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Dolphinvest Global Asset Managers Barometer | January 2024

Promotional material

Capital markets union: Few impulses for asset managers

The traumatic experience of the Lehman Brothers bankruptcy in 2008 triggered a sense of urgency among politicians on both sides of the Atlantic. Banks were the main financiers of companies, particularly in mainland Europe. Once again, it became clear that the fate of entire economies could be threatened overnight by risks emanating from banks. In the European Union, there was a prevailing belief that stronger protection against these risks was needed for its still ultimately fragile community of states. In the ensuing euro crisis of 2012, then ECB President Mario Draghi was forced to intervene with his "whatever it takes" statement in order to prevent a worst-case scenario.

What followed was the capital markets union that EU Commission President Jean-Claude Juncker called for in 2015. Its aim is the defragmentation and strengthening of capital markets in the EU, and ultimately diversification through the greater participation of non-bank market players in corporate financing.

On the borrower/investee side, small and medium-sized enterprises (SMEs) should especially benefit, partly due to reduced bureaucracy for the initial public offerings of SMEs. With the 2020 publication of its action plan for the capital markets union, the European Commission committed itself to specific measures to overcome the biggest hurdles along the path to a fully integrated internal market for financial services. The focus of these measures is on reducing the debt ratio, or rather strengthening the equity ratio, in the balance sheets of companies in the EU.

On the lending/investor side, private investors should in future be able to benefit more from capital market returns that exceed the interest income on bank and savings accounts over the long term, thereby contributing to improved wealth creation and retirement provision for larger sections of the population.

Therefore, the prospects are generally good for the asset management industry in the EU, and the EU Commission is making every effort to provide support. It created the fund vehicles EuVECA (European Venture Capital Funds) and ELTIF (European Long-Term Investment Fund), giving them privileged status versus comparable AIF (Alternative Investment Fund) vehicles by simplifying the distribution approval process to the greatest extent possible in local EU markets.

But the expectation that the asset management industry would go into raptures just by facilitating distribution and international business expansion turned out to be unrealistic. The subsequent regulation amendments to EuVECA and ELTIF were also unable to change anything in this regard, even though lower capital requirements for private investors, for example, represented an important and appropriate correction. Many people have voiced criticism that ELTIFs can now invest in UCITS (Undertakings for Collective Investment in Transferable Securities), i.e. in public markets. Instead of hot love for the new fund vehicles, it's mostly dispassion that still prevails.

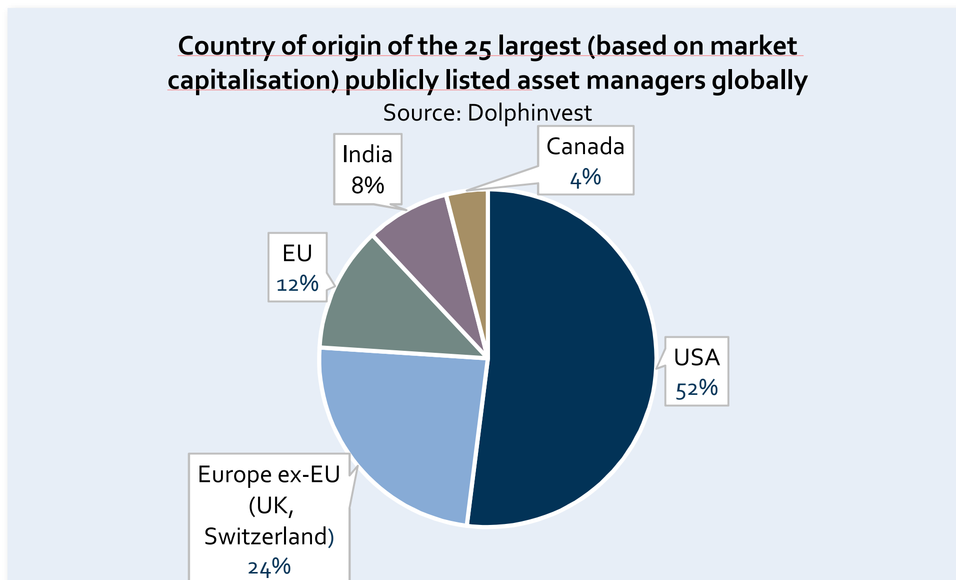
There are three reasons for this. Firstly, the new funds cannot be sold within the framework of pure investment brokering to private investors. Instead, investment advice is absolutely mandatory, or at least the suitability test for the private investor. As a result, distribution via independent financial intermediaries is limited.

Secondly, the market for the asset management industry itself is highly fragmented. In Germany alone, 683 capital management companies were registered at the Federal Financial Supervisory Authority (BaFin) at the end of 2023, and a further 546 companies had a licence to manage financial portfolios. For the vast majority of market participants, the possibility of EU-wide fund distribution is a theoretical option at best, but it is completely irrelevant in practice. They are purely hometown heroes. But even many of the big players that operate EU-wide have no direct client department locally.

And thirdly, there are regulatory concerns at a national level. This is because even though the placement of retail funds in primary markets via ELTIF and EuVECA is a key element of the capital markets union, some national regulators – including France's Autorité des Marchés Financiers (AMF) – have warned of the risks that arise from a greater engagement of private investors in less liquid assets. Arguably, this hasn't been the best marketing strategy, and as long as there aren't any noteworthy EU-wide tax privileges, the new vehicles to support retirement provision won't gain traction across the EU.

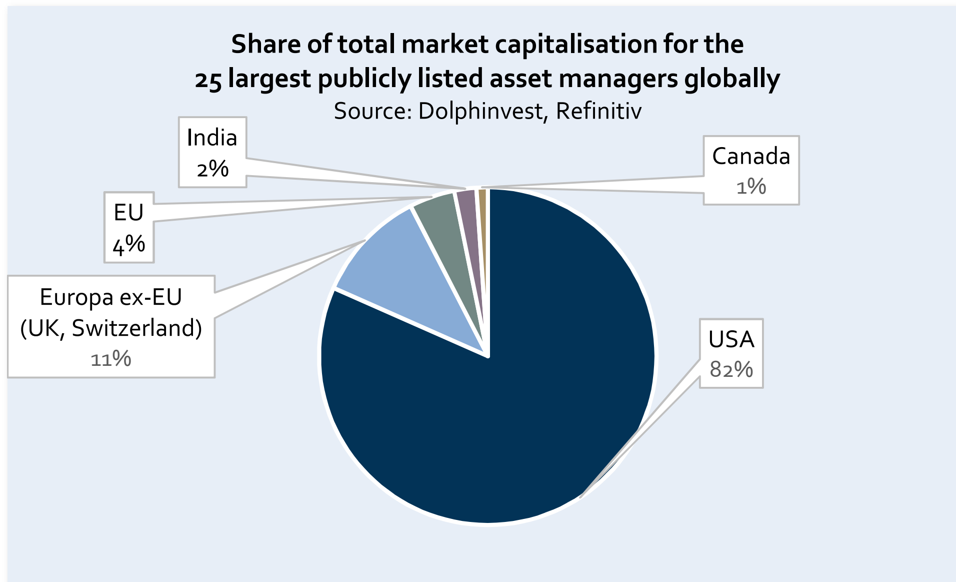
EU closer to India than to Switzerland and the United Kingdom

After an ongoing series of political and economic crises, a sense of urgency to act now prevails again 15 years after the Lehman collapse. At a political level, the necessity to take quick and effective action is in the public domain.



Paschal Donohoe, president of the Eurogroup meeting of finance ministers from the euro area's member states, emphasized in March 2023, that now is the time to proceed with the deepening and strengthening of capital markets in order to "invest in a better future for our citizens."

The finance ministers of Germany and France – Christian Lindner and Bruno Le Maire – stated in a joint op-ed in the (UK!) Financial Times in September 2023: "In the past decade, the capital market growth of some major industrial powers has consistently outpaced that of the EU. We have gone from having a similar number of IPOs to the US to less than half the number today." At its core, the capital markets union project has always been about reducing market fragmentation, they wrote. "It is high time that we step up our efforts," the two ministers demanded.



ECB President Christine Lagarde was singing from the same song sheet in November 2023 when she said confidently "that a capital markets union emerges when there is a need to finance an economic transformation that exceeds the capacities of fragmented financial markets." In February 2020, Lagarde already made clear what she means by an economic transformation of transnational dimensions, when she described the fight against climate change as part of the ECB's mandate.

The asset management industry behaves paradoxically. Asset managers draw their raison d'être from the existence of capital markets. Their practice – besides real-asset and private market allocations – essentially consists of selecting publicly listed financial instruments, such as bonds, equities and derivatives, along with managing funds and securities portfolios. But asset managers shy away from initial public offerings of their own companies, even though it would bring them greater visibility, better capitalisation for business expansion, and advantages for staff retention and succession planning.

The reasons for this caution are obvious: Unlike banks and insurers, asset managers need only minimal regulatory equity capital, and their optimal cashflows protect them from illiquidity. For asset management companies – except for private market specialists – debt is a foreign concept that comes from the real economy.

Before they are motivated to seek additional equity capital in the market, asset managers therefore need a growth-supportive environment and sufficient incentives. But these are lacking: Only since the 2023 amendment of the relevant EU directive has an ELTIF been allowed to invest in financial companies as well – but only if they are no older than five years. Furthermore, such a financial company is not allowed to have a holding structure nor be a mixed-activity enterprise. For companies from the real economy, there are no such limitations. The EuVECA directive even adds another thing on top: It explicitly forbids any investment in financial companies. A fund vehicle that is created by the EU for the purpose of the capital markets union, has privileged status and – unlike EuVECA and ELTIF – focuses on supporting medium-sized and bank-independent financial companies is completely lacking.

A rethink is necessary. If the EU – with its capital markets union – wants to support the initial public offering of companies, for example, there must be more IPOs, also of asset management companies. The fact that there is so far only one mutual fund – ARC ALPHA Global Asset Managers – that invests exclusively in publicly listed asset managers reveals an imbalance. On the one hand, the asset management industry has enormous macroeconomic significance as the major service provider on the

buy side of global capital markets. On the other hand, it is a completely underrepresented sector on their sell side.

In the resolution of this imbalance, we see considerable potential for investors with a long-term horizon. A start has been made and should encourage imitation: BlackRock, the world's biggest asset manager (based on client funds under management), is publicly listed. Meanwhile, large private market specialists with global operations – such as Blackstone, Apollo and Partners Group – are also listed on exchanges, as are the biggest ETF providers in the world (BlackRock, Wisdom Tree, Invesco, Amundi and DWS).

The industry and therefore also the ARC ALPHA Global Asset Managers Fund are traditionally characterised by strong volatility in the short and medium term. 2023 was no exception. The first quarter initially went very well in absolute and relative terms, but then came the Silicon Valley crisis, which subsequently put pressure on the sector's stocks. The turnaround started at the beginning of the second half, during which the fund outperformed the broader equity market (+9.34% versus +6.23%). The fund continued this trend in the final quarter (+7.75% versus +6.79%) and in the last month (+9.76% versus +3.62%). For 2024, we see further positive potential – as long as no nasty surprises emerge on the interest rate front.

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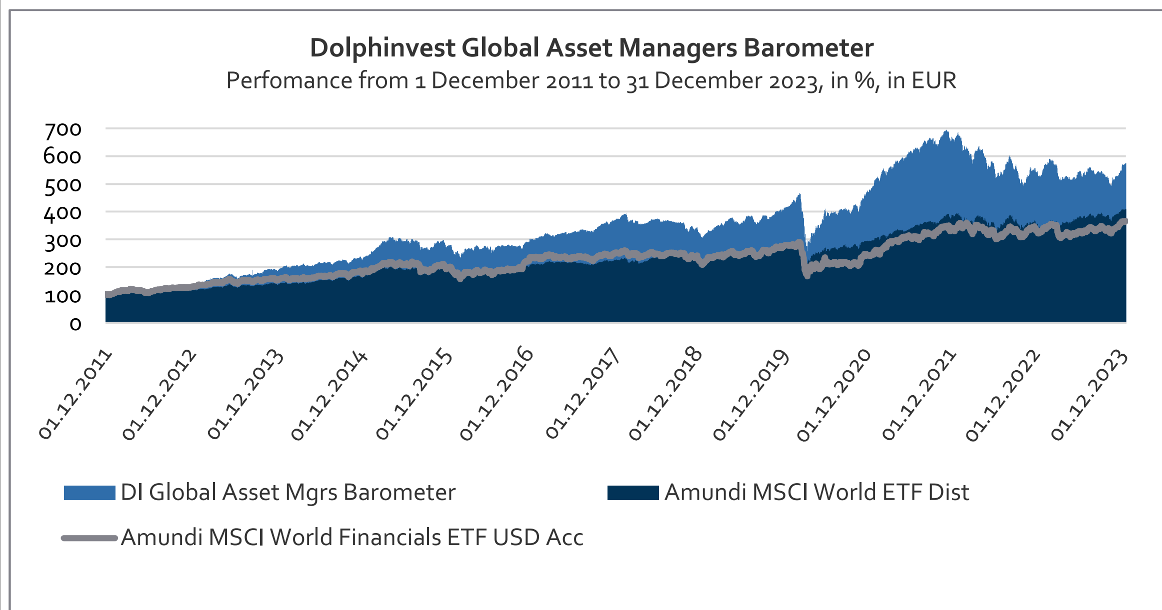
What is the Dolphinvest Global Asset Managers Barometer?

Each quarter we publish the "Dolphinvest Global Asset Managers Barometer". This barometer is a tool for us to analyse the current situation of the asset management industry and to illustrate the view of international investors on the industry. For this reason, the "Dolphinvest Global Asset Management Barometers'" publication is by no means a buy or sell recommendation.

The barometer displays the performance of more than 100 listed asset management companies in EUR. For inclusion in the barometer, it is a mandatory requirement that a minimum of 75% of the overall revenue of a company is derived from asset management fees. Banks and insurance companies that have major asset management entities will, therefore, normally not be included in the barometer. The barometer represents all continents.

The transparency of listed asset management companies enables us to consolidate relevant information on the individual asset management companies included in the barometer into generally valid statements and to take them into account in our consulting work. Depending on the mandate, we divide the universe of constituents of the "Dolphinvest Global Asset Managers Barometer" into groups of similar companies against which we then benchmark our clients.



Sources: Euroswitch, Morningstar. As of 31 December 2023. Past performance is no reliable indicator of future returns and is not constant over time.

Disclaimer:

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