Fund houses buy up 'alts' specialists to move beyond equities and bonds

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25 mars 2022

Fund management

Asset managers add private strategies to grab share of market worth $15tn and growing

Prominent asset managers are looking at alternatives such as real estate, private lending and infrastructure to improve profitability © FT montage/Dreamstime

Brooke Masters in New York

March 25 2022
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Traditional asset management groups are racing to expand offerings in alternative investments as they seek to boost profitability and head off competition from private equity giants.

More than a dozen groups known for their mutual and exchange traded funds each reported managing at least $100bn in alternative assets at the end of last year, up from nine groups five years ago. Their ranks include BlackRock, Invesco and PGIM.

They and others are bulking up rapidly, often by acquiring alternative specialists. AllianceBernstein last week announced plans to build its alternative assets to nearly $50bn with the purchase of CarVal Investors, and Franklin Templeton expects to top $200bn after it completes its acquisition of Lexington Partners in April.

At BlackRock, where invested alternatives under management have more than doubled in five years to $265bn, chief executive Larry Fink told shareholders this week plans to "accelerate growth . . . in private markets" were central to the group's strategy.

"Asset managers are going after this space [because] their investors are asking for it," said Ju-Hon Kwek, head of asset management consulting at McKinsey. "Investors are fighting for allocations to high-quality private market strategies. Everyone wants more."

The fund companies are concentrating on private lending, real estate, infrastructure and stakes in private companies, all areas where institutional clients have been increasing allocations in recent years. A recent Preqin survey found 86 per cent of limited partners intended to invest the same or more money in private capital this year.

The fund managers also hope to capitalise on an expected wave of interest from wealthy retail clients looking for stable long-term returns at a time when bonds and equities have been volatile. Some envy the success of alternative managers in introducing products for the very rich, such as real estate and credit funds launched by Blackstone, the world's largest private equity group.

"Penetration in the institutional channel is already quite high. There is much more room for allocations in the wealth management channel to increase," said Rob Sharps, chief executive of T Rowe Price, which last year bought alternative credit manager Oak Hill. "Blackstone is tapping into a tremendous amount of demand and other people will try and compete for that."

Globally, alternative assets topped $15tn and 15 per cent of total assets under management (AUM) last year, and that is expected to rise to $22tn and 16 per cent by 2025, according to a recent Boston Consulting Group report.

Adding alternatives is also a way to boost revenue at a time when other fees are compressing and mutual funds cannot assume that new money will boost management fees. Net flows to US long-term mutual funds have been negative for seven of the past eight years, according to the Investment Company Institute. Some of that money has gone into exchange traded funds that do much the same thing, but they tend to carry lower fees.

Alternatives, by contrast, continue to command higher management fees and have the potential for performance-based fees. BCG said alternatives account for 42 per cent of the industry's revenue and that will rise to 46 per cent in 2025.

"The pressure on the mutual funds is that there is no flow. There are going to be periods when the markets are down. You have to diversify and that's why [they] are buying alts," said Peter Kraus, the former chief of AllianceBernstein, who heads Aperture, a new asset

management company.

Traditional asset managers feel they are well placed to offer alternatives to the wealthy investors they serve either directly or through financial advisers.

“Clients want somebody who can understand their collective needs,” argued Greg McGreevey, head of investments at Invesco, where alternatives AUM are approaching $200bn. “Being a broad-based firm that can do passives as well as alternatives gives us a leg up in the wealth management space.”

There are clear risks to buying into alternative managers as prices are rising fast. Fund groups used to buy traditional rivals for well under 1 per cent of AUM. AllianceBernstein paid more than 5 per cent for CarVal.

“There is a limited supply of very strong pedigree teams with track records and a lot of interest out there,” said Matt Bass, head of private alternatives at AllianceBernstein, adding that he expects to profit from the deal by reducing the smaller firm’s cost of capital and helping it to grow.

Cultural fit can be a problem. Alternatives groups pay their employees differently than traditional managers: they rely heavily on performance and the amount can be exponentially higher.

“The different compensation structures attract very different kinds of people and they don’t necessarily coexist naturally,” said Jay Horgen, chief executive of Affiliated Managers Group, which has been investing in alternatives strategies for years. AMG heads off potential conflicts by eschewing full acquisitions and taking stakes in individual asset managers that remain independent and are run separately.

Other firms say they believe the clashes are manageable because all employees understand the need to attract new revenue. “If anything, the broader business is excited to see these new alts businesses grow because we are all shareholders,” said Shane Clifford, senior managing director for alternative strategies at Franklin Templeton, where alternatives now account for almost 10 per cent of AUM.

The other big risk is that alternative products aimed at retail will fail to deliver the strong, stable results investors are looking for. Recent research from Morningstar found that retail-oriented alternative funds delivered lower total returns over the 15 years from 2007 to 2022, and were more correlated with equity market funds than a traditional bond fund would have been.

Still, Morningstar CEO Kunal Kapoor is optimistic. “Historically, the firms that were most focused on launching alternatives were not the best in class. What’s happening now is that the parents that are getting in are among the best, so the outcomes are likely to be much better,” he said.

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