Forces of Disruption

March 18, 2016

In the early 1960s, Charles Feeney and Robert Warren Miller revolutionized international travel purchases, establishing the first duty-free shop in Hawaii, catering to Japanese tourists. Today, Duty Free Shoppers is one of the world's largest duty-free networks—and innovation and disruption are everywhere, from medical advances changing lives to sports equipment revolutionizing athletic performance.

Investing is no exception, but no discussion of disruption in investing would be complete without reference to regulation. Compliance requirements have increased, and tax laws and accounting methodologies are changing, incentivizing various forms of saving. For instance, in the United States the emphasis has moved from defined-benefit plans to defined-contribution plans in order to reduce the volatility of financial statements and decrease risk. The superannuation scheme in Australia is another example of how regulation has shaped the industry through forced savings of the population, while MiFID II in Europe will clearly change business models of sell-side and buy-side investors alike.

Just as the rise of the "style box" disrupted balanced funds, alternative strategies and players are disrupting investing. Hedge funds have been in existence for 66 years and now have nearly $3 trillion in assets, but the recent rise of hedge fund mutual funds has increased transparency, potentially disrupting the fee structures of traditional hedge funds. Exchange-traded funds (ETFs), which have been in existence for 25 years and have $3 trillion in assets, have also grown substantially in the past several years, supplanting other index funds and active managers alike.

Will we see the rise of innovation outside of traditional asset management? It is not too far-fetched to think of a

company such as Google or Tencent launching an asset-management platform, just as Amazon disrupted traditional retailers.

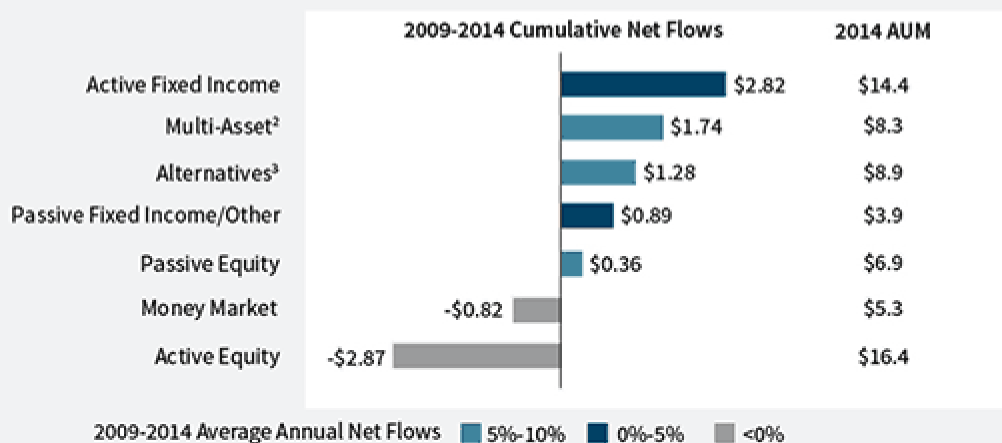
Buying-power shifts are also disrupting asset management. According to BCG, global private wealth totaled approximately $91 trillion in 2005, with approximately 85% of it in developed markets (primarily North America and Europe). In 2014 global private wealth had grown to $164 trillion, but only 66% was in developed markets. Emerging-markets based wealth is thus growing at a significantly faster pace. Who are these new investors and how are their objectives different than investors in developed markets? How do we reach them effectively and, more importantly, keep them?

The millennials bear the scars of the global financial crisis and that has changed their risk tolerance (as it has for investors of any age). Younger generations are also more focused on experience and charitable giving, which affects how much they save and the structure of their investments. We also observe changing objectives institutionally through the aforementioned shift from defined-benefit to defined-contribution plans, affecting investment strategies, fee structures, and distribution models.

One way to quantify the disruption in investing is to evaluate global asset-management flows over the past five years. Active fixed-income, multi-asset, alternative, and passive strategies have garnered significant inflows at the expense of active equities.

Part of this trend is cyclical: after the global financial crisis, investors were skittish about equities and therefore invested more heavily in multi-asset and fixed-income strategies. However, there are structural trends embedded in these flows as well. Defined-benefit plans begin to “de-risk” when attaining fully funded status, increasing their fixed-income allocations at the expense of equities; this is a secular trend rather than cyclical. Meanwhile, multi-asset flows have been bolstered by the rise of target-date funds, which have increasingly become the qualified default investment alternative for defined-contribution plans. At the same time, index funds have gained popularity given their outperformance of active strategies. But just as the industry declared that “active management is dead,” active managers began outperforming again. While this is a cyclical phenomenon, changing structures within institutional and high-net-worth asset allocations have increased the emphasis on index strategies with more focused, actively managed strategies around them.

So is investing being disrupted? Of course it is. The question is, what can investors focus on to not only combat these disruptive forces, but also capitalize on them? That’s another topic for another day.


Global Asset Management Industry Flows and AUM (in Trillions)[1]
2009-2014 Cumulative Net Flows
2014 AUM
Active Fixed Income
$2.82
$14.4
Multi-Asset[2]
$1.74
$8.3
Alternatives[3]
$1.28
$8.9
Passive Fixed Income/Other
$0.89
$3.9
Passive Equity
$0.36
$6.9
Money Market
-$0.82
$5.3
Active Equity
-$2.87
$16.4
2009-2014 Average Annual Net Flows
5%-10%
0%-5%
<0%
[1]Includes 20 largest asset-management countries, accounting for ~95% of the global market.
[2]Includes actively managed target-date funds.
[3]Includes retail alternatives.
Source: McKinsey & Company

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