

Deloitte.



**2019 Investment
Management Outlook**
A mix of opportunity and challenge

Deloitte Center *for*
Financial Services



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2019: Another year of challenges with new opportunities for success

Investment management is in a period of rapid change, driven by shifting investor preferences, margin compression, regulatory developments, and advancing technologies. While the nine-year bull run has diminished the intensity of these industry challenges, experience tells us that markets work in cycles. Successful investment managers (which we define as managers of mutual funds, hedge funds, and private equity firms) in 2019 will likely be the ones that can continue to manage these challenges with plans designed to withstand changing market conditions.

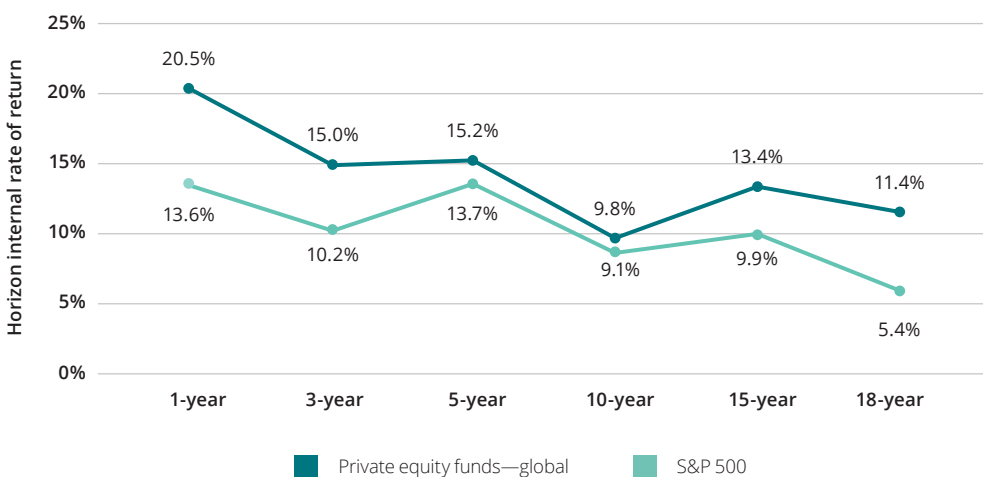
Priorities for long-only managers are more acute than those for alternative managers

Passive funds continue to garner assets. In the first half of 2018, 16 of the top 20 funds by net flows were passive mutual funds and exchange-traded funds (ETFs) garnering \$143 billion.¹ The advent of zero-cost ETFs may accelerate this growth even further. According to State Street Global Advisors' estimates and Investment Company Institute's data, global ETF assets could touch the \$25 trillion mark by the end of 2025, up from \$4.8 trillion in 2018.^{2,3}

At the same time, making the case for alpha for many active managers remains a challenge. A study has shown that 86.7 percent of US active funds have underperformed their benchmark, on a net-of-fees basis, over the 10-year period ending in 2017.⁴ European funds have similar results: 85.4 percent of actively managed European equity funds underperformed their benchmark over the same period.⁵

In the private equity (PE) world, consistent strong performance rewarded accredited and institutional investors, which led to large capital inflows and record dry powder (undeployed capital) (figure 1). As of March 2018, global PE dry powder stood at \$1 trillion, ready to be invested in new portfolio companies with growth potential.⁶

Figure 1. PE funds exhibit strong performance globally



Data as of 12/31/2017
Source: Global PE & VC Fund Performance Report, PitchBook.

Customer preferences are diverging

Expectations are diverging between investor segments. Most Millennials and Gen Z (born from 1995 to 2010) have made a quantum change in their investment practices from those of their parents. These cohorts will eventually hold a significant share of global investable assets as the multitrillion-dollar intergenerational wealth transfer progresses in the United States and Europe.⁷ They tend to prefer engaging with online and mobile channels, a low minimum initial investment amount, and 24/7 access to investment advice on smart devices. Meanwhile, more experienced segments (Gen X and Baby Boomers) are often expecting elegant interactions through their mobile and online investment accounts and professional advice on demand. On the other side of the spectrum, most institutional investors are demanding better portfolio transparency, tailored investment solutions, and global products.

Regulatory fragmentation continues

Securities regulations across the United States, Europe, and Asia are changing according to diverse priorities. Navigating multiple regulatory regimes could be challenging for many global investment management firms. In addition, the onset of new rulings globally will likely complicate regulatory compliance management in 2019. Building regulatory-ready organizations to manage change as though it is ever-present may improve efficiency as firms manage regulatory and compliance risk.⁸

Tech-savvy firms are putting pressure on traditional firms

Many investment management firms are planning for potential disruption caused by new technology-based entrants. These disruptors could shake up online fund distribution, digital advice, or micro-investing with their expertise in digital experience delivery or large customer bases. These potential new entrants are likely to provide low-cost services, coupled with digital-age capabilities, aiming to build relationships with Millennial and Gen Z cohorts before they are targeted by incumbent firms.

Given this complex and challenging industry environment, investment management business leaders should consider three core questions:

1. How can we grow our business?
2. What are the possibilities to run our operations more efficiently?
3. How can we deliver the next level of customer experience?

The answers to these questions are typically particular to each organization and tend to evolve over time. Investment management firms that address them with bold, strategic investments and effective execution are more likely to achieve success.

Regulatory change is driving many firms to commit resources to evaluate and change their operating models to meet their plans for growth and efficiency.

—Patrick Henry, Vice Chairman, US Investment Management leader, Deloitte & Touche LLP

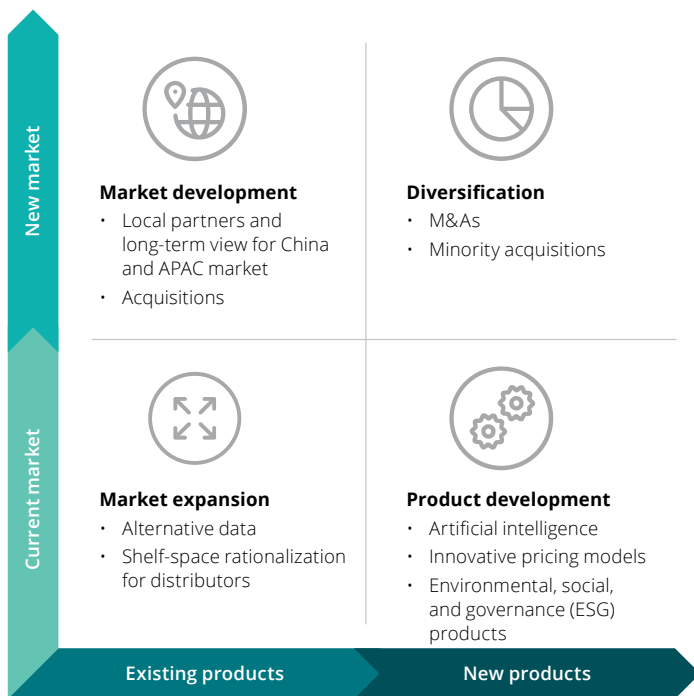
Picking the right growth options

While many investors have been enriched with the continuation of the longest bull market since World War II, some investment managers are taking a more cautious stance.⁹ As valuations rise, so does the likelihood of market volatility or perhaps even a correction. Adding to the investment manager’s angst, fee pressure and margin compression have persisted for many investment managers throughout this bull market. In such an environment, one of the biggest challenges for investment managers is to obtain profitable growth.

Some larger investment managers have used their scale to expand profit margins, while offering products at lower costs.¹⁰ A study covering more than 95 investment managers with a combined \$35 trillion in assets under management (AUM) found that the leading investment managers increased median operating margins to 35 percent over the 2014–2017 period, outperforming their peers by 4 percentage points.¹¹ Some of these firms have done so by investing in new technology, which can in turn improve investment analytics performance and efficiency, while freeing resources for more profitable activities. Success has been concentrated to these leaders, thereby building a trusted brand among investors. These firms have leveraged this trust to command a 19 percent fee premium relative to competitors.¹² Many small and midsized investment managers, lacking scale, are battling to maintain profitability. For these firms, making the right investment choices for market and product development (figure 2) is imperative for sustained growth.

Figure 2. Growth matrix for investment managers

Investment managers are pursuing a variety of organic and inorganic strategies to achieve their overall objectives



Source: Deloitte Center for Financial Services analysis.

Diversification: Acquisitions and minority stakes lead the way

Many investment managers are hunting for strategic acquisitions. These acquisitions can add new markets, product offerings, and investment capabilities. The net result is that valuations for deals offering such capability enhancement are increasing.¹³ In fact, 2018 has seen more \$1 billion plus deals than any of the previous five years.¹⁴ Diversification strategies (i.e., adding new products in new markets) are often realized through acquisitions. Indeed, the fast-growing ETF segment has seen a wave of acquisitions in the last few years. In September 2017, Invesco announced the acquisition of Guggenheim Investments' ETF business for \$1.2 billion.¹⁵ The acquisition may help Invesco on two fronts—complementing the existing self-indexing capability and expanding global ETF market share.¹⁶

Many investment managers are also seeking minority stakes to enter new markets. A leading US investment manager's recent investment in micro-investing app Acorns helps them understand how to engage younger (i.e., Generation Z) investors in a mobile-first world.¹⁷ The deal may also help the incumbent firm diversify its distribution capability into apps and chatbots.¹⁸

Market development: Partnerships and long-term view for crossing the Great Wall of China

Most global investment managers have locked their gazes on China, India, and Asia Pacific for further growth. The Chinese market attracts particular interest, considering the recent relaxation of ownership requirements for foreign firms.¹⁹ A strong shift in investment preference is also underway as the savings culture transitions to personal investing, with millions of Chinese citizens focusing on retirement.²⁰ These factors are expected to drive China to become the second-largest investment management market globally, powered by double-digit growth in net-new flows.²¹ In fact, retail and high-net-worth investors in China are expected to represent more than \$17 trillion in AUM by 2030.²² The conversation has moved from “Should we enter these markets?” to “How can we build a successful investment management business here?” Many firms have already established their foothold in China via local partnerships and are building their presence for the long term. Regulatory modifications like the Asia Region Funds Passport, pioneered by Australia, Japan, New Zealand, South Korea, and Thailand, could foster cross-border fund distribution in the Asia Pacific region.²³ However, investment managers should expect a long road ahead because of the cultural diversity, regional complexities, and regulatory challenges present in this market.

Chinese expansion

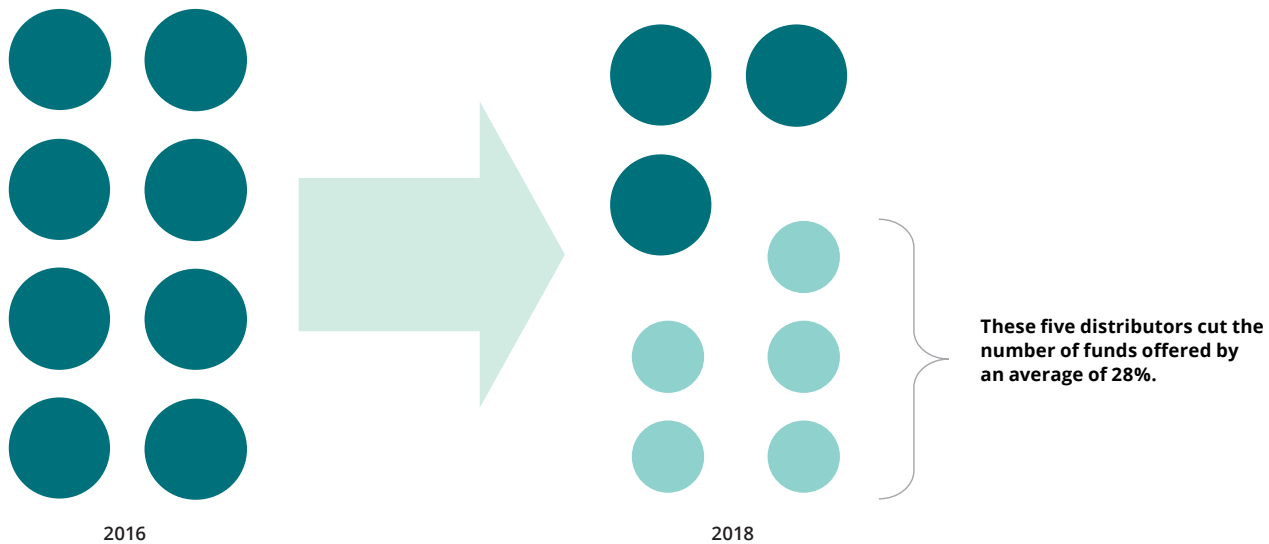
UBS Asset Management has built its presence in China through joint ventures and partnerships with local firms. In 2005, a joint venture with State Development & Investment Corporation (SDIC) enabled UBS Asset Management to offer onshore mutual funds in China, while a wholly-owned enterprise for alternative investments was set up in 2011.²⁴ The growth potential of the Chinese market was highlighted when assets managed by UBS SDIC Fund Management Co. touched \$30 billion in 2018, from \$250 million in 2006.²⁵ As part of the company's long-term plans to offer China exposure for onshore and offshore investors, UBS Asset Management launched an onshore equity fund in November 2017. It was followed by two bond funds in May and September 2018. These three funds were launched via the private fund management wholly foreign-owned enterprise in Shanghai.^{26, 27}

Market expansion: Alternative data sets and shelf-space rationalization to the fore

Differentiation via alpha generation is an optimal way to gain assets. Investment managers continue to explore new alternative data sets to drive organic growth through differentiated alpha generation. Already adopted by some hedge funds and other alternative investment managers, long-only funds are now exploring the integration of alternative data in their investment processes.²⁸ A leading US-based investment manager recently launched a series of active funds that utilize an assortment of alternative data sets in the pursuit for alpha.²⁹ Investment insights are not the only application of alternative data that investment managers are focusing on. Goldman Sachs has built a team to identify internal data that could be of potential use to clients in investment and risk management.³⁰

As organic growth slows, protecting shelf space and AUM will likely come to the fore in 2019 as a key tactic for remaining competitive. Rising cost pressures and investor preference for low-cost funds have led many distributors to cull funds from their platforms (figure 3). This shelf-space rationalization trend was accelerated by the US Department of Labor’s fiduciary rule. Even after the rule was overturned, the trend persists among distributors. For many incumbent firms, retaining shelf space may be most important for success. The surest route for active managers to retain shelf space is by consistently delivering alpha.

Figure 3. Five of the eight leading mutual fund distributors have rationalized shelf space by dropping more than 4,900 funds from their platforms over the last two years



Source: CitywireUSA, Deloitte Center for Financial Services analysis.

Product development: Reimagining investing using artificial intelligence, ESG, and innovative pricing models

Artificial intelligence (AI) has graduated from a buzzword to an enabler that offers differentiated capabilities across the investment value chain. Deloitte's *2018 Investment Management Outlook* covered the role of AI algorithms in understanding market patterns and making investment decisions.³¹ The technology has now reportedly found promising applications in enhancing wealth advisory services, offering customized portfolios, and digitizing customer service.³² Morgan Stanley is combining machine learning (ML) algorithms with predictive analytics to help its 16,000 financial advisers generate more insights and provide customized advice for clients.³³ The ML algorithms are designed to browse through research reports, diverse data sets, and news articles to not only generate unique insights for future investments, but also better understand the potential impact of events on clients' portfolios.³⁴ Launched in early 2018, a leading investment manager's suite of ETFs uses natural language processing (NLP) to scan regulatory filings of companies to create a proprietary index.³⁵ The firm has replaced the index provider with AI capability contributing to the investment manager's ability to offer the funds at lower cost than traditional index ETFs.

Acquisitions and partnerships can provide a more immediate solution for firms that wish to incorporate AI or related capabilities in new products. Some investment managers are acquiring robo-advisers to offer custom portfolio solutions for independent advisers as well as traditional wirehouse representatives.³⁶ Imagine receiving investment advice directly from the chief investment officer of a major bank. AI is enabling one large European bank to provide this service today.³⁷ This widening application of AI across the investment value chain increases the possibilities of a shift in the business model, especially across customer touchpoints.

Aside from expanding capabilities across the value chain, investment managers have worked to keep their product offerings from becoming stale. For example, the availability of products with an investment mandate that complies with ESG issues is seeing a strong uptick. Greater social awareness from Millennials, pension funds' long-term horizon, and favorable regulatory changes are driving the increased interest toward ESG investing.^{38,39} Investment managers are preparing for this rising demand with 90 percent of US managers planning to integrate ESG in their product development plans.⁴⁰ While ESG products have the strongest foothold in Europe, increased client interest has led to Asian managers also handing out ESG mandates.⁴¹

A new pricing model for passive funds has emerged: free. The announcement of a no-fee fund was a seismic shift for the industry.⁴² With other investment managers also following suit with the launch of zero-commission platforms, firms' revenue-generation focus now moves toward securities lending, order-flow payments, and shareholder-servicing fees.⁴³ Larger investment managers will likely also use these zero-fee products to sell other offerings and keep investors within the fund family. Active funds are also seeing resurgence of a pricing model. A "fulcrum model" links fees to fund performance and charges a base fee if the fund does not outperform its benchmark. If the fund achieves alpha, an additional performance fee is charged. Such variable fee structures may create a win-win situation, delivering better net returns to investors and incentivizing fund managers on performance. Allianz Global Investors has been one of the early adopters of a performance-based fee model in the United Kingdom. Investors are charged a base fee of 20 bps and an outperformance fee of 20 percent on the performance over the benchmark.⁴⁴

Predictions for 2019

- **Crossing the Great Wall.** The traditional global operating model for investment managers may not lead to success in China and other Asia Pacific markets. The firm that succeeds in these markets will boast an operating model focused on distribution agility, local partnerships, and product transparency.
- **Fulcrum fees for new active funds.** A couple of investment managers have adopted the “fulcrum fee” model, in which the investment manager is rewarded for generating alpha. This trend could accelerate with more than 10 firms adopting this pricing approach in the next 12–18 months.

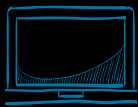
The bottom line on growth:

Key actions the investment management C-suite should consider



Investment managers can consider the following steps to drive growth:

- **Invest in data storage and analytics.** Adopting alternative data sets and AI have proved to be a differentiating factor for alpha generation. Firms should invest in greater processing power and data storage to stay competitive.
- **Be aggressive when acquiring new capabilities.** As the gold rush for M&A and minority stakes is expected to continue over the next 12–18 months, investment managers would be better served by pursuing deals, even pricey at some levels, that would add capabilities aligned with their strategic objectives.



Creating operational efficiencies

Continual operational improvement is one avenue for investment managers to alleviate the pressures of shrinking margins. Operating models across many investment management firms can be incrementally improved by investing in talent, technology, and processes. Simultaneously, firms should monitor the evolving legal and regulatory landscape to identify potential cost control opportunities. Considering these internal and external factors, investment management firms may evolve their business models to improve efficiency and maintain compliance.

Internal factors

Many firms may consider enhancing talent, technology, and processes irrespective of their growth path. Pursuing the inorganic route allows a firm to evaluate different approaches (existing vs. acquired organization) for efficiency enhancement. On the other hand, investment managers growing organically often target incremental change through adoption of novel technologies. Adopting cloud and advanced analytics technologies to reinvent a range of business functions from investment decision making to risk analytics is another approach. Let's explore how investment managers have utilized cloud services and advanced analytical tools to optimize their current operating models.

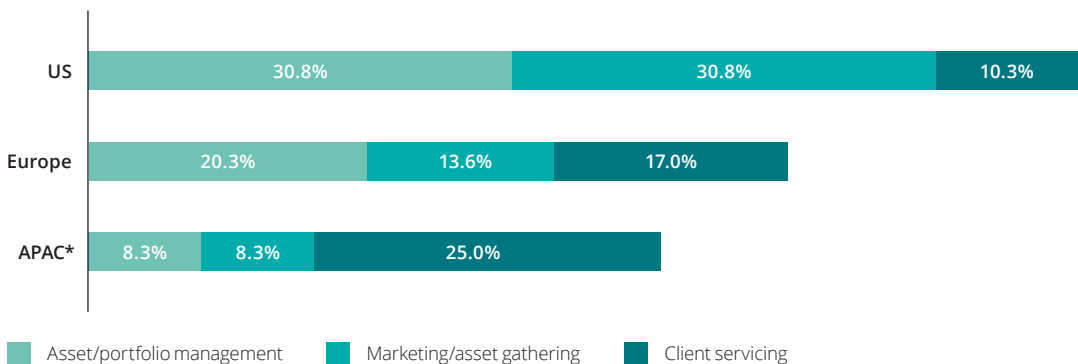
Cloud and advanced analytics enhance cost efficiencies

Investment managers are fast embracing the cloud for differentiating and non-differentiating processes. Migration to the cloud enables technological agility that would be too costly to maintain with in-house systems for most firms. Some investment managers, such as T. Rowe Price, have directed much of their recent technology efforts toward cloud migration to achieve operational scalability and lower fixed costs.⁴⁵ The cloud also brings in on-demand storage and processing capabilities enabling new developments such as advanced analytics.

Advanced analytics enable processing of virtually all kinds of structured and unstructured data to improve decision making. For example, NLP can help generate investment insights from news reports, analyst reports, and social media. Advanced NLP tools can even sense change in the sentiments of company management and research analysts by analyzing earnings calls and research reports, respectively.

In an Ovum survey, US firms prioritized advanced analytics deployment in the front office, especially in the portfolio management and marketing functions (see figure 4).⁴⁶

Figure 4. Top priorities for advanced analytics deployment in front office, by region



*Includes North Asia, South Asia, and Southeast Asia

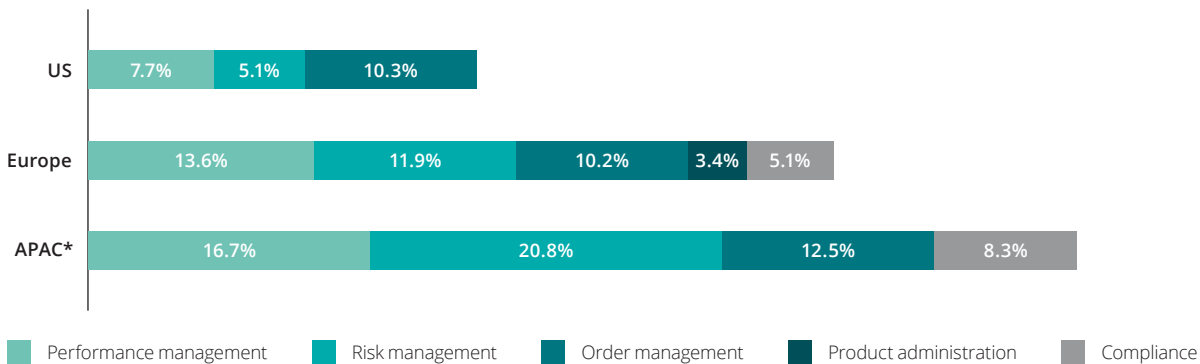
Source: Ovum ICT Enterprise Insights survey 2018–19.

An example of how analytics can increase throughput and enable improved decision making is State Street’s Verus mobile application. Verus combines the power of ML, NLP, and human knowledge to analyze global news reports and then allocates a score based on their potential impact on portfolio holdings. The investment manager is provided with a customized news feed that is most relevant to its portfolios, helping the manager with investment decisions and managing portfolio risk.⁴⁷

Middle-office priorities for deploying advanced analytics seem to diverge globally (figure 5).⁴⁸ US respondents, surprisingly, did not consider compliance functions to be a priority.⁴⁹

Running an efficient organization requires the right talent and culture alongside improved technology and processes. The competition for talent with the right technical skills is hot; for example, buy-side firms are hiring chief data scientists to develop new analytics capabilities. As firms develop their talent, reinforcing collaboration between new-age tech-enabled personnel and old-school industry veterans should be a focal point. Similarly, using advanced analytics to complement human expertise is an important element of success. The end users of a system should have a deep understanding of how the tool sources, interprets, and analyzes data. In 2019, striking the right balance between technology-enabled processes and human-enabled business wisdom may separate the winners from the pack.

Figure 5. Top priorities for advanced analytics deployment in middle office, by region



*Includes North Asia, South Asia, and Southeast Asia

Source: Ovum ICT Enterprise Insights survey 2018-19.

External factors: Laws and regulations

External factors, especially laws and regulations, regularly evolve and continuously influence the business environment. Though firms may not be able to control these factors, they should be carefully monitored to run the organization efficiently. Globally, regulatory oversight of investment management firms appears to have escalated in recent times. Sweeping changes over the past year have impacted reporting requirements, deal structure, and taxation. All these changes can add to the time and effort required to be compliant. On the other hand, the recent SEC ETF proposal standardizes regulation to ease the operational barriers for firms. Given the diversity of regulatory impact, firms need to strike the right balance while allocating resources between operational and compliance activities.

Let's take a closer look at some of the potential changes on the horizon:

- **Technology adoption to influence compliance processes.** Technology adoption can be a double-edged sword for regulatory purposes. While technology may help firms comply with some regulatory requirements, it may also create additional liabilities. For instance, cloud technologies can help firms meet the Markets in Financial Instruments Directive (MiFID) II's requirements of recording client conversations and securely storing them for a minimum of five years.⁵⁰ However, firms should be cautious about using cloud services under the EU's General Data Protection Regulation (GDPR).
- **Conversion from partnership to C corporation.** The US Tax Cuts and Jobs Act (the "2017 Tax Act") has compelled many PE firms to consider transforming from a publicly traded partnership structure into a C corporation owing to the corporate tax cut. The benefits of conversion may include tax savings as well as a boost in firm valuation from a wider investor base. C corporations can be included in stock indices, and consequently, in funds following such indices. C corporation investments are also typically easier for non-US investors because they don't require a US partnership tax filing. The resultant increase in demand may lead to share price appreciation. Many PE firms are likely to observe the results of early movers before finalizing their plans.

- **Selecting strategic operating locations.** Brexit, scheduled to take place on March 29, 2019, is considered one of the most important events for the year.⁵¹ The European Union has indicated that post-Brexit Britain would face stricter regulations.⁵² In the investment management space, most firms are closely watching for tightening of the delegation rule, which allows funds to be domiciled and regulated in one country while being actively managed from another. United Kingdom's investment management industry manages nearly 1 trillion British pounds on behalf of funds domiciled in Dublin and Luxembourg, so any changes in the delegation rule may highly impact the UK investment management industry.⁵³ A study covering 29 investment managers with collective AUM worth 12.3 trillion euros found that 59 percent of investment managers are preparing for a hard Brexit.⁵⁴ Consequently, financial centers in the European Union such as Dublin, Frankfurt, Luxembourg, and Paris could be benefiting. Firms based outside the European Union, as well as UK-based firms, are setting up new hubs in these cities. Citigroup and Wells Fargo are among the global investment managers establishing a presence in these cities.^{55,56}

In the United States, developments following the 2017 Tax Act have also led to some PE firms shifting their operations. The 2017 Tax Act barely touched the carried interest provision allowing long-term capital gains taxation (ceiling of 20 percent). The law increased the holding period from one year to three years instead of levying a higher rate for ordinary income (ceiling of 37 percent). Some states have decided to close this provision by taxing the difference.⁵⁷ In a bid to maintain the tax advantage of the carried interest provision, some PE firms are shifting operations to states with favorable tax laws.

- **Increase in asset purchase transactions.**

The 2017 Tax Act has introduced certain provisions that may limit the utility of debt in PE deals. The act generally caps business interest expense deductions at 30 percent of EBITDA, with the limits tightening to 30 percent of EBIT after 2021.⁵⁸ This cap can present a significant challenge because much of the recent growth in PE firms' portfolio companies has been financed through debt. PE firms using debt financing can model their earnings expectations to determine the extent to which interest deductions are allowed. Accordingly, PE firms may decide to use more equity capital or take the asset leasing path instead of debt.

Another provision of the 2017 Tax Act allows immediate expensing of new as well as used assets. PE firms can utilize this provision to their advantage by designing transactions as asset purchases rather than stock transactions.

- **Disclosing robo-adviser models to regulators.**

Regulators in China have collectively issued guidelines for financial institutions providing robo-advisory services, which now mandate regulatory approval. FIs also need to report model information such as key parameters, asset allocation logic, and risk disclosures. China is leading the way in regulating robo-advisers, and 2019 may see other regulators following suit.

Firms should apply the “zoom out/zoom in” approach to technology investments. The “zoom out” perspective looks at a time horizon of 10 or more years and tries to predict the market landscape and customer expectations. It then “zooms in” to address the next 6 to 12 months in identifying the business initiatives that have the greatest potential for accelerating the organization’s progress toward the longer-term goal.

—Jib Wilkinson, principal, Deloitte Consulting LLP

Predictions for 2019

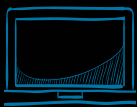
- **Proprietary indexing.** The number of firms launching proprietary ETF indices is expected to increase, enabling them to lower expense ratios of these new index funds by as much as 10 bps.
- **Alternative data.** As the competition for acquiring companies increases with more strategic investors joining the deal table, PE firms are likely to join traditional long-only asset managers in using alternative data for identifying investment opportunities. Long-only managers will join their hedge fund brethren by using alternative data sets such as satellite data, Internet of Things data, and social sentiment data to augment their investment decisions.

The bottom line on operational efficiencies: Key actions the investment management C-suite should consider



Investment managers can consider the following path to advanced analytics deployment

- Start with an open and collaborative mind-set looking for ways to augment, not supplant, existing investment decision processes.
- When opportunities are identified, finding the right data set and testing it for investment value generally comes next.
- As the processes move from pilot to production, the development of a flexible and scalable operating approach typically becomes a priority.
- Building trust among stakeholders in the investment process will likely be needed to facilitate the changes needed to get optimal value from these new technologies.



Firms can fine-tune alignment with regulatory changes for efficiencies and compliance

- Design of compliance processes for new regulations should consider similarities with existing regulations. For instance, Securities Financing Transactions Regulation (SFTR) implementation can leverage the systems and processes used for complying with existing regulations such as European Market Infrastructure Regulation (EMIR) owing to similarities in messaging standards, reporting structure, and regulators involved.
- Firms should note that advanced analytics systems and model risk are receiving regulatory attention.⁵⁹ Accordingly, firms should evaluate the accuracy and robustness of their systems.
- The recently developed US state tax law differences may warrant an operating relocation. This proposal concerns financial optimization rather than the strategic market access issues caused by Brexit.

Delivering the next level of customer experience

For each investment management firm, choosing the right digital transformation plan is interdependent with its growth and operational efficiency strategies. Existing customer segments are important to continuing operations and generally require incremental investment. Serving customers in new demographics with different preferences, however, typically requires a leap to new capabilities.⁶⁰ Some new investment management firms are targeting Millennials, a segment estimated to account for \$15 trillion in the United States over the next 15–20 years, with innovative capabilities. They touch on several Millennial preferences: a technology-driven interface, peer-to-peer interaction, low cost, transparency, and thematic investing, including social impact. The technology platform and its business model were developed in the digital age, but its elegance appeals to more than just Millennials.

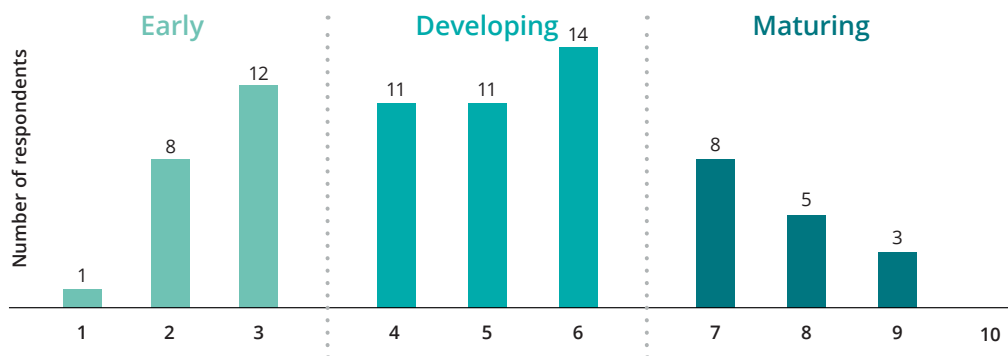
The digital-age account opening process can be differentiating. The entire process, from downloading an app to funding the account, can typically be completed on a mobile phone in about 20 minutes. While there are a few unique account and identification numbers new users will need on hand, most of the “paperwork” is intelligent. For example, once a ZIP code is entered, the city and state are populated without manual data entry. Functionality developed in the digital age has an elegance that the multi-part paper-centric account opening processes of the not-so-distant past lacked.

The digital age sheds the notion that documents are required to house the information. The database takes over, and as such, the notion of initials or signatures on each page or section is transformed. Selections and approvals are recorded as data points with time stamps and unique identifiers. Process controls can virtually eliminate errors such as skipped signatures. All these process upgrades render the earlier “documents approach” as cumbersome and costly.

Incumbent firm strategies seem to be dictating a more measured approach. Their customer-facing digital transformation projects are broad-based in terms of segments targeted, and rarely target Millennials uniquely, as they usually focus on high-net-worth or mass affluent segments. Often these projects begin with back-office upgrades of processes and technology that are difficult to translate into customer-facing improvements. Legacy system drag often prevents new operating models or radically transformed operating models from emerging. There are indications that investment management firms would prefer to change more rapidly. Investment management firms tend to not rate themselves well on their ability to drive change in their operating model with digital technologies (figure 6). When asked about their digital transformation capabilities, just 16 out of 73 polled firms rated themselves as digitally maturing (7 or higher out of 10).⁶¹

Figure 6. Investment manager use of digital technologies and capabilities for different activities and processes

How close is your firm to becoming digitally mature?



Source: “Coming of Age Digitally,” MIT Sloan Management Review and Deloitte Insights, June 2018.

Methodology

Respondents were asked to “imagine an ideal organization utilizing digital technologies and capabilities to improve processes, engage talent across the organization, and drive new value-generating business models.” Respondents then rated their company against that ideal on a scale of 1 to 10.

Digital voice assistants are expected to drive differentiation

One area for digital transformation that cuts across customer segments, including Millennials, is digital voice assistants (DVAs). Customer experience is one of the most important factors outside of investment performance for competitive advantage. DVA integration is entering the investment management space, and some firms may use it to delight existing customers and attract new segments.

Digital voice may become the next customer interface. Estimates show that nearly half (48 percent) of Americans may have a smart home speaker by 2019.⁶² But the richness of the digital voice interface can vary, similar to the way mobile applications are still developing. Therefore, the depth and breadth of functionality will likely separate the truly exceptional from the rest. Firms that excel will likely be able to provide a broad range of services through the DVA. The most successful DVA will also be multichannel in its results delivery, communication, and confirmation. The results of the DVA interaction may trigger multichannel actions, such as texts, emails, smartphone apps, and smart watch interactions. The DVA may be an area where incumbent firms can shed the barriers that legacy drag places on innovation. Firms that execute with excellence, creating a seamless process across legacy systems, are more likely to be able to build a competitive DVA.

One US-based investment management firm is working toward offering advice through Amazon's Alexa.⁶³ Establishing control over the DVA for an investment firm may be important to avoid disintermediation by the DVA manufacturers. These DVA-based services may guide clients on the amount they need to invest and suggest portfolio allocations based on their goals. Investment managers will not want to lose control of this relationship.

The next 10 years in investment management will likely be exciting as the competition to earn customer business plays out in this dynamic environment. Who will win—the tortoise or the hare? Or will it be a selection of each (new firms and incumbents) that execute their strategies with excellence? Never count the tortoise out.

Predictions for 2019

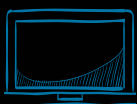
- **Differentiate through customer experience.** Customer engagement and building meaningful relationships will be more in focus than ever as investment managers compete for AUM in 2019.
- **Redesign customer platforms.** Many investment managers will strive to offer newly designed customer portals, most likely by acquisition or partnership with tech-savvy firms.

The bottom line on customer experience: Key actions the investment management C-suite should consider



- **Develop customer and technology strategies.** To build a platform that can maximize customer engagement, consider incorporating a coordinated vision of the future with technical knowledge and a deep understanding of the customer.

- **Align goals across teams.** Clearly define operational goals to build seamless customer experiences, such as DVAs that span front-, middle-, and back-office services.



- **Manage change differently.** Adopting different change approaches can be important as the pace of technological advancement accelerates. Traditional approaches may not cycle fast enough.
- **Focus on differentiated customer experience.** Millennials expect a paradigm shift in the investing experience, especially from a behavioral and technology perspective. From chatbots and apps to virtual agents, investment managers should be willing to experiment to win Millennials as customers.

2019: Execution drives success

Investment management firms have battled similar pressures for a number of years. Firms have spent a lot of time developing plans and strategies. 2019 may be the year that some firms innovate and emerge through the execution of bold actions. Some investment managers will likely push their boundaries as they seek to grow their business, run operations efficiently, and deliver the next level of customer experience. Surely, some firms are executing plans with emerging technologies, separating themselves from the competitive pack in 2019.

Look out! Firms that don't invest in growth, operational efficiency, and customer experience risk becoming the inorganic growth fuel for firms with more efficient and effective platforms that yield higher profitability.

Now is the time for investment managers to develop plans with a two- to five-year horizon to match the changing state of play and win investors of the future.

—Paul Kraft, US Mutual Fund and Investment Adviser leader, Deloitte & Touche LLP

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