ADRIAN CLAYTON
Chief Investment Officer,
Northstar Asset Management

WHY SIZE MATTERS

Size matters in investing, just not in the way we may have been led to believe. In many ways smaller is better. This is certainly true of the inverse relationship between size and the ability to generate returns above the benchmark, which has been confirmed in study after study.

Specialist investment managers – a term we at Northstar Asset Management prefer to 'boutique' – not only have a bigger investment field in which to play, but can also be more dynamic in the market, aren't obliged to chase large stocks when these are overvalued, and can exit investments more rapidly should a situation reverse.

Big investment managers have an edge with their powerful brands and diverse business models, which allow them to earn fees off the same customer at several points in the investment value chain. Pity the monoline boutique manager who sets up shop promising to shoot the lights out and fails to deliver.

Large managers can use their diverse income streams and economies of scale to offset the not insignificant costs of investment compliance and administration. But the rise of competitive outsourced solutions gives specialist managers access to equivalent services and the ability to manage these costs down for the benefit of their clients, without having to worry about damaging another part of their business.

Combining outsourcing with a streamlined business model gives specialist investment professionals the space to indulge their passion for investing, ensuring that clients' interests and investment returns stay firmly where they should be – at the centre of the business.

Size matters, too, for the clients of specialist managers. On top of improved performance, they also have far greater access to decision makers than with a large manager. This also supports greater accountability – sitting across the table from an investor to explain underperformance or the thinking behind an investment that goes against market consensus certainly sharpens the mind.

Recent trends in investment flows show that investors and multi-managers are beginning to recognise the considerable expertise available outside the large managers and appreciate the performance advantages this confers. As the approach to portfolio construction evolves with the entry of further competitive products and the rise of artificial intelligence, the unique differentiation offered by specialist managers is likely to become a sought-after asset. Large managers risk losing their position at the centre of the traditional 'core and satellite' portfolio construction approach to low-cost exchange traded funds. This could benefit specialist managers as the important role their particular approach plays in portfolio outperformance becomes better understood and more effectively modelled.

We expect the total number of asset managers to reduce, as the industry is definitively overtraded. The managers most likely to prosper during this consolidation will be those with a clearly defined specialisation and a track record of generating alpha over time. For specialist managers that can combine a passion for investing with good business skills, minimise distraction and keep clients' interests at the centre of their business, being small is far from a disadvantage.