Boutiques vs giants

Can star fund managers outperform at smaller firms?

STEPHEN LITTLE

In recent years, there has been a raft of fund managers leaving large houses in order to set up their own boutiques.

While it allows fund managers to escape the pressures and bureaucracy of a larger organisation, the boutique model can bring its own risks.

Going it alone may seem appealing, but increasing regulation and cost pressures could mean it is more difficult than ever to make the move.

Money Marketing spoke with advisers and consultants to find out the advantages that boutiques have over larger investment firms and whether investors should follow managers when they leave.

Cutting through the red tape

In February, Stuart Widdowson launched boutique asset manager Odyssean Capital in a joint venture with Harwood Capital after quitting GVQ Investment management in 2017.

Widdowson believes the pace of fund managers leaving larger investment firms for boutiques is unlikely to slow down. He says: "Many of the larger houses are struggling to differentiate themselves, and the mandates are often solely focused on shorter-term market performance and risk management regimes based on tracking error to indices.

"Many fund managers intrinsically want to invest in a more flexible, unconstrained way and for the longer term. In addition, the growth of passive investing at some houses may have made those homes less accommodating for genuine conviction active managers.

"There is also a natural cycle of managers leaving larger houses after periods of consolidation to join or found smaller boutiques."

Square Mile senior investment research analyst John Monaghan says boutiques can outperform larger investment firms, but it ultimately comes down to the skills of the underlying fund manager to generate performance.

> There is a creeping bureaucracy at the bigger asset managers, so they don't necessarily implement ideas as quickly

He says: "Quite often when you find managers move from large organisations to set up their own shop, the principles are broadly the same, but with the flexibility of being able to hold slightly more aggressive positions since they are not as hamstrung by sector weights, which would have been dictated by a previous mandate. They can run the money exactly how they want to."

7IM senior investment manager Damian Barry says that smaller firms can be more "nimble" as they have to deal with less red tape.

"We certainly agree with the notion that on average it is harder to outperform when you're running huge assets, and we have often supported boutique firms, which can benefit from fewer distractions.

"At larger firms, new ideas often

EXPERT VIEW

Jason Hollands

Boutique firms are not without great risk

Boutiques tend to be set up by managers that do one or two asset classes really well. That sort of greater focus usually means they have a culture that is more performance-driven in their particular area of expertise, but this can also make them quite vulnerable if there is a downturn.

Although we use funds from boutiques as well as larger asset managers, we don't believe one is better than the other. Our choice is determined by the team and the asset class.

Boutiques often have a buzz of excitement about them and they will always have a role. In some sense, the pendulum is swinging back the other way as the costs of business are so high now.

Firms are having to comply with a growing regulatory burden and get distribution and increased research costs. Larger asset managers are realising that if you want to keep the most talented people, you have to give them room to flourish.

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Companies no longer rigorously force one approach to investment across all their desks and are more willing to allow different managers to adopt their own investment philosophy, so as a result we have seen the multi-boutique model develop.

It often is an 'eat what you kill' environment at boutiques. If you do well, you will really share in the rewards, but if you can't deliver commercial success on top of investment success the security isn't there of a nice salary or bonus every year, and that's not for everyone. It is not without risk for people who do it.

Jason Hollands is managing director at Tilney Bestinvest

have to go to an investment committee. There is a creeping bureaucracy at the bigger asset managers, so they don't necessarily implement ideas as quickly."

AJ Bell head of active portfolios Ryan Hughes says that he tends to favour boutiques over larger groups because they potentially offer greater returns.

"We certainly favour managers that are specialist in their asset class as we would hope over time they deliver superior returns," he says.

"That level of focus is important for us as it stops the investment proposition being diluted by other factors that could be existing within a bigger fund management group.

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"There is evidence to suggest smaller funds outperform larger ones over time, but you have to be acutely aware of the impact of costs on smaller funds. There is always the risk a smaller fund structure may be more expensive, which offsets any additional performance."

However, JP Morgan Asset Management head of intermediary sales Dale Erdei says scale gives larger asset managers a number of advantages over boutiques, including depth of resource.

He says: "Larger firms tend to have sizeable research budgets and extensive infrastructure platforms supported by cutting-edge technology.

"Moreover, having a dedicated team on hand to help navigate an increasingly complex and nuanced regulatory backdrop is another key advantage."

Following the leader

Star fund managers Paul Casson, Richard Pease and Neil Woodford have all managed to prove that it is possible to successfully operate under a boutique model.

Woodford left Invesco Perpetual in 2013 after 25 years to start his own business, Woodford Investment Management.

The Woodford Equity Income fund has given an average annual return of 5.3 per cent since its launch in June 2014, according to FE. By comparison, the Invesco Perpetual Income fund – which was handed over to Mark Barnett – produced a return of 4.2 per cent over the period, while the UK All Companies sector achieved an average 7.8 per cent over the same period.

Former Henderson star manager Paul Casson has been managing the Artemis Pan-European Absolute Return fund since July 2014.

Since then, it has delivered an annual return of 5.8 per cent, while the Janus Henderson Horizon Pan European Alpha fund, which he previously managed, saw annual returns of 4.5 per cent over the same time period. The fund is now managed by John Bennett.

Richard Pease differs from the other managers in that he took his European Special Situations fund with him from Henderson to Crux Asset Management in 2015, rather than setting up a brand new fund. Between October 2009 and June 2015 the Henderson European Special Situations fund had an average annual return of 12.4 per cent compared with 7.7 per cent for the sector. Since then, the fund has achieved a slightly higher annual return of 12.5 per cent, compared with 10.8 per cent for the sector.

While these managers have all enjoyed relative success since leaving larger asset managers, Architas investment director Adrian Lowcock warns that it is too soon to judge their overall performance.

He says: "Generally, it is good to follow the manager as that is the person who will deliver performance, but you have to judge each by their own merits and look at what they are doing.

"When someone moves to a new firm, it is always good to look at what resources are going to support them and what controls are in place.

"Woodford had to effectively set up his fund from scratch, but had to deal with outflows and restructuring of the fund. While Pease also had to set up his own business, he took the fund with him, so there is more of a continuous track record there."

However, he says that buying into the cult of the star manager does have its risks.

He says: "If the manager goes off and does something else or retires, you could potentially see assets flow out of the door very quickly, so you need to have a back-up plan should the worst happen."

ADVISER VIEW

Simon Webster
Managing director
Facts & Figures

As far as boutique funds are concerned, we regard them as the preserve of higher net worth individuals for a small percentage of their overall wealth. We are a mass affluent business based in Ashford, Kent so have few clients for whom that would be appropriate.

We use funds from some of the larger asset managers as part of our portfolios, but the reality is that no one company has the monopoly on the top funds in all sectors.

We avoid boutiques and DFMs as we have our own centralised investment proposition, which allows us to control every part of the process. The client understands they are dealing with us for the advice, asset allocation, and the implementation of funds. We regard it as a totally transparent journey and clients are very comfortable with that, as are we. I understand why some advisers prefer to sub-contract fund picking to people they consider more expert because it is not their field.

As a medium-sized firm, we have the resources and the people to be able to make those fund selections.