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THE BUDGET:



Boutique funds out of fashion

PUBLISHED : 9 hours 18 minutes ago | UPDATED: 0 hours 28 minutes ago PUBLISHED: 11 May 2010
12:07:00 PRINT EDITION: 11 May 2010

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Sally Patten

They are some of the biggest names in funds management.

Paul Fiani at Integrity, Peter Morgan from 452 Capital and Greg Matthews at Independent Asset Management have collectively made millions by setting up their own boutique operations.

But few are set to try to follow in their footsteps. The global financial crisis has made it almost impossible to go it alone.

Following the sharemarket rout in 2008, it is no longer sufficient for boutique funds to be able to demonstrate strong performance figures in order to win business.

Superannuation schemes and private investors are demanding greater assurances that boutique managers have the financial backing to be able to withstand market downturns.

They are also pushing for improved compliance and better administration.

As a result, stand-alone managers, particularly those who oversee only small amounts of money, are finding it increasingly difficult to attract clients. Instead they are teaming up with companies that offer financial backing and distribution, technological and compliance services.

“We saw a particularly significant increase in the number of people contacting us in the March-April-May period last year and that is continuing,” says Mark Burgess, the chief executive of Treasury Group, a publicly listed incubator firm.

Rival Pinnacle, owned by broker HTM Wilson and Ascalon, a subsidiary of Westpac Banking Corp, also reports a hefty increase in inquiries.

“We have moved from a time when we needed to go and seek people as candidates, to one where now there are a great many people approaching us,” Pinnacle managing director Ian Macoun says.

Pinnacle is receiving double the amount of approaches on a monthly basis compared with 2008.

The rise in the number of managers seeking financial and administrative support has been triggered by an increase in due diligence on the part of investors and their gatekeepers, such as research houses and asset consultants.

After the financial crisis, investors have become increasingly concerned about the underlying health of the fund manager’s business, as well as other non-investment processes such as compliance and corporate governance standards, and distribution strength.

“When markets took a downturn, people said: ‘Maybe we need to look at the business model’,” says Burgess, whose Treasury Group has a 50 per cent stake in high-profile manager Investors Mutual.

Ascalon managing director Andrew Landman says: “Suddenly everyone is looking at the business of the manager and not just the investment performance.”

Macoun argues: “A few years ago if you had good-quality investment people with a good-quality reputation, that was good enough and they could get by with everything else. You can never do it now.”

The problem many fund managers face is that while they might be competent investors, they lack acumen in running a small business and often do not have sufficient money to keep the business properly capitalised during a market downturn.

In contrast to the mid-2000s, incubators say that in addition to receiving inquiries from fund managers working for large wealth firms who want to go it alone, they are also being approached by existing boutiques that are struggling to expand after the financial crisis.

Distribution is key because investors are concerned about so-called key client risk.

If a boutique fund has only three or four clients, it runs a big risk that one of those investors might withdraw, potentially endangering the health of the underlying business – and potentially diverting manager attention away from the core business of investing.

And as superannuation funds merge and consolidate the number of fund managers they employ, only the fittest are likely to survive. Consolidation of super funds will, at least in part, lead to a 20 to 25 per cent fall in the number of fund managers in Australia over the next few years, argues Burgess.

Incubator funds were almost non-existent a decade ago, although the industry has existed in the United States for many years.

In Australia, Perennial Investment Partners was one of the first to be established in 1999 as a joint venture between IOOF Funds Management, former BT fund manager and industry doyenne Mike Crivelli and Macoun.

The universe has since expanded dramatically, with the big banks also vying for a slice of the action.

Apart from Ascalon, BT Investment Management, which is part-owned by Westpac, is looking to team up with boutique funds.

National Australia Bank is one of the more recent entrants, having set up nabInvest in November 2007, when it signed up the investment team from Insurance Australia Group.

Other players include Challenger Financial Services, Australian Unity and Bennelong, and insiders say more companies are looking to join the club.

Treasury has nine boutiques in its stable, Ascalon has eight, Pinnacle has seven and nabInvest has six.

Challenger has signed up six funds.

Incubators typically take stakes in the fund manager of between 25 and 40 per cent, although some will have a 50 per cent holding.

On top of the holding, some incubators will take a distribution fee.

Some companies, such as Pinnacle and Treasury, hire a team of sales people who market the boutique funds to private and institutional investors.

Others, such as nabInvest and Ascalon, have the ability to distribute the products through their armies of financial planners and place them on their investment platforms.

Some industry insiders believe that small managers who oversee portfolios of alternative assets, such as private equity and hedge funds, will find it particularly hard to survive without a backer because of the complexity of the investments and the level of due diligence required.

The Australian Financial Review

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