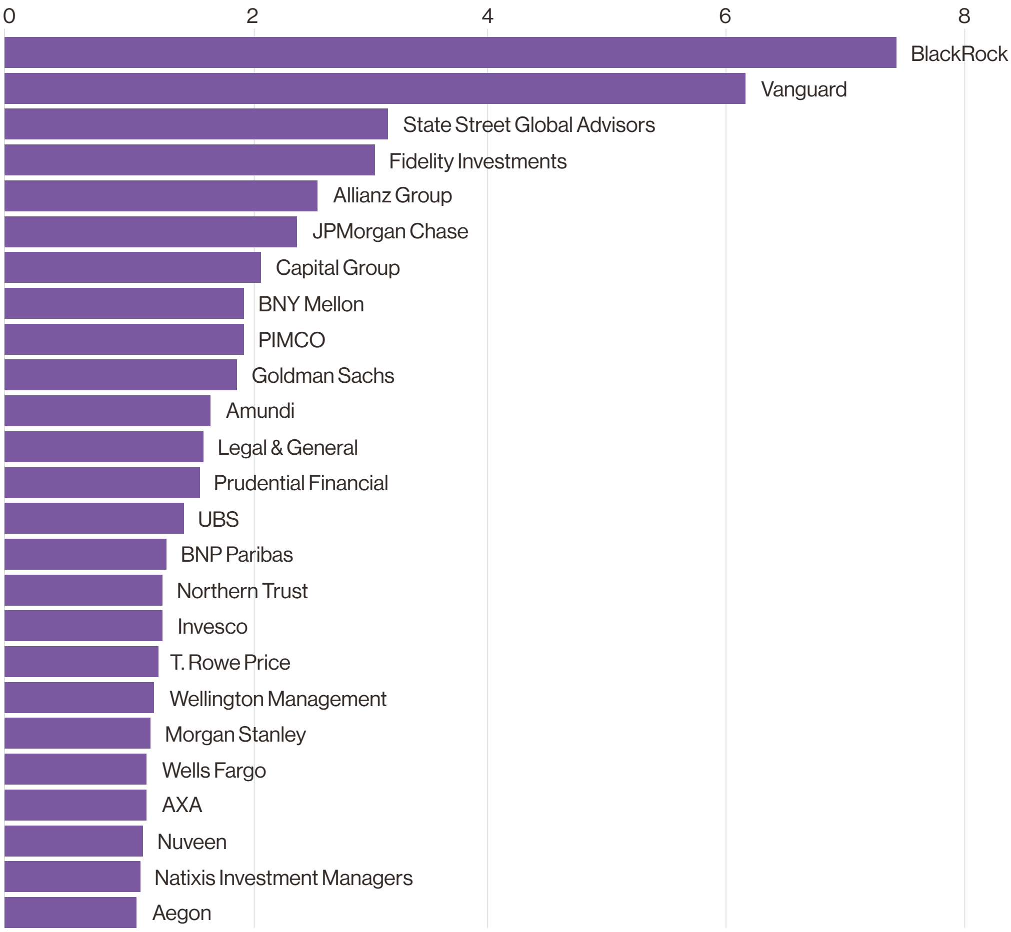
Smaller asset managers are being squeezed on all sides. Cheaper passive funds are taking a growing slice of the cake. For example, in October 2020 alone, low-cost behemoths Vanguard and Blackrock together captured close to two-thirds of net inflows into the exchange traded fund industry. And for the year 2020, Blackrock and Vanguard alone have collected over USD 540 billion in the first 10 months, which is up 36% on the same period last year, according to ETFGI data. These firms benefit from a virtuous circle, in which lower costs mean lower fees, more inflows and yet lower costs. Their dominance is only the most salient sign of consolidation in the asset-management industry.

The outlook for 2021 seems clear: the biggest firms are set to get bigger. A global elite has already emerged that manages more than USD 1 trillion in assets **(Chart 9)**. The growth of these providers suggests significant and growing advantages in scale, especially with respect to the production of low- cost, plain vanilla products. Moreover, this trend toward greater concentration is being accelerated by the fact that smaller managers are forced to spread rising regulatory costs over smaller revenue bases. Indeed, the proportion of assets managed worldwide by the industry's leading 20 firms continues to grow steadily, with these top 20 firms already controlling over 40% of the assets managed by the largest 500 **(Chart 10)**.

The increased concentration is set also to widen the gap between leading and lagging asset and wealth management firms, as small firms get acquired. This in turn accelerates the shift to a winner-take-all scenario. At the same time, boutique managers with specializations in private markets (e.g. private debt, private equity and private real estate or infrastructure) are best positioned to buck the trend and could see significant growth in 2021.

Chart 9. The trillion-dollar club

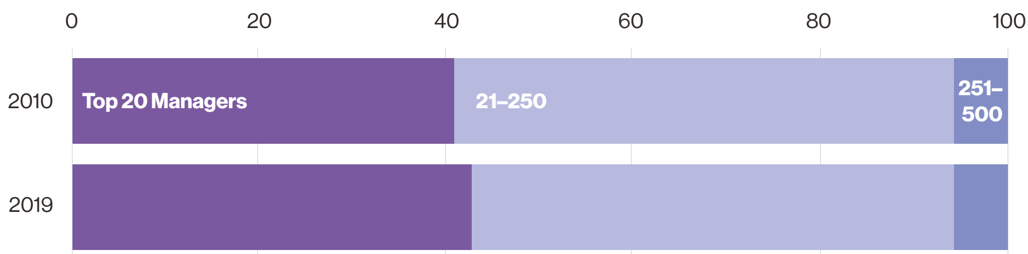
Global assets under management, 2019, $trn
Asset managers with more than $1trn under management



Source: Thinking Ahead Institute; Pensins & Investments 500, RFS.

Chart 10. The sticky middle

Top 500 managers, assets under management (% of total)



Source: Thinking Ahead Institute; Pensins & Investments 500, RFS.

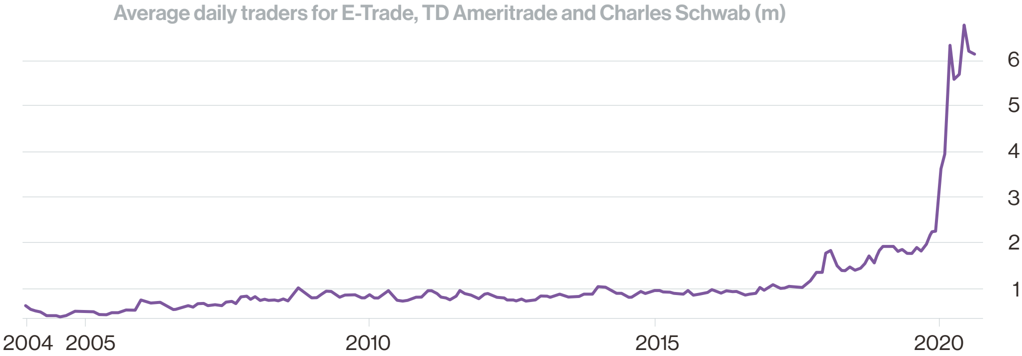
The rise of the retail investor

The lockdown period has accelerated a number of consumer trends, including the shift toward online stock trading.

The lockdown period has changed a lot of consumer behaviour. Consumers of financial services are no different. Online retail trading has risen enormously. The average number of daily trades is up by 75% this year **(Chart 11)** – and now make up 20-25% of total US equity trades, which is an increase from just 10% a decade ago. The trend has been driven by a number of factors: first, the brutal price war among brokerages to cut trading commissions to zero. Second, a new generation of retail investors encouraged by lockdown boredom, zero commission products and lack of sports betting opportunities. And third, with the Nasdaq up 40% on the year, influencers on social media suggesting that "stocks only go up" are generating a larger following. Looking ahead, this trend is likely to only accelerate as the next generation of investors get access to the new technology-enabled tools to trade easily, cheaply and quickly.

At the same time, this uptick in retail trading also has a dark side: Some observers worry the new class of e-brokers have helped turn the experience into something akin to a video game with constant updates about profits and losses and social media fuelling the frenzy. This is particularly relevant in the context of academic work that suggests that it is virtually impossible for individuals to day trade for a living, which conflicts directly to what the day trading personalities assert. In fact, research shows that 97% of all traders who persisted for more than 300 days lost money **(Chart 12)**. Despite this evidence, this trend is likely to persist in 2021.

Chart 11. Retail trading has skyrocketed
Average daily traders for E-Trade, TD Ameritrade and Charles Schwab (m)

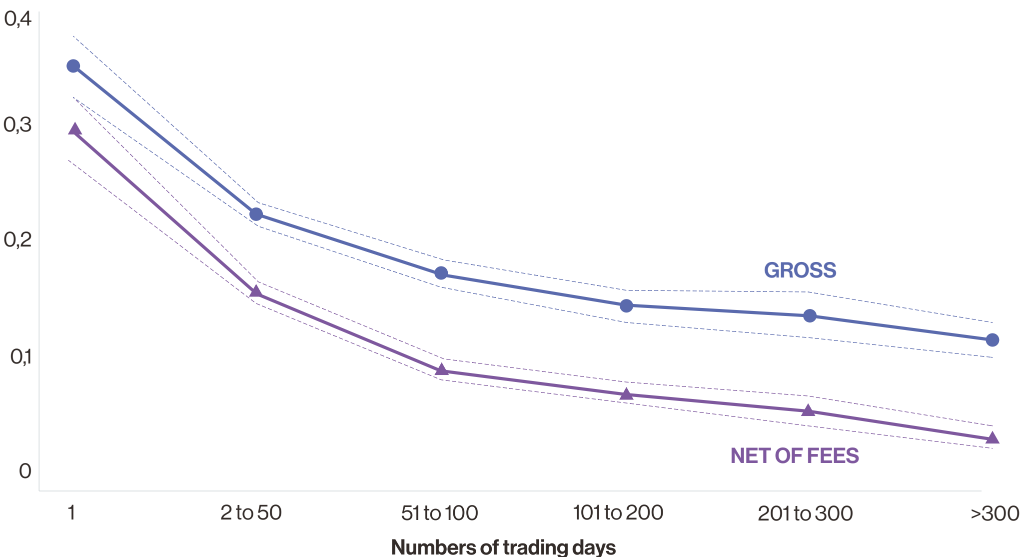


Source: RFS.

The implications for the wealth and asset management industries are potentially far-reaching. This new investor class tends to rely less on fundamental analysis of companies and more on speculative tips, consumer habits, and discussions on social media or recommendations from friends and influencers (**Chart 12**).

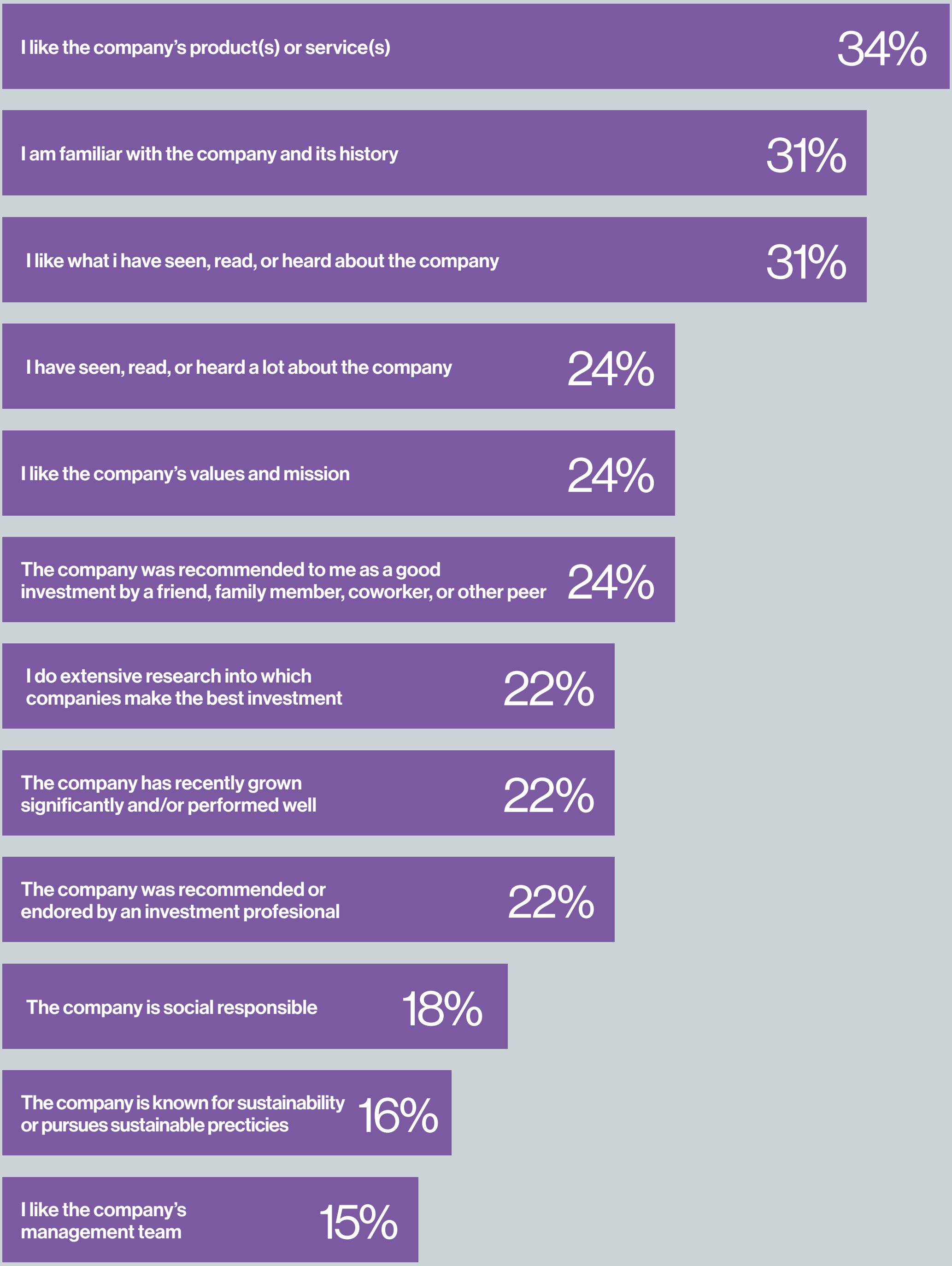
The opportunity for providers is to help protect retail investors and traders from losing a lot of money during the next correction. More specifically, this means managers can integrate new sources of information such as sentiment analysis from social media insights into a broader service framework dedicated to financial education.

Chart 12. Fraction of day traders with positive profit



Source: RFS.

Chart 13. When deciding which companies to invest in, which of the following has to be true for you to invest in that company?



Source: RFS.

Online trading platforms on the rise

Online trading platforms are forcing many providers to lower their fees and to redesign the customer journeys they offer their clients.

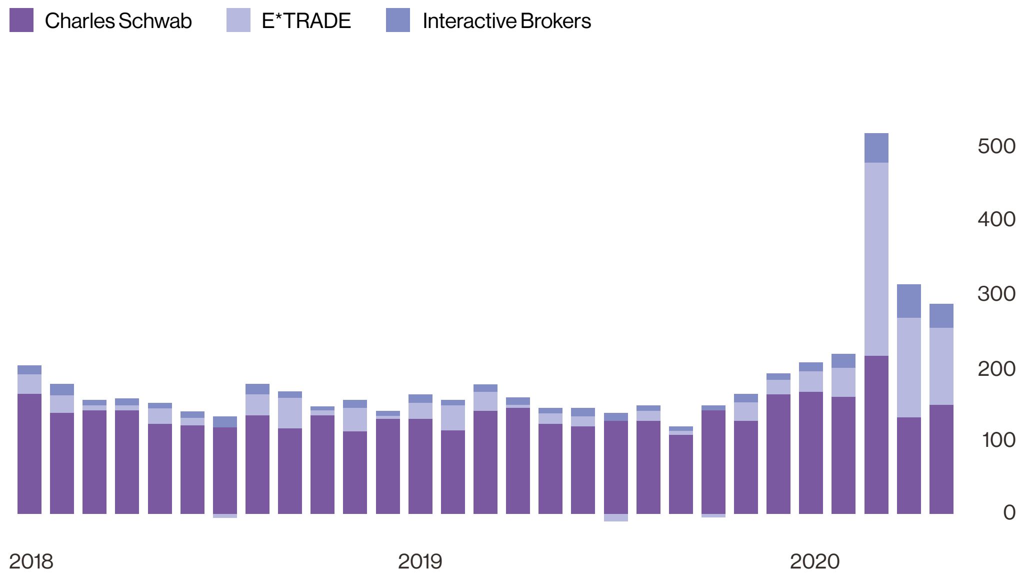
New online trading platforms (OTPs) have benefited enormously from the boom in retail trading **(Chart 14)**. The best example of an OTP is Robinhood, a company offering zero-commission trading facilities that grew its customer base in 2020 to over 13 million clients (Chart 15). But Europe offers multiple examples of low-commission digital platforms too. For example, Degiro increased its customer base by 45% and its revenues by 67% over the same time last year.

But OTPs like Robinhood and Degiro are not the only one's offering zero commission trading to retail investors. For example, digital banks like Revolut, Money Lion, Sofi, or Square intend also to offer commission-free trading and zero-minimum account balances **(Chart 15)**. Such developments have pushed brokerages like Ameritrade, E-Trade, Charles Schwab, and Interactive Brokers to slash their trading commission to zero **(Chart 16)**. Importantly, these shifts are forcing established players to reduce their fees as well. For example, Fidelity and JPMorgan Chase have significantly reduced their fees in response to the OTP zero-commission offerings.

The shift toward zero-commission trading has enticed a new generation of investors into the market. In fact, more than 50% of Robinhood's customers were first-time trading platform users, and its median customer age was 31. The trading activity of these new investors is further incentivized through the use of behavioral nudges and gamification elements. This makes the trading experience seem like a video game with constant updates about profits and losses and social media fuelling the sentiment in one direction or another. With the lower fees and the unique user experience, the OTP space is likely to become a key battleground in 2021 upon which fintechs with big customer bases and brokerages challenge incumbent wealth and asset managers.

Chart 14. Online brokers enjoy lockdown boom

Monthly new client accounts ('000s)



Source: RFS .

Chart 15. User number at select trading platforms

Global, millions of users

Source: Business Insider, RFS.
Note: Although all user numbers are 2020 figures, they are not from the same month.

Chart 16. The stock trading ecosystem

Source: BI Intelligence, RFS.

Chart 17. Comission-free trading reaches an inflection point

BROKERAGES GO ZERO

Interactive Brokers
September 29th, 2019

E*TRADE
October 1st, 2019

TD Ameritrade
October 4th, 2019

Fidelity
October 10th, 2019

charles SCHWAB
October 1th, 2019

ally
October 4th, 2019

FINTECHS GO ZERO

MoneyLion
5.7m accounts

SoFi
7.5m accounts

Revolut
8.5m accounts

Cash App
15m accounts

robinhood
6m accounts

Source: RFS .

Next generation clients shift priorities

The next generation of investors are likely to put forward new demands of their financial advisors, emphasizing digital excellence and sustainability.

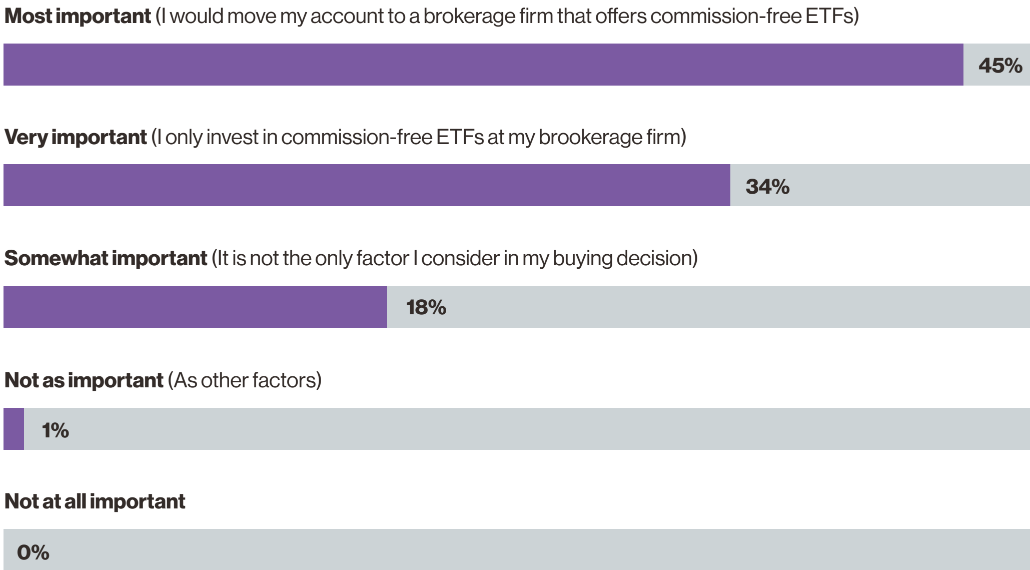
Younger investors are set to have different expectations of their money managers. This point is relevant because the coming year(s) will see an unprecedented generational redistribution of wealth. Baby boomers, the generation of people born between 1946 and 1964, will bequeath no less than USD 68 trillion in assets to younger generations with different expectations of their providers. And for Switzerland the assets in motion are notable: For the coming five years EY expects wealth transfers of CHF 250 to 300 billion due to intergenerational transfers, pension payments and corporate liquidity events.

Studies show that this next generation is a demanding one. Spoiled by the seamless offerings of large Internet companies, they want more for less **(Chart 18)**. They also desire more frequent customer contact. At the same time, they are less loyal to their advisors and change more quickly when dissatisfied. They find it difficult to trust banks and financial advisors and are more frequently skeptical about the value propositions they are offered by their advisors. As such, they also negotiate fees more persistently. This is particularly due to the fact that thanks to digital providers, investors today often have free access to investment research and in-depth analyses. Moreover, they often get their investment ideas from a variety of online sources such as social media and online discussion forums.

Indeed, next generation investors tend to use technology-enabled tools to organize virtually every aspect of their lives. But despite their affinity for digital solutions, this customer segment requires human advice in more complex investment situations **(Chart 19)**. They also continue to depend on the human advisor for important life decisions such as marriage, the setting up of company foundations, inheritance questions, and financial planning for their own children. For financial managers who master hybrid approaches, this generational shift offers great opportunities.

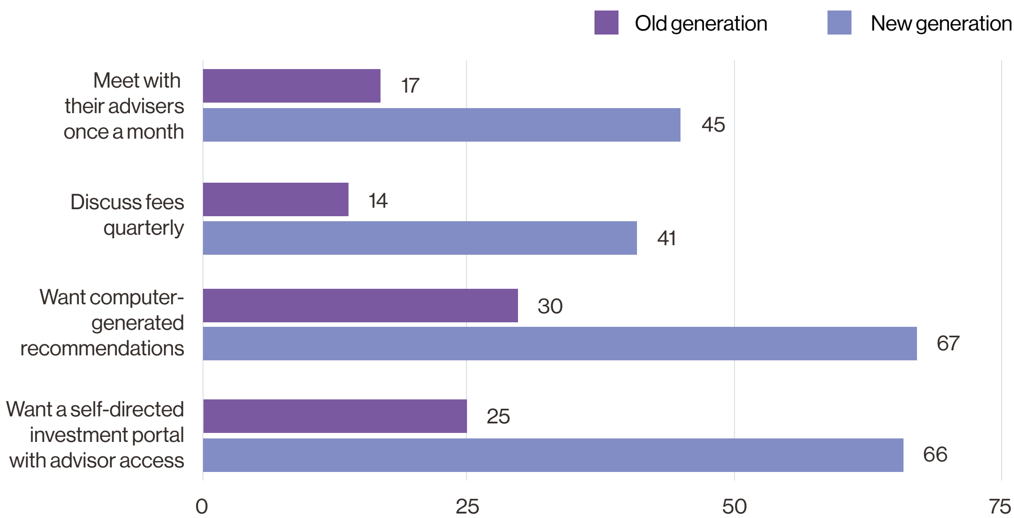
Chart 18. Importance of commission-free trading for millennials

How important select features are in making a decision to use a trading platform



Source: Business Insider, RFS.

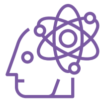
Chart 19. Comparison of expectations of old generation clients and new generation clients



Source: Accenture, RFS.

Chart 20. According to surveys, this new generation wants

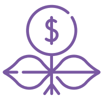
More personalized recom-mendations and advice.



More know-how regarding investments in innovative growth companies.

Broader investment options (for example, they also want access to start-up investing).

More frequent interaction with customer advisors.



Access to sustainability information and sustainable investments (86% are "very interested" or "interested" in sustainable investing.

Clearer research insights (e.g. with interesting charts and graphics).

Source: RFS.

Mainstreaming of sustainable investing

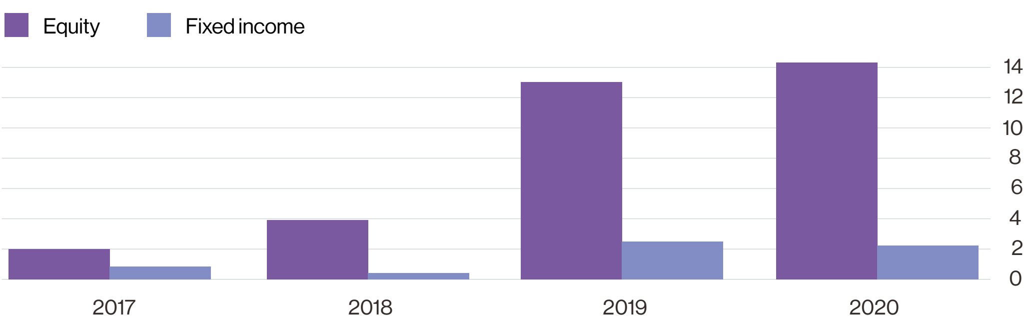
A key driver of the mainstre-aming of sustainable investing is whether passive strategies are being deployed to support this growing trend.

The new color of money seems to be green. A key driver of the mainstreaming of sustainable investing is whether passive strategies are being deployed to support this growing trend. At present, only about 7-10% of the USD 32 trillion invested in "sustainable" strategies is done passively (i.e. via low-cost exchange traded funds). This is set to change.

Indeed, as regulations incentivising the integration of environmental, social and governance (ESG) themes continue to grow, many large pension funds and insurance companies are increasingly looking to passive products with an ESG tilt. Such products help large institutional investors achieve three goals: 1) keep costs down, 2) easily place very large orders according to ESG criteria, and 3) to profit from the tax benefits of passive ESG investing. **Chart 21** shows that these incentives are already boosting ETF investments with an ESG bias to unprecedented levels for both equity and bonds. This may be a sign of a tectonic shift in the way capital is allocated, especially if one considers that existing ETF products only incorporate exclusion strategies, leaving enormous potential for growth in the area of positive screens.

Chart 21. ESG flows have already surpassed last year

Net flows to ESG ETFs in the EMEA region ($bn)

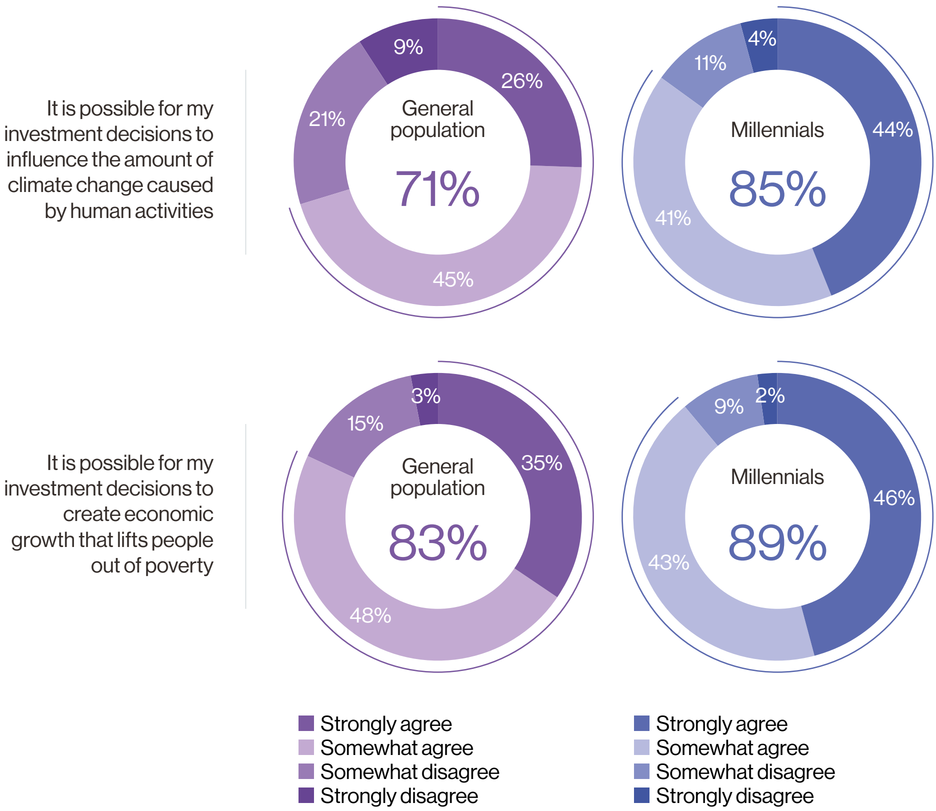


Source: RFS .
Note: 2020 data as of August 10.

In addition to the realization that ESG integration can offer investment value, many investors also believe that they can make a difference with their investments **(Chart 22)**. For example, 71% of all investors now believe that their investment decisions can actually influence the climate. Two years ago only 17% of investors believed this. Furthermore, 84% of investors are interested in receiving detailed impact analyses of their investments. This data suggest that sustainable investing is here to stay and is likely to further enter the mainstream.

Chart 22. Investors believe they can affect change through their investment decisions

Please indicate if you agree or disagree with each of the statements below



Source: MorganStanley, RFS.

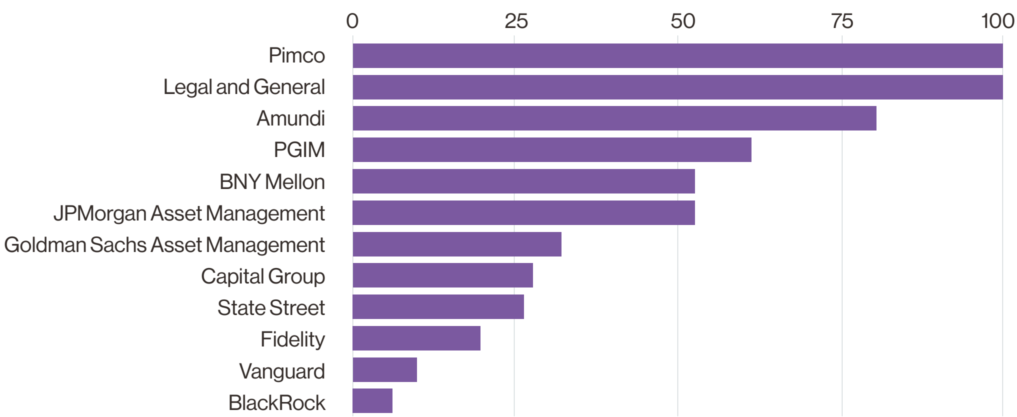
The power of shareholder activism

Proxy voting can be a powerful tool for effecting corporate governance changes in the interests of important sustaina-bility themes.

The integration of ESG considerations can be achieved through security selection or via shareholder activism. For example, proxy voting can be a powerful tool for affecting corporate governance changes in the interests of important sustainability themes like climate change, biodiversity, labor rights, etc. This may mean exerting pressure when it comes to strategy, remuneration or governance rules.

As it turns out, some asset managers are faster-moving of ESG-voting than others. Companies like Allianz and DWS are more supportive of ESG voting themes, while behemoths like Vanguard and Blackrock have a long way to go – supporting less than 5% of ESG initiatives on average. By voting against climate change shareholder proposals at annual meetings asset managers essentially shield non-active boards from accountability on climate change – and leave a big lever of change untapped. For example, BlackRock and Vanguard voted overwhelmingly against the climate-critical resolutions at S&P 500 companies. The good news is that the potential for change via proxy voting for climate change remains large.

Chart 23. Percentage of votes in favour of climate critical resolution



Source: RFS.

Chart 24. The 10 most and least supportive fund groups of ESG voting

FUND	# OF RESOLUTIONS VOTED '15–'19	SUPORT
Most Supportive		
DWS	998	87%
Alianz Global Investors	794	78%
Blackstone	360	73%
TIAA (Nueveen)	977	67%
AQR	882	67%
Alliance Bernstein	942	65%
PIMCO	646	65%
Guggenheim	929	65%
Wells Fargo	1,003	64%
Mainstay (Incl. IndexIQ)	976	63%
Least Supportive		
Federated	970	8%
Hartford (Wellington)	795	7%
JP Morgan	1,002	6%
Amundi (Pioneer Funds)	554	6%
American Funds Capital Group	737	4%
Vanguard	1,033	4%
BlackRock (incl. iShares)	1,033	3%
Lord Abbett	706	3%
Voya	1,027	3%
DFA (Dimensional)	1,004	1%

Source: Morningstar, RFS.

A shift from robo-advice to hybrid models

The premise of active investment is that managers with enough skill are able to outperform the market average.

Robo-advisors like Betterment, Wealthfront or even True Wealth in Switzerland have not met expectations for client growth. As it turns out, their low-cost business models often imply prohibitively high customer acquisition costs. Nonetheless, although robo-advisors have not yet gained mainstream traction to compete seriously with incumbents, their business idea is based on relevant premises.

Indeed, some forms of advice like asset allocation and fund or stock picking can often easily be automated. This saves costs and allows providers to lower fees, and thus address a large client segment. At the same time, many providers have realized that the human advisor remains indispensable, especially in more complex or emotional situations. As a result, many incumbent players have started building hybrid advice platforms, which help cut costs while also providing human touch. Indeed, the hybrid approach combines key aspects of the technology-first approach with conventional wealth management business models to provide users with a cost-efficient and holistic service.

The advantages of the hybrid approach are clear **(Chart 25)**. The example of Vanguard's Personal Advisor suggests large potential: the service currently manages USD 190 billion worth of assets (up from just USD 17 billion in 2015). This example suggests much potential for incumbents in 2021. It helps their relationship managers focus on value accretive activities, and of course to cut costs.

Chart 25. Wealth management business model comparison

	Conventional Wealth Managers	Hybrid Robo Advisors	Fully Digital Robo Advisors
Advantages	• Highly tailored offering for customers • Users have access to personal human advisors that hold the entire customer relationship • Thorough support for users • Access to portfolios generated by humans, which is preferred by some users who don't want to rely on technology	• Portfolios are developed and rebalanced by algorithms • Users can reach out to human advisors to varying extents, depending on a firm's business model, but can use the digital interface to self-serve • Customers receive personalized advice from human advisors • Low fees for customers, as fewer human advisors are needed • Ability to lure in younger demographics with cheaper services	• Low fees for customers, as no human advisors need to be hired • High digital efficiency and self-serve capabilities for customers • Ability to lure in younger demographics with cheaper services
Disadvantages	• Firms charge high fees for users as relying solely on humans for portfolio management and advice comes with a hefty price tag for providers as they need to hire more licensed advisors • Portfolio development and rebalancing must be supervised or completed by humans, adding extra work for staff • Users must consult human financial advisors whenever they have a concern or question	• Human advice is not always available without limit, which could deter some users that need more support • For some offerings users have to pay extra for human advice • During a crisis, human advice may be in higher demand, which could lead to wait times for users	• No human support should a complicated question arise • Limited personalization as the service is based purely on algorithms • No value-added services • Services often can't take a complex financial situation into account, like the coronavirus

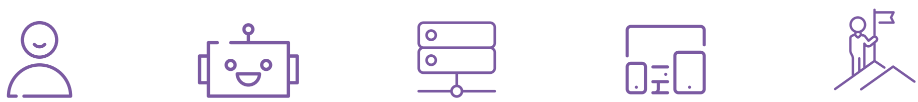
Source: Insider Intelligence, RFS.

Conclusions

These 10 trends suggest that 2021 could be a watershed moment for the asset and wealth management industries. Looking ahead, size is likely to evolve as one the most important impera-tives as the gap between leading and lagging asset management firms is set to rise. This should force the acquisition of smaller firms in what is likely to become an increasingly ferocious battle for market share in 2021.

The benefits of tech-enabled scale are clear: not only are asset managers better able to pay for their rising (regulatory) costs, but they will also be able to service and understand their clients more efficiently. Future market leaders now need to build the know-how for emerging strategic concepts including hybrid advice, building seamless omnichannel experiences for clients, comprehensive sustainable investing and advisory services, producing proactive and relevant content, and defining a clear company purpose. These leaders are likely to exhibit five characteristics that will help them optimize the perceived client value:

Chart 26. Five key characteristics



1. **Client first** — A business model focused on enhan-cing the client expe-rience that clearly differentiates itself from one focused on pushing products.
2. **Flexible fees** — Avoids an all-out price war, but allows clients to benefit from “pay-as-we-perform” models.
3. **Tech advantage** — Using tools like robotic process automation (RPA), artificial intelli- gence (AI), and block- chain technology to en- able mass customization of the service offering.
4. **Distribution 2.0** — Optimizing distri-bution channels, offering an omni-channel approach that includes a direct to consumer offering
5. **Activate purpose** — A Purpose-driven culture, set to be the biggest differen-tiator in the age of commodification and disruptive change

Source: RFS.

In this context, leading firms are likely to follow one of three strategic paths: first, firms decide to go for a low-margin, high volume strate-gies, seeking to acquire new assets; second, firms decide to pursue alpha strategies and buy new technological capabilities to build hybrid models; and third, firms bet on a shifting business model, aiming to build platform scale for distribution rather than product expertise. This quest for scale is likely to see a wave of disruptive acquisitions and strategic alliances with tech companies shaking up the market in the coming years.

One thing remains clear for the asset and wealth management industries in 2021: COVID has accelerated the structural transformation and the race for the next generation business models in asset and wealth management has already begun.

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