



2023 investment management outlook

The global investment management industry looks
to drive success in a virtuous cycle

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KEY FINDINGS

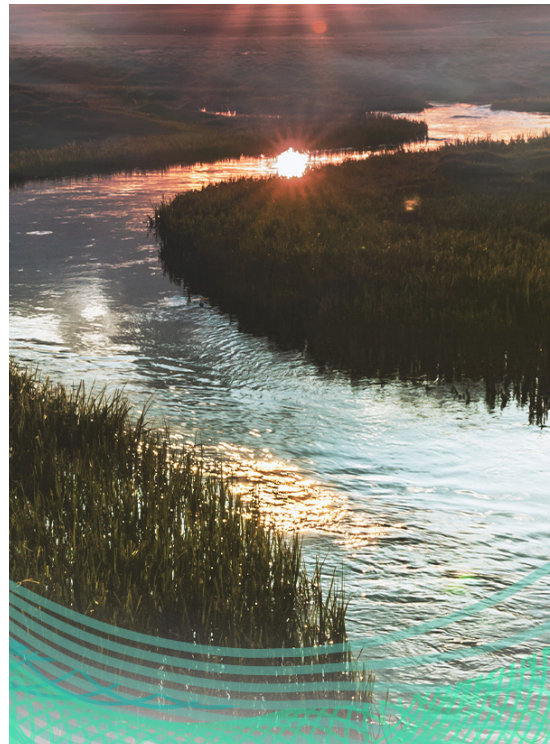
- Our survey results indicate—for the second consecutive year—that a virtuous cycle exists in investment management firms. Effective leadership and vision can enhance efficiency and overall success.
 - Since investment management is talent-driven, most businesses are working to optimize their talent models. Firms are updating their workplace policies to influence employee satisfaction. However, these updates alone are not always enough. Progress toward establishing and communicating a corporate purpose is correlated to improved efficiency, revenue opportunity, and reduced employee turnover.
 - Firms continue to invest in digital transformation with new technologies that improve the client experience, gain operational efficiencies, and potentially generate alpha. Leadership can help drive these changes effectively with communication to foster collaboration across departments to achieve transformative results.
 - As investment management firms plan and execute their strategies for 2023, leaders who engrain a sense of purpose throughout the organization are likely improving the chances of success on many levels.
-

Investment management firms need to keep their virtuous cycle turning for continued success

PROGRESS IN INVESTMENT management firms is driven by leadership. Investment management leaders provide the initiating spark for success and guide the organization to achieve their firm’s vision. By investing in talent, tools, and innovative technologies, leaders can help their firms achieve competitive advantage and operational efficiency. Two of the important findings from this year’s investment management outlook survey are the consistency of opinion between organizational functions on the health of firm culture and the agreement on priorities for allocation of resources over the coming 12–18 months. These findings represent a meaningful improvement in coordination across departments from results reported in the [2022 investment management outlook](#).

Of course, revenue and profit growth are not distributed equally among investment management firms. Some firms responded better than others to the unprecedented disruptions of the last two years. Investment managers continue to be faced with tough decisions on how to respond to internal pressures such as rethinking traditional workplace models without sacrificing workplace culture. They also face external pressures such as increasing societal demands for greater equity and inclusion. Through our proprietary survey, we examine actions that leaders are implementing to guide their firms in this highly competitive

environment (“Methodology: About the Deloitte Center for Financial Services 2023 investment management outlook survey”). The survey findings indicate that strong connections between leadership, culture, and operating results are persistent year over year. In the face of market challenges, changing client expectations, and the adoption of new technologies, investment management firms that keep their virtuous cycles turning could be more likely to earn continued success.



METHODOLOGY: ABOUT THE DELOITTE CENTER FOR FINANCIAL SERVICES 2023 INVESTMENT MANAGEMENT OUTLOOK SURVEY

The Deloitte Center for Financial Services conducted a survey among 300 senior investment management executives in finance, risk management, regulatory compliance, operations, talent, marketing, and technology.

Survey respondents were asked to share their opinions on how their organizations have adapted to the varied impacts of the pandemic on their workforce, operations, technology, and culture. We also asked about their investment priorities and anticipated structural changes in the year ahead, as they pivot from recovery to the future.

Respondents were equally distributed among three regions: North America (the United States and Canada), Europe (the United Kingdom, France, Germany, and Switzerland), and Asia Pacific (Australia, China, Singapore, and Japan).

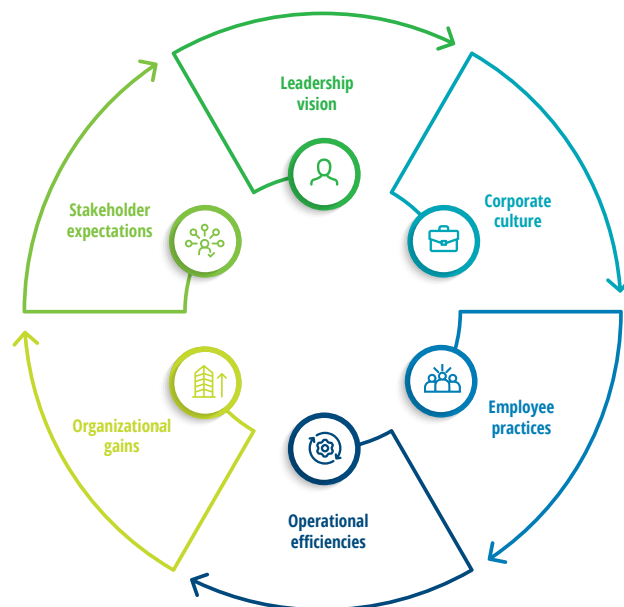
The survey included investment management companies with at least US\$50 billion in assets under management and was fielded in June and July 2022.

Let's look at industry performance and assets under management to get a sense of how different types of investment managers are faring. Since investment management is a talent-driven business, we will explore how firms are optimizing

their talent models, and then look at investments that are creating advantages. Connections to the virtuous cycle are explored each step along the way (figure 1).

FIGURE 1

Many investment management firms are driving success in a virtuous cycle



Source: Deloitte Center for Financial Services analysis.

Performance and M&A activity update

The competition for assets continues

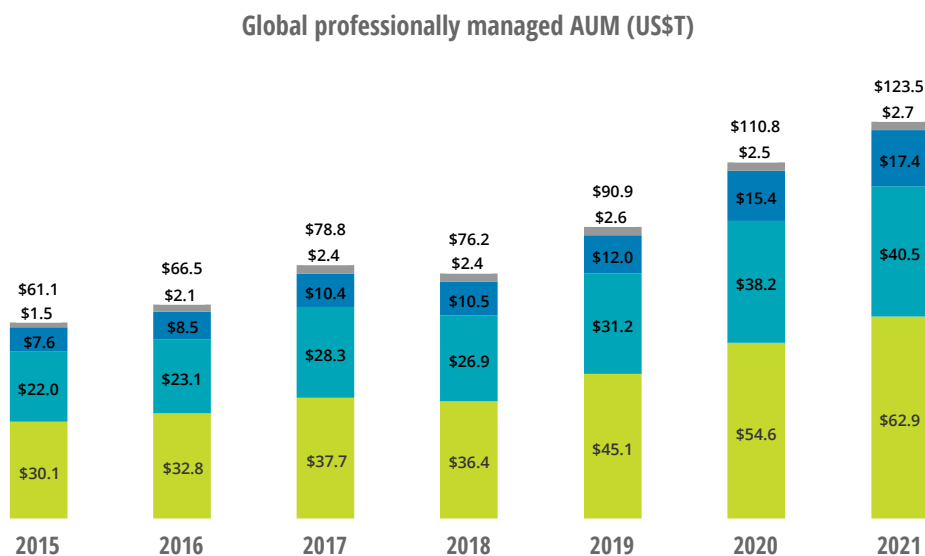
Globally, professionally managed assets under management (AUM) grew for a third consecutive year, setting an all-time high of more than US\$123 trillion at the end of 2021 (figure 2). However, this growth in AUM is being realized by investment managers in varying degrees. After a promising start to 2020, some believed the tide was turning (as noted in last year’s outlook), but US active

equity manager performance slid back toward historical averages in 2021. For example, active mutual funds in the United States experienced an eighth straight year of net outflows through the end of 2021.¹ Only about 20% outperformed the broader US equity composite on an absolute returns basis for the one-year period ended 2021, slightly better than the longer 10-year period, over which 14% outperformed.² On average, the equally weighted performance of US active equity domestic funds trailed the broad benchmark by more than 6%, the largest deficit since 2008.³

FIGURE 2

Global AUM has increased year-over-year crossing the US\$120 trillion mark in 2021 with North America attracting the most investments and Asia Pacific recording the fastest growth since 2015

■ North America, CAGR 13.1% ■ Europe, CAGR 10.8% ■ Asia Pacific, CAGR 14.7% ■ RoW, CAGR 10.1%



Sources: Investments and Pensions Europe; Investment Company Institute; Deloitte Center for Financial Services analysis.

While 2021 proved to be a challenging year for many active managers, 2022 and beyond is expected to present new challenges for managers. Globally, 66% and 59% of survey respondents, respectively, are concerned that both inflation and the geopolitical landscape will negatively impact their firms over the next 12 months. Respondents with significant inflation concerns are overwhelmingly located in the United States. These significant concerns seem to be impacting the US public markets, which entered a bear market during the second quarter of 2022. Now, active managers have another opportunity to demonstrate their acumen with securities-level selections tailored to this market cycle, potentially differentiating them from passive products.⁴ Bear markets also squeeze revenues at investment management firms, so leaders will likely need to focus on prioritizing projects and lowering spending. A prolonged economic downturn may exacerbate margin pressures that are already impacting some investment management firms. Even as firms respond to falling revenue and asset levels by reducing non-compensation-related spending, higher technology, and data costs, coupled with increased marketing spend, have made margin expansion challenging.⁵ Should the uncertainty surrounding the macroeconomic environment and technology-related cost increases continue through 2023, the gap between the most successful investment management firms and those trying to catch up could widen.

In 2021, active equity managers around the globe experienced similar challenges as their peers in the United States. On average, active equity managers in Canada, the Eurozone, and Japan struggled to generate alpha relative to their regional benchmarks

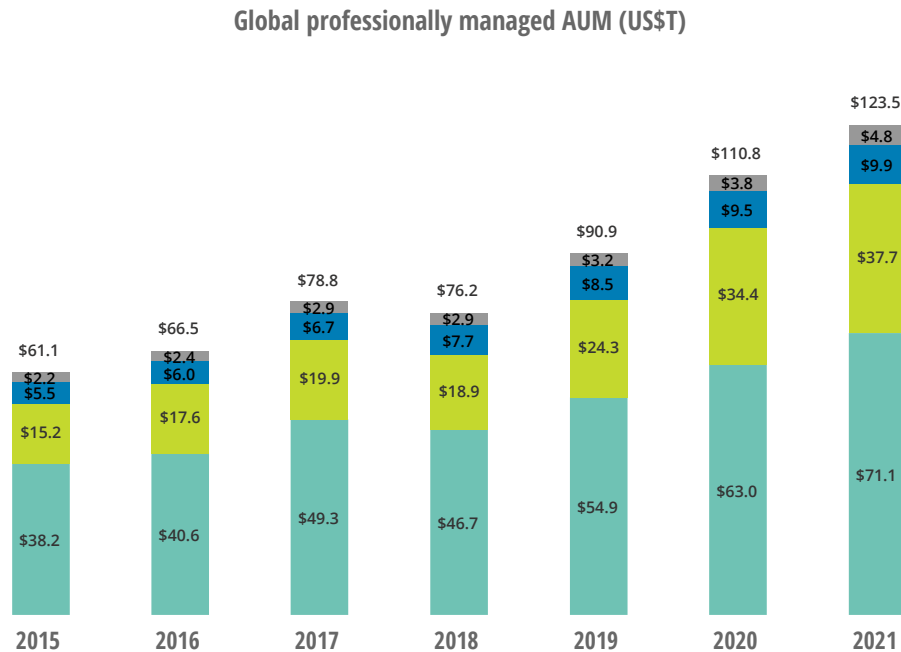
over the one-year period ended 2021 (–2.7%, –3.3%, and –2.2%, respectively).⁶ Conversely, portfolio managers focused on the United Kingdom and Australia, on average, were able to surpass their benchmarks by 0.4% and 1.1%, respectively.⁷ Regional differences in performance are likely to persist through the rest of 2022 and into 2023. However, our 2023 investment management outlook survey shows that many active portfolio managers are investing in capabilities such as artificial intelligence (AI), data acquisition, and data analytics. These investments may enable alpha generation as managers strive to provide superior risk-adjusted returns to index investing.

Turning to global alternative investments, private capital (private equity, venture capital, real estate, real assets, private debt, fund of funds) continued to outperform hedge funds, returning 37.9% in 2021 compared to 10.2% for hedge funds.⁸ Hedge funds had strong AUM growth in 2021 when compared to open-ended mutual funds, exchange-traded funds (ETFs), and private capital, although open-ended funds continue to attract a bigger share of investments (figure 3). While the similarities in AUM growth of hedge funds and private capital that was seen in the first half of 2021 held through the end of the year, fund flows for the first quarter of 2022 point to a possible divergence in investor allocations for the coming year. Outflows from global hedge funds totaled US\$27.3 billion during the first quarter of 2022, vs. capital raises of US\$293 billion for private capital funds.⁹ Private capital funds raised 13% more capital during the first quarter of 2022 than during the same period in 2021, demonstrating that investors continue to hold a favorable view of the asset class.¹⁰

FIGURE 3

Open-ended funds continue to attract the lion's share of investments even as hedge funds and other products have grown at a faster rate since 2015

■ Open-ended funds, CAGR 10.9% ■ Private capital, CAGR 10.3% ■ Hedge funds, CAGR 13.7%
 ■ All others, CAGR 16.4%



Sources: Investments and Pensions Europe; Investment Company Institute; PitchBook Data, Inc.; BarclayHedge; Deloitte Center for Financial Services analysis.

In addition to raising capital, private capital fund managers have been busy putting investor capital to work. In 2021, dry powder fell to its lowest levels in absolute dollar terms (US\$3.2T) since 2018 and also as a percentage of total AUM (33%) since 2007.¹¹ Deployment of capital is also reflected in capital contributions, which outpaced distributions for a third consecutive year in 2021.¹² However, investors were not left empty-handed; distributions grew more than 30% last year to reach the highest level on record, at US\$1.2 trillion.¹³ While capital deployment may slow in the coming year due to uncertainties surrounding the global economy, distributions are expected to remain elevated. Competition for investor capital remains fierce even though the number of private capital funds coming to market in 2021 declined

15% from 2020.¹⁴ The funds that remain tend to be larger and the median fund size is the largest it has been since 2007.¹⁵ For the five years ended in 2021, private capital returned US\$4.9 trillion to investors, which likely contributes to the continued strength in yearly capital commitments.

Mergers and acquisitions

Through the first half of 2022, global deal activity in the investment management and wealth management industry remained elevated, with 307 mergers or acquisitions announced or completed compared with 298 during the same period in 2021.¹⁶ However, global quarter-over-quarter trends indicate that a slowdown in activity may

have begun during the second quarter of 2022. While deal volume in the first quarter rose about 18% from the same period a year earlier, signs of a pullback developed in the second quarter as activity fell about 9% from Q2 2021.¹⁷ Respondents to our survey report above average concerns for rising inflation and geopolitical events, which may, in part, be creating a more cautious environment for deals.¹⁸ Interestingly, while concerns about rising inflation were the highest in the United States, the reduction in mergers and acquisitions (M&A) deal activity would have been much more pronounced globally had it not been for the US exhibiting some deal resiliency. Deal activity in H1 2022 compared to H1 2021 fell 5% in Europe and 7% in Asia-Pacific, while the US deals rose 16%.¹⁹

While the fundamental motivations behind M&A deals, such as increasing scale or diversifying product lineups, remain intact, the downward

trend in activity may continue globally in 2023. Across all regions, only 49% of survey respondents indicate their firm is likely to increase mergers and acquisitions over the next year, compared with 76% last year.²⁰

As potential deals move to the backburner in 2023, some investment management firms may focus more on integrating previously closed acquisitions to maximize synergies and transform operations. Most survey respondents (58%) report *integration and transformation* among the top two issues for their firms in the M&A deal life cycle.²¹ Capturing and maximizing deal value for stakeholders through renewed attention to postmerger integration activities will likely be the emerging M&A theme in the next year. This postmerger activity is expected to share the goals of major organic investment initiatives, albeit with different approaches and risk profiles to firms.

Optimizing the talent model

Managing workplace changes

Investment management firms of all types compete daily to attract and retain assets under management. The primary enabler of competition in investment management is the talent pool at each firm. Effective investment management leaders drive success by establishing and communicating a vision that creates a sense of belonging and purpose for the firm. Leaders can build a culture that fosters collaboration and translates into creativity and efficiency.

One of the talent challenges that firms are expected to continue to face through 2023 is managing the return to the workplace. For many employees, their mindset about the workplace has changed dramatically. The pandemic proved that over yearlong time spans, remote work can be effective. With the great resignation in the United States and similar talent environments globally, many employees changed employers. At their new jobs, many are familiar only with fully remote or hybrid workplace arrangements. Leaders have to continue to manage and plan for the future beyond a one- or two-year timespan, and in investment management, building lasting bonds among employees could be a critical step to develop the next cohort of company leaders.²²

To tackle these challenges, many firms are deploying a framework and goals approach at the firm level while enabling team-level variations to achieve these goals. Our survey results indicate

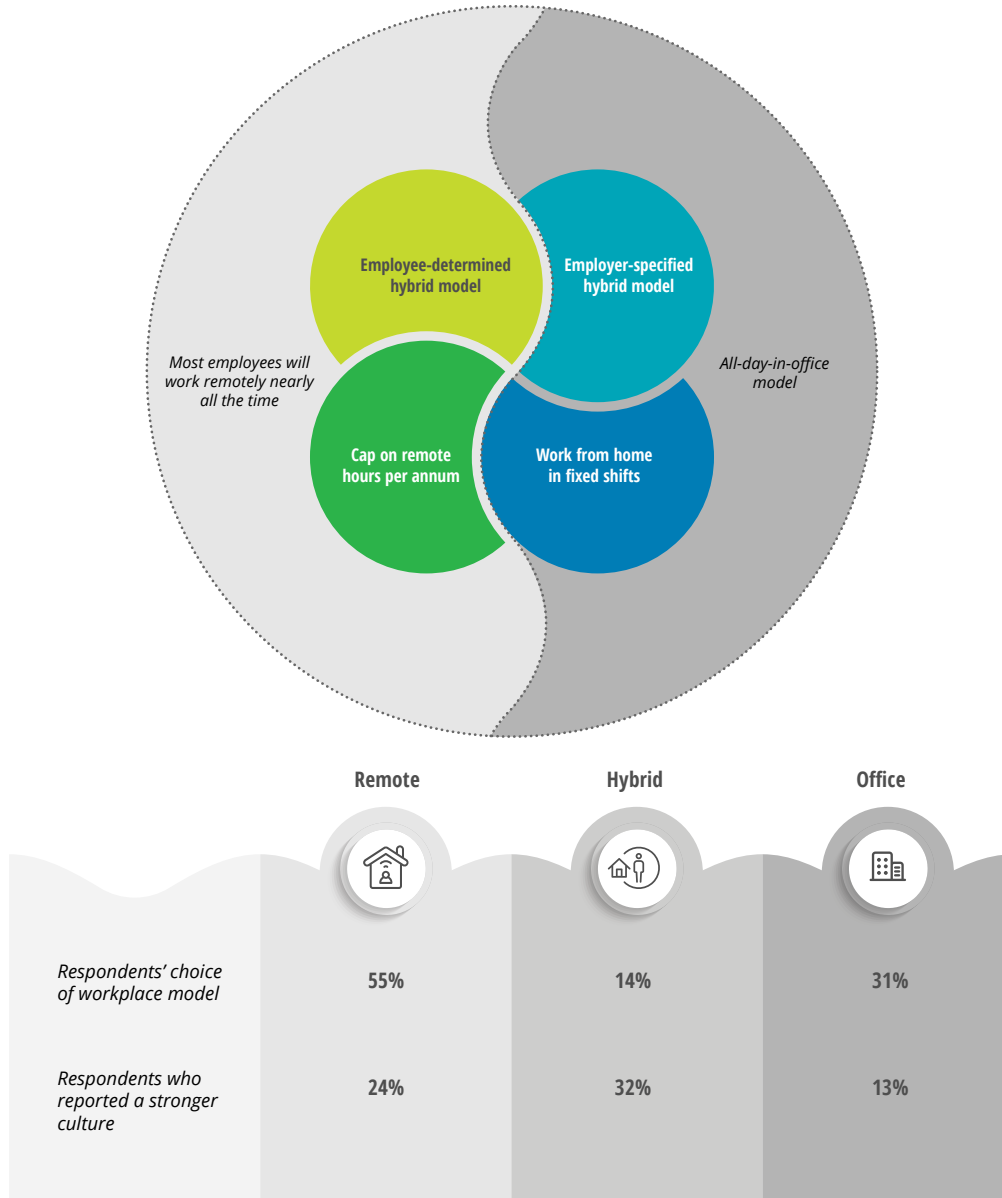
that the relationship between workplace policy and strengthening culture is linear: As firm policy becomes less flexible and requires more time in the office, the percentage of survey respondents reporting strengthening culture since the beginning of 2022 declines. Meanwhile, 32% of respondents at firms that were likely to adopt a hybrid workplace strategy report that their firm's culture has become much stronger. Among firms likely to adopt a policy in which most employees return full-time to the office, just 13% of respondents reported a strengthening culture—a shift from last year's survey results.

Last year, among respondents who said most employees will eventually return to the office, 38% reported that their firm's culture had become much stronger compared to only 25% who indicated that their firms are likely to adopt a hybrid model for the long term. Interestingly, among the remote work group in figure 4, almost a quarter of these respondents also indicate culture had become much stronger, suggesting that certain employees may be able to remain working virtually, leading to an improvement in an organizational culture, reviewed in detail in this [Deloitte report](#).

As disease transmission becomes less of a concern, leading back-to-the-workplace plans will likely strike a balance between employee preferences and long-term corporate goals to help smooth the transition from pandemic workplace policies to future-state policies.

FIGURE 4

The pandemic acted as a catalyst for workplace model transformation, with remote work gaining prominence



Source: Deloitte Center for Financial Services 2023 Investment Management Outlook Survey.

Investment management firm leaders will need to balance employee expectations and the long-term ability to create a meaningful, cohesive, and durable corporate culture. The great resignation may be a consequence of this dynamic, sorting out

employees into firms that match their desired workplace models. If so, it could be the right shift for both employers and employees—provided firms and migrating employees have well-thought-out workplace strategies and desires, respectively.

Connecting talent with the organization

While workplace policies influence employee satisfaction, other factors are also important. Our survey results demonstrate that progress toward communicating and achieving a strong corporate purpose is correlated to efficiency, revenue opportunity, and reduced employee turnover.

PURPOSE

Two areas that continue to help define a corporation's purpose are its environmental, social, and governance (ESG) policies and, especially, its diversity, equity, and inclusion (DEI) policies, which are a subcomponent of ESG. Across industries, including investment management firms, transparency, and quantifiable progress for ESG and DEI are among the goals of most stakeholders, which includes leaders, employees, customers, investors, communities, and regulators. In the 2022 investment management outlook, greenwashing and diversity-washing were highlighted as two issues many investment management leaders faced. Based on this year's survey results, it appears that some firms are still working towards quantifying DEI initiatives, as almost half have yet to begin or have only made some progress.²³

Our survey results reaffirm the correlation between making progress on this task and cultural benefits. In fact, consistent with last year, respondents from firms that made significant progress quantifying their DEI initiatives were 44% more likely to report that collaboration across teams got much stronger. These respondents were also 29% more likely to say that engagement and productivity got much stronger.

Some investment management firms may also benefit from instituting transparent ESG policies at their portfolio companies. Research suggests that companies that have these policies ingrained in their business models may outperform their peers, which, in turn, would boost revenue, fund

performance, and investment flows for the investment management firm.²⁴ Given these significant benefits, leading investment management firms are expected to prioritize the disclosure of their firm's progress on DEI initiatives over the next year.

ESG AND TALENT

Demand for ESG-aligned investment strategies continues to increase for institutional and retail investors.²⁵ Hiring the right people to not only execute these strategies for clients but to monitor compliance will likely accelerate over the next year. In the United States, some firms are stepping up the hiring of ESG compliance specialists, even more so, due to the heightening attention from regulators.²⁶

However, the pool of qualified applicants may not be keeping pace with the demand for talent with specific skills related to ESG investing. Wages for ESG specialists are outpacing the broader industry and competition for qualified professionals is so heated that applicants are increasingly able to choose between multiple job offers.²⁷ Specialization programs, such as the *Certificate in ESG Investing* from the CFA Institute and the *International Sustainable Finance* designation awarded from the International Association for Sustainable Economy, are gaining traction and helping to narrow the skills gap and equip the investment management workforce with specialized skills for ESG and sustainability-related investing.²⁸ Many investment management firms and asset owners have formed partnerships with these organizations to not only upskill current staff, but also to demonstrate their firms' commitment to ESG and sustainability issues.²⁹

Survey respondents who agreed or strongly agreed that their institution's ESG initiatives are influencing their employees' decision to work with them were 69% more likely to also report a much stronger overall culture and 50% more likely to report significantly better revenue expectations for the coming year.³⁰ While the ESG specialization skills gap is likely to persist over the coming year,

investment management firms that proactively form partnerships with training organizations to upskill employees and attract new talent may better position themselves for long-term success. Firms that make these ESG investments could reap cultural and financial rewards while meeting investor expectations for ESG-aligned investment strategies.

LEARNING IS A CORNERSTONE IN TALENT

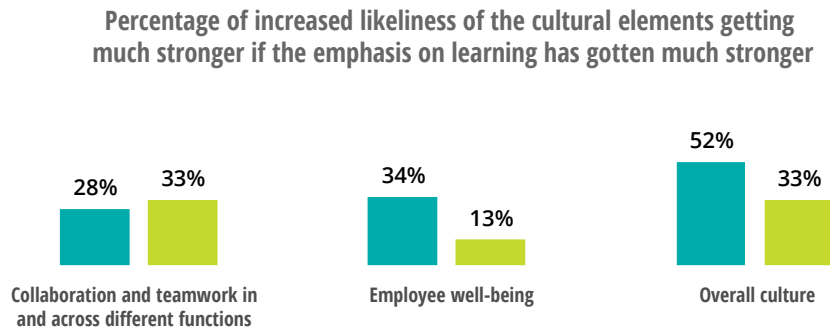
An old story about investing in training employees recounts a conversation between a CFO and CEO. The CFO complains about the high cost of training, lamenting that if employees leave the company, the company loses its return on investment (ROI) on the cost of their training. The CEO responds, “But what would the future of our firm look like if we did not encourage training, *and they stayed?*” Employee training has benefits that far outweigh the specific knowledge learned through the courses themselves.

For the second year running, survey data shows that a stronger emphasis on learning is correlated to important workplace behaviors (figure 5). Improvements in collaboration, wellbeing, and overall culture are related to an increased emphasis on learning. In this year’s survey, respondents at firms with a strong emphasis on learning were 33% more likely to report that their firm’s culture was strengthening, than respondents from firms that placed less emphasis on learning. Strong learning emphasis is also related to employee well-being. Finally, respondents from firms with a strong learning emphasis were 33% more likely to report much stronger collaboration across teams, an important success factor in today’s age of digital transformation. Firms looking to measure the ROI of employee training should note that a focus on personal growth may contribute to employee retention and an emphasis on learning may help foster the attitude and softer skills that often lead to success on the big efforts that require commitment and collaboration across the organization.

FIGURE 5

Stronger emphasis on learning may increase the likelihood of improving other aspects of culture

■ 2021 ■ 2022



Sources: Deloitte Center for Financial Services 2023 Investment Management Outlook Survey; Deloitte Center for Financial Services 2022 Global Outlook Survey.

Strengthening culture

Survey findings suggest that strong cultures help empower decision-making in organizations. Similar to last year, this year we found an increased likelihood of empowered decision-making (47%) at firms where their culture was strengthening. These findings point to how the virtuous cycle feeds itself as it connects vision, operational achievement, alignment with stakeholder expectations, staff practices, and corporate culture. Staff well-versed with the firm's corporate vision often demonstrate greater confidence in strategic decision-making, thereby energizing the virtuous cycle, according to our survey.

Communicating for alignment

Respondents across departments in investment management firms consistently report that culture is getting much stronger. Our survey asked respondents to rate overall culture and nine subcomponents. The nine subcomponents: understanding of firm vision, employee engagement & productivity, collaboration & teamwork, emphasis on learning, employee wellbeing, risk appetite, empowered decision making, customer orientation, and agility in execution show no significant differences by analysis of variance across departments. If

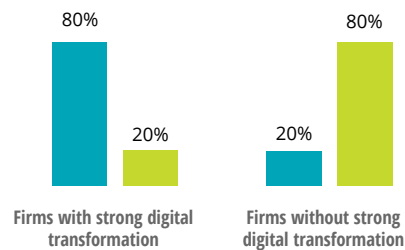
improvements were driven more by department-level management, less department-level consistency would be expected. These results indicate that leaders are positively influencing the overall culture, and there is firmwide progress. Training staff and inculcating a corporate vision can lead to quantifiable change for investment management firms. Managing talent well can lead to an energized virtuous cycle.

FIGURE 6

Firms far along in their digital transformation journey are more likely to have a stronger culture

Percentage of respondents who said that since the beginning of 2022:

- The firm's culture became much stronger
- The firm's culture didn't become much stronger



Source: Deloitte Center for Financial Services 2023 Investment Management Outlook Survey.

Investing for advantage

DIGITAL TRANSFORMATION INVOLVES investing in new technologies to improve the client experience, gain operational efficiencies, and, for investment managers, potentially generate alpha. There are multiple stages of digital transformation, as described in this [Deloitte research](#), ranging from incremental process improvement to creating new business operating models. The efforts underway in investment management often fall in the middle where process changes are dramatic—using new data sources and analytical capabilities to enable new product development. Deloitte research shows that as projects get more comprehensive, leading practices tend to call for more hands-on leadership from the C-suite. Higher leadership is beneficial because cross department process transformation generally needs more coordination and collaboration.³¹ The connection between progress on the digital transformation journey and improving culture is remarkably strong. Of the few respondents who reported that their firm were very far along in their digital transformation journey, 80% also reported that their firm’s culture got much stronger since the beginning of 2022 (figure 6).

Expected changes in spending for major technology categories was also analyzed to see if there are any differences between the expectations of finance executives and leaders from other parts of the organization. The results show few significant differences. While the differences in spending expectations do indicate that more coordination would likely level out the expectations in a few areas, the finance executives expected larger increases than the rest of the organization in most

cases (figure 7). Often when the finance department gets a digital transformation makeover, it leads the way for other departments. In one area where there is a significant gap (blockchain spending), we found that finance is expecting greater investment than other departments. This sort of gap is likely easier to manage, but still needs to be resolved to maximize efficiency.

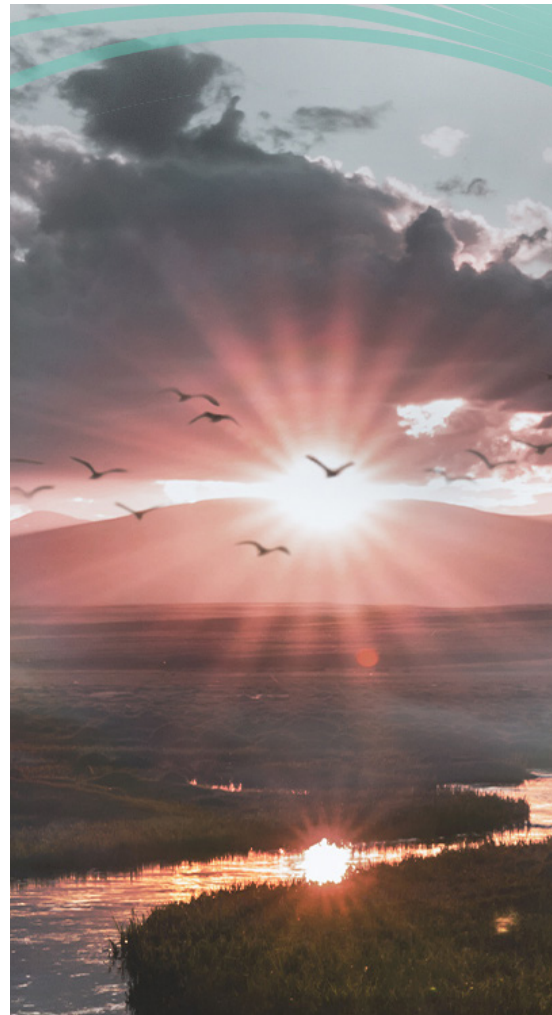
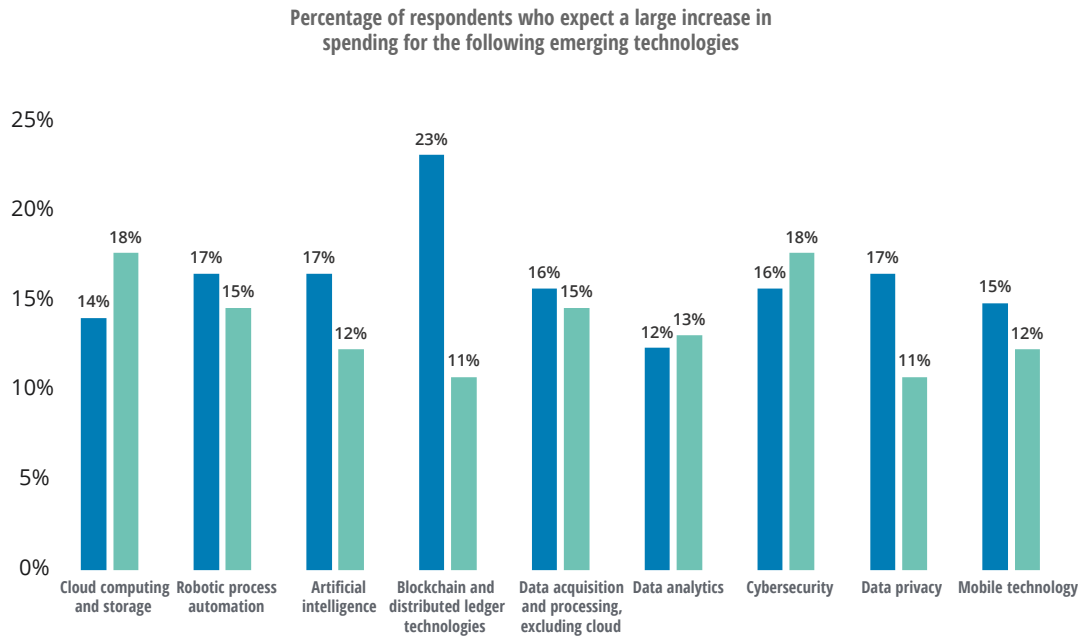


FIGURE 7

Compared to respondents in other functions, more of those in finance expect large spending increases on most emerging technologies

■ Finance ■ Other functions



Source: Deloitte Center for Financial Services 2023 Investment Management Outlook Survey.

Outlook for alpha, client experience, operational efficiency

Delivering alpha in a consistent manner to clients efficiently is what leading investment management firms strive to do. Reinvesting in the firm should support alpha generation, elevate client experience, and improve operational efficiency.

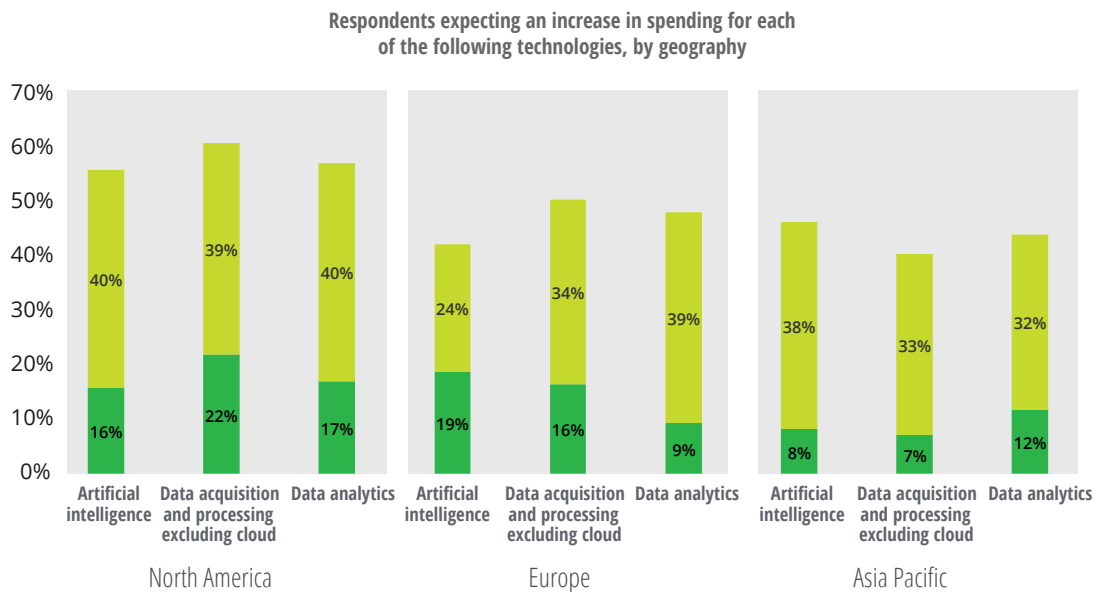
GENERATING ALPHA

Three technologies that can contribute directly to alpha generation (although they are not exclusively for alpha generation) are AI, data acquisition and processing, and data analytics. In terms of spending in these technologies by region, North American respondents plan greater spending increases compared to their counterparts in Europe and Asia Pacific (figure 8).

FIGURE 8

North American respondents plan greater spending increases on alpha generating technologies than those in Europe and Asia Pacific

■ Respondents expecting a large increase in spend ■ Respondents expecting a slight increase in spend



Source: Deloitte Center for Financial Services 2023 Investment Management Outlook Survey.

For two of the three potentially alpha generating technologies, AI and data analytics, respondents who expect a large increase in spending have a higher probability, 53% and 54% respectively, of having significantly better revenue prospects in 2023 compared to respondents who did not expect large increases in spending on these technologies. The connection between technology implementation and revenue is in the application. Many investment management firms are applying these technologies to incorporate new datasets into the investment decision process, and to streamline front- to back-office integration in their core operating systems. These developments can lead to information advantage through better, faster investment decisions, supported by tighter systems and data integration.

“Leading firms continue to upgrade their core investment management processes with new datasets and technology in pursuit of alpha.”

— Tony Gaughan, EMEA investment management leader, partner, Deloitte LLP

In general, information advantage historically has provided investment managers with reliable outperformance. Active investment managers prioritize research and analysis in their efforts to create information advantage. Advanced technology is becoming a more frequently used path to legitimately generate it. AI and data analytics are some of the latest technologies being deployed in the competitive war for information advantage.

QUANTUM COMPUTING—A POTENTIAL EMERGING CAPABILITY

Quantum computing technology has emerged from research-lab novelty technology to the cusp of practical application, in a matter of just decades. There is an abundance of uncertainty about the timing of the first enterprise-level commercially available application of quantum computing. The investment management industry has plenty to gain from this technology especially in terms of optimizing portfolio risk and return calculations. Several investment management firms are already staffing quantum computing specialists to apply the technology as it becomes commercially available. While it's unclear when this technology will be commercially viable, the amount of money being invested in it has grown exponentially over the past three years. Firms in North America and Europe have a higher deal volume and value than

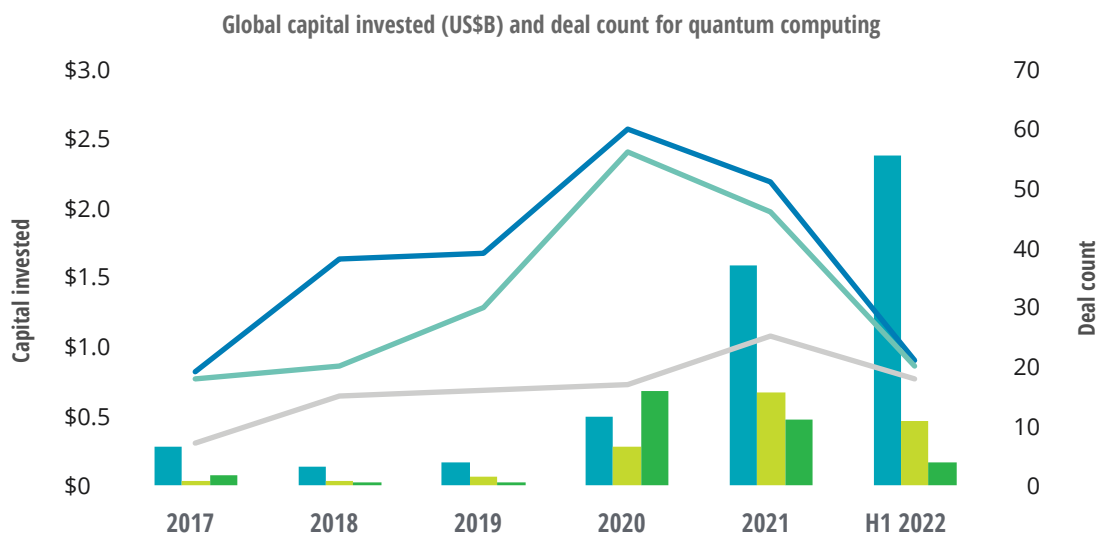
those in Asia Pacific at this stage (figure 9). Patent development has also accelerated exponentially over the past five years (figure 10). This increased focus on funding and technological innovation is likely to drive progress and the investment management industry may be a beneficiary.

Quantum computing may not deliver information advantage in 2023, but when it does, the technology has the potential to deliver differentiated results. However, knowledge on the application of quantum computing, unlike previous technologies, isn't necessarily transferrable. It may take a year or two for employees to become fully productive using the technology. Firms that are investing in these capabilities in 2023 are likely to be the first movers when it does become commercially viable.

FIGURE 9

North America has recorded almost as much capital inflows in H1 2022 as in the past five years combined

Capital invested ■ North America ■ Europe ■ Asia Pacific
Deal count — North America — Europe — Asia Pacific

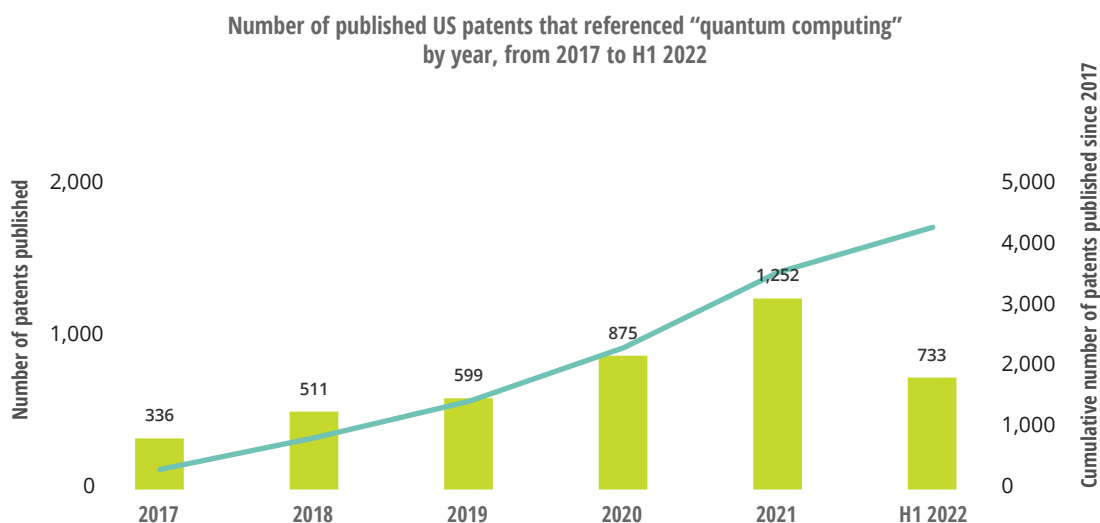


Sources: PitchBook Data, Inc.; Deloitte Center for Financial Services analysis.

FIGURE 10

The number of published patents referring to “quantum computing” has increased significantly since 2017

■ Number of patents published [CAGR 2017—21: 38.9%] — Cumulative number of patents published since 2017



Sources: The United States Patent and Trademark Office; Deloitte Center for Financial Services analysis.

INVESTING IN CLIENT-CENTRICITY

Digital transformation for client-centricity falls into two main groups: investment products and client connections. Digital transformation in investment products ranges from improving the investment process for product strategy to enabling the investment approach itself as is the case with direct indexing. Another form of investing in client-centricity is through client connections themselves. Cloud computing and mobile technology enhance client connections as they allow firms to increase scalability, improve collaboration, and provide additional channels to interact with clients.

Products

Client-centric product offerings provide portfolios with investment objectives, risk profiles, price points, and legal packaging that resonate with the firm’s target customer segments.

Direct indexing, ESG-aligned portfolios, and digital assets are notable developments in investment

management that augment customer-centricity. A lot will depend on how new technologies associated with these product offerings are utilized.

Direct indexing

In addition to benefits from tax-loss harvesting, client preferences for ESG investment strategies that align with their own personal social and sustainability goals have led to a resurgence of interest in an offering that has been around for decades: direct indexing. Once available only to institutional clients and high-net worth individuals, direct indexing is now expanding its base, especially in the United States. Over the past year, at least three investment management firms with large retail investor client bases have offered customized client-directed portfolios such as direct indexing.³² The addition of direct indexing to product lineups may be viewed as a natural progression as advisers look for options that offer the typically low-cost advantages of a passive product along with customization and tax-loss harvesting opportunities. Direct indexing will likely

compete for assets with both active and passive investment managers. Offering a single product that combines active and passive-like investing within one platform leads many to believe that direct indexing will likely disrupt the investment management industry. Growth in direct indexing AUM in the United States is expected to accelerate over the next year. However, as direct indexing and other separately managed account strategies expand, it remains to be seen whether they will significantly replace ETFs or actively managed funds in client portfolios in the near future. North America is likely to be the market leader for direct indexing products, followed by Europe and Asia Pacific due to more mature technology platforms and a broader base of high-net-worth investors.

ESG

When it comes to obtaining ESG-related data metrics for use in the investment decision-making process, there is no shortage of third-party data providers in the market today. The growing number of providers demonstrates the value that these datasets bring to investment managers. An ESG portfolio manager is likely to struggle without access to data—whether its traditional data related to a firm’s financials or alternative data utilized to capture carbon emissions. Given the growing number of data providers and the importance of high-quality ESG-related datasets, it would be reasonable to expect spending to continue to accelerate exponentially. However, our survey findings indicate that investment management firms may be becoming more selective in data acquisition. The percentage of respondents indicating that their firms are planning to increase spending on data acquisition and processing over the next 12–18 months fell slightly to 51% in 2022. More interestingly, respondents who reported a decrease in spending more than doubled to 22% in this year’s survey, up from only 9% last year.³³ This shift by no means suggests a falling interest in ESG-related datasets. In fact, client demand for ESG-aligned investment strategies is expected to continue to expand and represent more than half of

all professionally managed assets by 2024.³⁴ The challenge going forward for many managers may be to either learn how to do more with less or become more efficient in their current data acquisition process.

Doing more with less is no simple task due in part to the varying degrees of disclosures by investee companies. Some portfolio managers will likely continue to look to multiple third-party data providers to fill the gap in data availability, but this presents a challenge as budgets shrink. Even when the needed ESG-related datasets are attainable, navigating through the sea of data providers remains a concern. However, integrating traditional and alternative ESG data from multiple providers at scale in a cost-effective manner remains an obstacle for many investment management firms. Investment managers may gain efficiencies from a platform which not only streamlines relevant ESG data metrics to identify sustainable investment opportunities, but also provides a method to report to clients how these metrics impact decision-making in a transparent way.³⁵ For example, quantifying and reporting to clients the actual ESG impact of their investment dollars on climate-related initiatives represents an emerging opportunity for differentiation. Detailed reporting of these performance metrics to clients may benefit the investment management firms themselves, as investors are more satisfied with their ESG reporting. More firms are expected to make this type of reporting a priority in 2023. Some leading firms may also integrate their ESG disclosures into the distribution model to attract sustainability-driven investors. The Securities and Exchange Commission (SEC) has joined other regulators around the globe, weighing in on this matter, with a clear message to the industry that ESG investment decision processes must align with the marketing communications for ESG portfolios. Investment management firms will likely have to disclose ESG methodologies associated with the investment decision process.³⁶

Digital assets

Professionally managed digital asset and cryptocurrency AUM reached a high of nearly US\$77 billion in October 2021 before dropping to approximately US\$33 billion as of July 2022, demonstrating the price volatility of the underlying digital assets.³⁷ Grayscale Bitcoin Trust (GBTC) comprises the majority of the total AUM as of July 2022.³⁸ GBTC invests in Bitcoin, although not directly, but rather through derivatives such as futures, swaps, and other Commodity Futures Trading Commission (CFTC)-regulated vehicles that reference digital currencies.

With a couple of recent notable exceptions, traditional firms are playing it safe for now as the primary challenge remains uncertainty in the global regulatory landscape.³⁹ Evidence suggests that traditional firms are in the early stages of developing funds that their clients, especially younger cohorts, desire. However, the uncertainty around regulation of digital assets is keeping a check on the growth of this industry. US regulators have yet to approve any proposals for exchange-traded products based on cryptocurrency spot prices.⁴⁰ Regulatory clarity will likely emerge in 2023 with acceptable forms of digital asset-based vehicles approved for investment managers, consumers, and investors. The growth in these first-mover products is likely to be significant given the pent-up interest in this asset class.

Connecting with clients

Firms focusing on client-centricity should also rethink fund distribution to reduce bottlenecks that investors face in accessing products. One way they can improve fund distribution, especially in low- and middle-income markets, is through collaboration with independent digital platforms. According to a regional survey of Southeast Asian managers, 41% of fund houses expected online channels to pull more AUM than traditional channels over the next decade.⁴¹ Digital payment transactions have increased in the pandemic due to restrictions on movement and the need for

contactless channels. A significant chunk of consumers in developing economies that made digital merchant payments in 2021 did so for the first time after the start of the pandemic.⁴² This digital transaction trend is also spilling over to other areas and may provide new avenues for attracting retail fund flows for the next few years.⁴³

Independent platforms have greater potential to attract retail investors in the low- and middle-income markets as these segments are underserved by traditional financial infrastructure.⁴⁴ In fact, according to World Bank data, more people in low-income countries saved money using mobile money accounts in 2021 than by using traditional financial institution accounts.⁴⁵ Over the next few decades, a majority of the working-age population, especially in low- and middle-income countries, will primarily comprise digitally native millennials and Generation Z cohorts.⁴⁶ A recent online poll of retail investors indicated that millennials and Gen Zs tend to trust digital sources more than other older generations and are more likely to use customer-centric digital platforms that offer a broad range of investment products.⁴⁷ These trends are also supported by our survey responses for the second consecutive year now. Most respondents say their firms plan to increase spending on technologies such as mobile and cloud that make integration with other platforms and applications easier.⁴⁸ Collaboration with independent investment platforms may help firms to tap into an underserved market with young tech-savvy investors.

Integration with retail apps is another area of opportunity. Many customers use these apps as a one-stop shop for payments, shopping, and entertainment. With a large number of participants, this group provides significant AUM growth potential even through low-income cohorts. In fact, when it comes to client interactions, investment management firms are likely competing for AUM with companies from other industries that have advanced customer-centric client interfaces. Digital investment platforms may be a viable avenue for

investment managers to reach the large existing userbase of these platforms.⁴⁹ To attract assets from the extremely competitive market of high- and very-high-net-worth clients as well as to build relationships with the generation to follow them, firms need to continually reinvent their digital interaction experiences. In addition to providing a stage to compete, integration and collaboration with digital platforms also open up easier access to newer geographies for investment managers.⁵⁰

OPERATING EFFICIENTLY

Digital transformation leads to operational efficiency, improving the organizational culture along the way. Just as they say in sports, winning is habit forming, there's so much that comes with an improved organizational culture. Our survey shows that respondents from firms that are satisfied or very satisfied with their digital transformation process are more than twice as likely (42% vs 18%) to be in firms with cultures that have gotten much stronger since the beginning of 2022, supporting the virtuous cycle concept. In addition, firms that report being far along on their digital transformation journey also report greater success at cost reduction. As high as 90% of respondents who reported that they are far along in the digital transformation journey also reported that they have fully or almost fully realized the benefit of cost reduction from digital transformation compared to 41% of respondents whose firms are not far along in their digital transformation journey (figure 11).

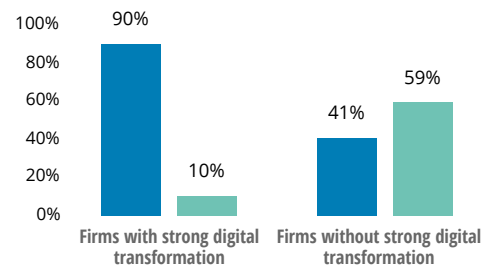
In our survey, we focused mainly on technologies such as cloud computing and storage, robotic process automation (RPA), and blockchain for operational efficiency. We found that 16–17% of respondents expect a large spending increase over the next 12–18 months for each of these technologies (figure 12). It is noteworthy that spending for cloud computing and storage is likely to be much higher in absolute dollar terms than in spending for blockchain and distributed ledger technologies. These are increases relative to prior

FIGURE 11

Firms far along in their digital transformation journey are more likely to have realized cost reduction benefits

Percentage of respondents who said their firm:

- Realized cost reduction benefit from digital transformation
- Did not realize cost reduction benefit from digital transformation



Source: Deloitte Center for Financial Services 2023 Investment Management Outlook Survey.

spending rates at each firm. Further, RPA projects represent a mature technology that may have been purposefully dialed back, based on previous survey results, as IT resources were directed to virtual work-related technology implementations. In the current stage of the pandemic, coupled with a mid-year economic slowdown in 2022, RPA may well be an attractive technology to counter-balance heightened staff departures, in addition to providing direct cost savings from the inherent efficiencies.

Technology-driven change may not only improve firm culture but can also help reduce costs. Clearly, firms are abandoning old-fashioned ways and gravitating toward doing things the new and efficient way.

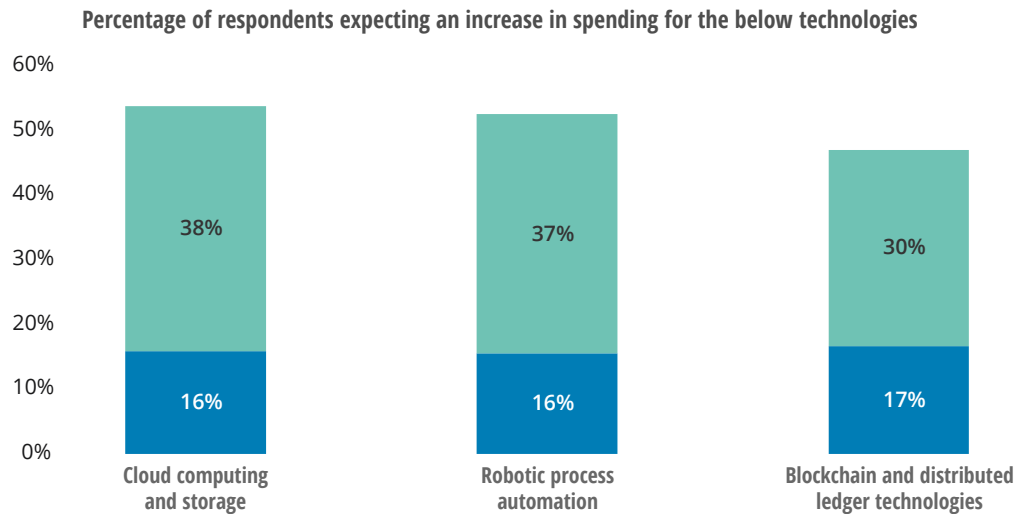
KEEPING TRANSFORMATION UNDER CONTROL WITH GOVERNANCE

During the early days of the pandemic, responding to the rapidly changing work environment was a top priority. Now, more investment management

FIGURE 12

Most firms are expecting an increase in spending on efficiency-enhancing technologies

■ Respondents expecting a large increase in spend ■ Respondents expecting a slight increase in spend



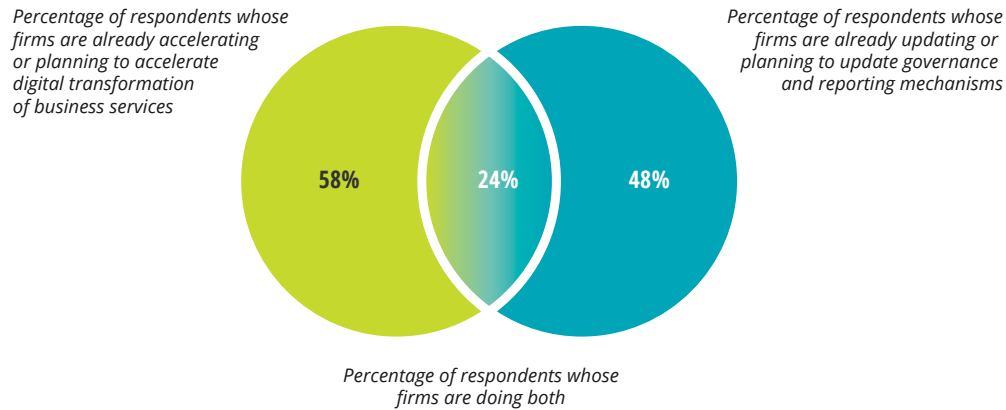
Source: Deloitte Center for Financial Services 2023 Investment Management Outlook Survey.

firms are turning their attention to responsible digital transformation. However, governance and reporting mechanisms at many investment management firms have still not caught up with the pace of digital transformation. About 58% of respondents to our survey say their firms have already or are planning to accelerate digital transformation of business services over the next 12–18 months, up from 54% last year.⁵¹ Yet only 24% of respondents indicated that their firm is taking both actions, accelerating digital transformation as well as updating governance and reporting mechanisms (figure 13). Encouragingly, respondents indicating that their firm is taking both these actions increased from just 19% last year.⁵² Much of this increase can be attributed to firms in North America, where the percentage implementing both these actions jumped from 11% last year to 22% in this year's survey.⁵³ Also, about

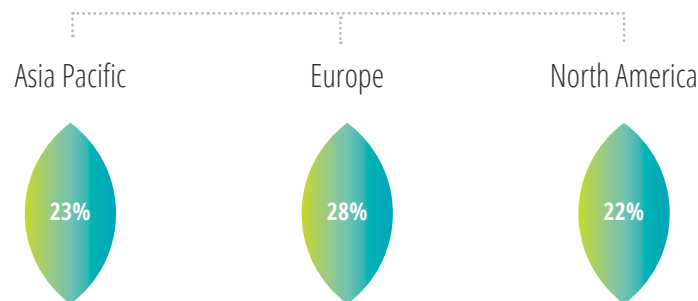
43% of respondents in North American firms identify technology, cyber, and data risk as a top operational priority over the coming year, up from 33% last year.⁵⁴ The heightened focus on updating governance and reporting mechanisms as well as managing technological operational risks in the United States may be due in part to increasing attention on the matter by the SEC. In the first half of 2022, the SEC proposed no less than five new rules or changes to existing rules that have implications for public and private fund managers.⁵⁵ These proposals include new reporting requirements for private funds, new compliance review documentation requirements for private fund advisers, new rules to adopt written cybersecurity protocols, recordkeeping rules for fund names, and disclosures related to the ESG strategy being utilized by fund managers.⁵⁶

FIGURE 13

Governance measures are not keeping pace with digital transformation efforts



How different regions stack up on responsible digital transformation



Source: Deloitte Center for Financial Services 2023 Investment Management Outlook Survey.

Cybersecurity

Cyber risk is one of the most pressing governance concerns for businesses, so it's no surprise that cybersecurity received the most respondent indications (17%) of a large increase in spending of the technologies presented (figure 14). This spending increase is from a mature base given that cybersecurity has been a top priority for several years running. The primary driver for the risk is the increase in ransomware attacks by both state

and nonstate actors on digital as well as physical infrastructure.⁵⁷ Investment management firms share similar—if not greater—risk than firms in most other industries. Since investment management is an intellectual property business, the principal investment management assets are either information processes or the data interacting with those processes. Being locked out of data, quite literally, could stop an investment management firm from functioning.

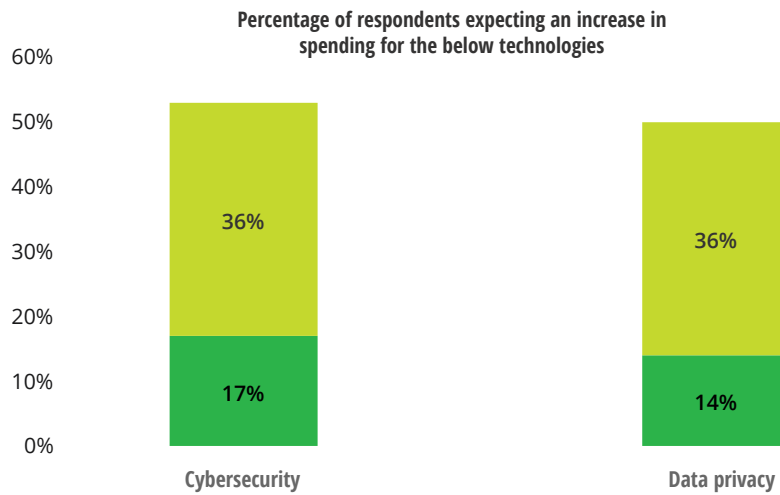
New developments are coming to cybersecurity. In the last few years, a Zero Trust approach to user authentication has emerged for security within the perimeter of the protected space, making it harder for bad actors to navigate once inside.⁵⁸ The Zero Trust approach has five pillars, and assumes that bad actors have already or will enter the systems network. The five pillars are identity, device, network, application workload, and data.⁵⁹ An interesting development that is likely to emerge over the course of 2023 is the advancement of the data encryption process under the US Cybersecurity and Infrastructure Security Agency’s Zero Trust

guidelines. The ability to encrypt (and back-up) data, using blockchain approaches, at the individual record level instead of the database level may commercialize in 2023.⁶⁰ This development may potentially redefine what is considered a reportable data breach, since access to or exfiltrating of encrypted data may not be considered a breach.⁶¹ One of the reasons that cybersecurity continues to be a growing investment area for investment management firms is the constant evolution of technology being deployed on both sides of the cybersecurity battle. Blockchain may become the latest tool deployed to enhance cybersecurity.

FIGURE 14

Many respondents expect an increase in spending on cybersecurity and data privacy over the next 12–18 months

■ Respondents expecting a large increase in spend ■ Respondents expecting a slight increase in spend



Source: Deloitte Center for Financial Services 2023 Investment Management Outlook Survey.

Looking forward

AS INVESTMENT MANAGEMENT firms plan and execute their strategies for 2023, the insights from our survey support the notion that leaders who engrain a sense of purpose throughout the organization take a meaningful step to success on many levels. Employees are perhaps the most important asset of investment management firms, and as such, planning investments over the coming year that benefit employees could also benefit the firms where they are employed. Culture, which leadership should work to enhance, correlates to components all around the virtuous cycle. In 2023, firms that invest in training for their workforce as well as technologies that improve operational efficiencies will be more likely to generate a positive impact on client experience and enable employees to execute on the firm's vision. Our survey results indicate that when firms are investing in on-strategy projects and delighting clients, a sense of accomplishment blooms. Investment management firms with differentiated success are likely to have a strong culture, and the first step that leaders can take to enhance firm culture is to communicate a purposeful firm vision. With the industry undergoing rapid changes, this first step is perhaps more important than ever for leaders in 2023.



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