Independent insights

Graviton

The rise of the boutique asset manager

We are entering an unprecedented time of flux in the asset management industry, along with anticipated lower returns. Dramatic declines in equity and bond markets have led investors to challenge their current investment choices. As a result, they are starting to look for increasingly specialist, diversifying investment opportunities in which to invest – making a case for the more flexible boutique asset manager.

What is driving the boutique trend?

The number of boutique managers in South Africa has risen from 8% of the investment managers' universe in 1999, to about 38% of the universe currently, according to ASISA's latest stats.

Why?
For us, it's a combination of different factors, says Rafiq Taylor of Sanlam's multi-manager business, which recently developed a platform of boutique managers, called the Select range of funds by Sanlam. In the context of a volatile, low-return environment, we are looking for the qualitative underpin, the ability to exercise fluidity, the greater opportunity set and potential to generate alpha. All this hinges on identifying true manager skill, however, and is part of Sanlam's diversified multi-asset investment strategy.

Identifying true manager skill

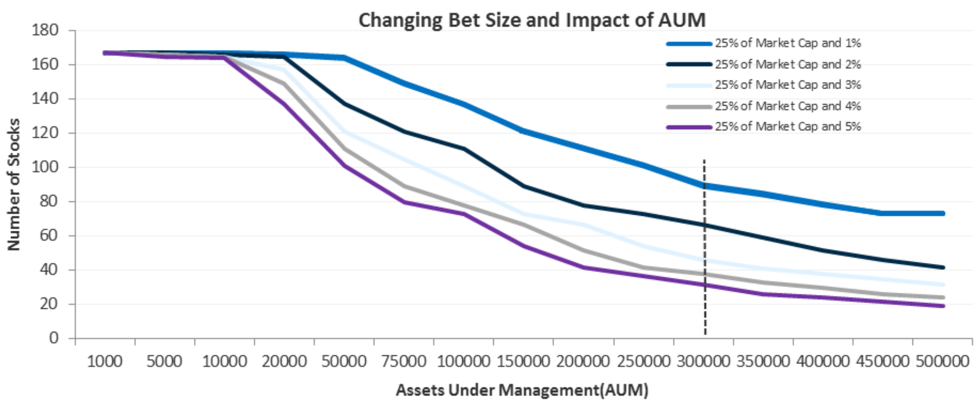
When analysing manager skill the first question that needs to be answered is whether a manager is exploiting a specific anomaly in the market. Then we need to explore whether the manager understands why this anomaly exists and whether this anomaly will persist. In order to utilise this anomaly to be able to outperform over time, the manager needs a repeatable process which can put their beliefs into action in order to generate alpha. It all comes down to whether the manager has a sustainable competitive advantage or edge that allows them to extract alpha from the market consistently over time.

Boutique managers' value-add

Benefits of boutique managers are two-fold: not only are they found to be nimbler, more agile and more responsive to opportunities in the market, but they offer exclusivity, focus, quality and value and can move more quickly to take advantage of market mispricings. They are typically headed by highly talented individuals and have ploughed a lot of their own time and money into a business they are truly passionate about. Having said that, however, we believe they are the next-generation asset managers, and have the ability to become bigger managers over time, according to Lilian Lerm, manager research specialist at Sanlam's multi-manager business.

Boutique managers are often able to exploit market opportunities that are not available to larger managers. This is due to the practicalities of trying to build-up a meaningful shareholding across multiple portfolios. The graph below illustrates how the investible number of counters available in the JSE All Share Index quickly reduces as the assets under management increases.

Inverse relation between AUM size and opportunity set



Source: SMMI, October 2015

Smaller managers tend to not suffer from the same investment constraints as larger managers and potentially have access to the entire universe of shares. There is a vast array of managers who do not have strong brands in the market, taking them off the radar of investors. However there are more often than not valid reasons for their weak brand. The trick is to separate the bad, the mediocre and even the good, from the great.

Manager selection is key

It must be emphasized that manager selection remains critical, cautions Lerm. Precisely because the barriers to entry to becoming an asset manager have been reduced, sifting through the universe to find talented managers is not a simple task. However, this is precisely where we believe our multi-manager proposition comes into play. We believe we have the skill to find these managers and to identify the next generation of true skilled managers, says Lerm. Identifying those boutique managers with real skill requires great expertise and significant on-the-ground resources who can analyse these boutique firms. We believe that skill is indeed rare: this forms the foundation of our manager research process. Through in-depth research we believe that we are able to identify managers that are truly skilful.

Excellent performance across the board

The Select range of funds by Sanlam have on the whole delivered very attractive performance for investors, since inception. While quite short term in track record, returns for these boutique managers demonstrate that spending the time to uncover truly skilful managers, even though they might be relatively unknown, is indeed being rewarded – and in an environment where returns on equity markets are expected to be relatively modest compared to the last 10 years – this is highly beneficial.

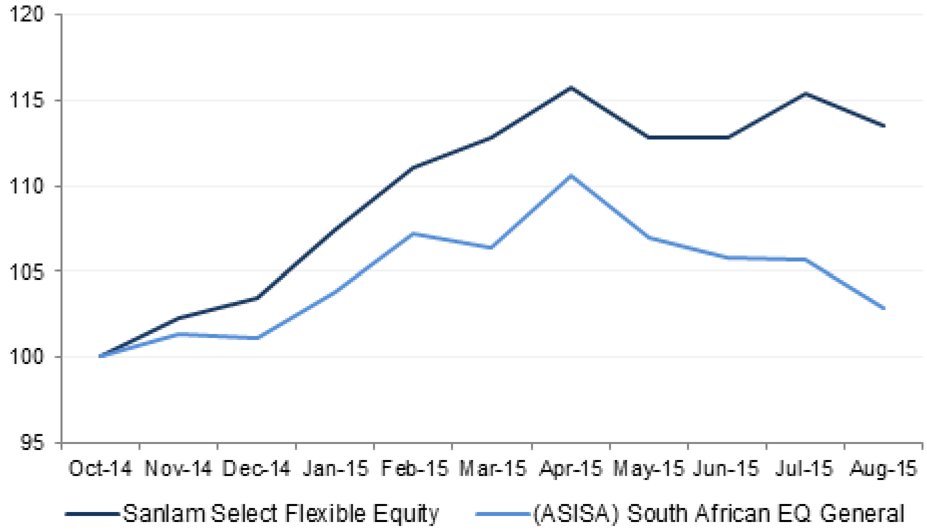
Several funds have been both top quartile and top decile performers:

Manager	Inception Date (first full month)	Performance since inception to 30 September 2015	Position in Peer Group
Capricorn Flexible Equity	1 Oct 2014	17.1%	8/83 – Top Decile
Sentio Absolute Return	1 Jan 2014	16.9%	32/120 – 2nd Quartile
Matrix Low Equity	1 July 2014	10.7%	20/107 – Top Quartile
SMM Balanced FoF	1 Oct 2014	9.6%	22/136 – Top Quartile

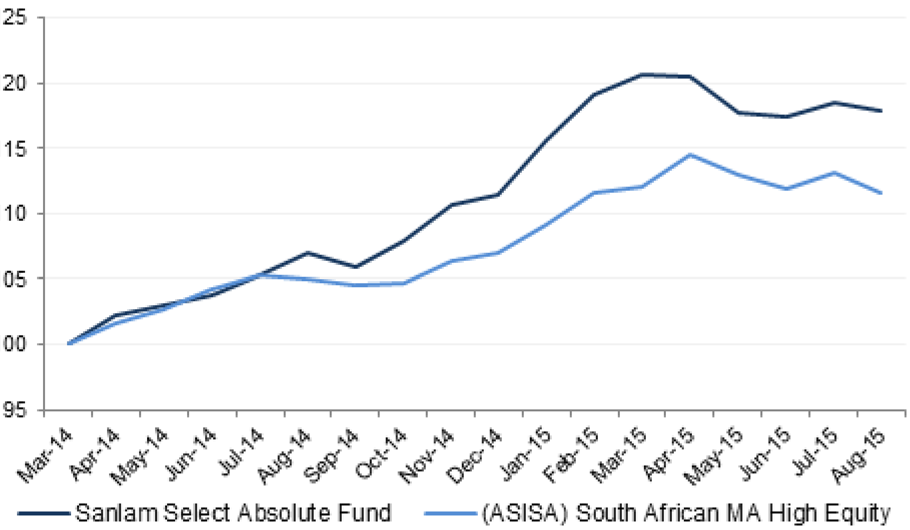
Source: SMMI, October 2015

Some of the top performers:

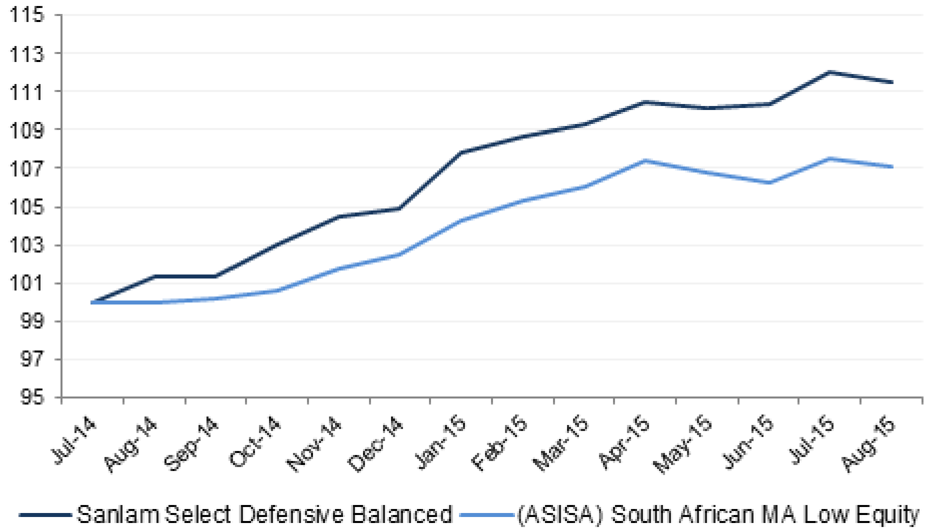
Sanlam Select Flexible Equity (managed by Capricorn Asset Management since October 2014) Capricorn's skill lies in their ability to identify themes from a top down perspective which helps them to identify the sectors where there are opportunities to exploit these themes. Their investment philosophy is quite different which sets them apart within a market where the focus is mostly on bottom up fundamental analysis. Capricorn have proven themselves to be very skilful investors in the hedge fund space, and we believe that this skill is transferable to the long only space, especially within a flexible fund where they are granted more freedom than in a traditional equity fund.



Sanlam Select Absolute Return (managed by Sentio Capital since March 2014)
Sentio adds value in every step of their process, from an experienced and passionate team that manage to create synergies with the way in which they work together, to a well thought-out and clear philosophy, a robust process that includes in-depth analysis to efficiently implement their philosophy, to a portfolio construction and risk monitoring process that is in-depth and repeatable. All these aspects combined enable them to be good stock pickers.



Sanlam Select Defensive Balanced (Low Equity fund managed by Matrix Fund Managers since July 2014)
Given that Matrix only runs R4 billion of assets, they are very nimble to take advantage of opportunities that bigger managers are not able to. Their focus has always been on seeking out shorter term opportunities to add value, especially on the bonds side, and they are able to do this given their hedge fund background. Their fund is driven by their Strategic Asset Allocation (SAA) with alpha added through Tactical Asset Allocation (TAA), which is generated through their top down asset allocation view, as well as through opportunities arising within the different asset classes.



A fund of funds also worth mentioning is the SMM Balanced Fund of Funds, which is a 'pre-packaged' mix of balanced funds. There has been a lot of interest in this fund, which has attracted inflows of around R130 million per month for the year to date. The fund's ranking versus its peers since its inception in October 2014 has been an exceptional 22 out of 135.

"We believe that going forward in an environment of expected lower returns, these boutiques will make a big difference, as they can trade faster, and are more likely to outperform. They have already proved themselves in a very short space of time..."

By Lilian Lerm, Sanlam Investments multi-manager business
