Expect More Small Managers to Shutter over the Coming Months

By Lisa Fu   March 19, 2020

Small managers face new challenges now that the bull market has come to an end, and many will likely search for a strategic partner or close their doors as pressure builds.

The public equities market has been battered in recent weeks, with the Dow Jones Industrial Average falling 6.3% Tuesday after a nearly 13% tumble the prior day, steep losses triggering multiple trading halts at the **New York Stock Exchange**. While business changes at asset management firms will move at a slower pace than capital markets, the industry will likely see a rise in the number of small managers — those with $10 billion or less in assets under management — closing over the next six to 18 months, says Chestnut Advisory Group CEO **Amanda Tepper**.

“If you talk about smaller managers in the context of this downturn and turmoil, I would say there’s a double-edged sword,” Tepper says.

Smaller managers have fewer clients and losing one or two major clients during a difficult time can result in the whole profitability structure changing, Tepper says. Redemptions may come even if investment performance remains robust because smaller institutions like endowments may pull their money for liquidity purposes, she explains.

However, having fewer clients can also be a strength in this time of uncertainty. With a smaller group of clients, managers are in a better position to get in touch, stay in touch and build closer relationships with every client, according to Tepper. While, larger managers can schedule conference calls and webinars, they have to triage client contact, she adds.

Not all boutique asset managers are equal and that some will fare better than others in a challenging environment, says **Machel Allen**, the president and CIO of **Metis Global Partners**, an asset manager with $500 million in AUM and seven employees. Any firm will face a decline in AUM due to market prices falling, but there will also be differences in managers’ cost infrastructure and product offerings, she says.

Managers that have a flexible cost structure or low fixed cost will be more resilient in a bear market, Allen says. For example, those that outsource back office capabilities rather than keeping them in house benefit from a low-cost structure, she says.

Allen also notes that as institutional investors react to the market downturn, some smaller managers will be better prepared than others.

“Institutional investors don’t make knee jerk changes,” Allen says. “They have very large ships to move. Most likely, those investors have strategic goals that keep them in major asset classes.” Rather, institutional investors often make changes within a certain range in the asset class, she adds.

Boutique firms that have multiple products will typically fare better because they can offer alternatives as an institutional investor moves around within an asset class, Allen explains. Managers that only offer one product may face problems, especially if the investment strategy is out of favor, Allen says. For example, investors may flock to value-based strategies over growth-focused strategies at this part of the market cycle, she adds.

Though a turn in the market can be challenging for many small asset managers, this can also be an opportunity for small, nimble active managers to differentiate themselves by outperforming, Allen says.

Not only have managers seen a drop in their assets under management due to market turmoil, but investors may use this challenging time to reconsider their manager relationships and investment allocation, says **Sondhelm Partners** CEO **Dan Sondhelm**. Institutional investors could pull capital as they reconsider existing investment strategies, he says.

The challenging market environment compounds the pressure that smaller managers have long faced. Several small managers have closed in recent years in part due to pressure from capital consolidation among the largest asset managers and an overall decline in industry margins.

Most recently, hedge funds **Solus Alternative Asset Management** and **Malachite Capital Management** shuttered, in part due to the current market environment. Progress Investment Management, a $5.3 billion manager-of-managers, announced plans to close on May 31; the $6.4 billion hedge fund **Arrowgrass Capital Partners** announced in September that it would close after a wave of redemptions; and hedge fund **Hutchin Hill Capital**, which had $2.2 billion at the time, closed in 2017 after just three years.

A shift in the market environment and the coronavirus outbreak may also spur managers to reconsider their spending. Smaller managers are deciding how to reallocate their travel budgets for sales, client services and portfolio management during these difficult times, Sondhelm says. Some managers may succeed in finding ways to engage clients that do not involve travel by supporting strong content, digital communication and technology, he explains. Sondhelm also expects layoffs and pay cuts in some situations as boutiques look to cut costs.

“For some firms, this situation is too challenging,” Sondhelm says. “They may have been on the fence but now are strongly considering strategic partners.”

For example, large firms with distribution capabilities may acquire an entire asset management firm or acquire just the mutual funds and keep the manager on as a subadvisor. For smaller managers looking to refocus on their core business strategy selling some extra capabilities can be an option, Sondhelm says.

For larger managers, this can be an opportunity to buy assets and strategies they have long desired. There are a lot of buyers out there because it is easier to gain scale through mergers and acquisitions than through the typical marketing and sales process, Sondhelm adds.

The challenging market environment will lead to consolidation and cost cutting, says **PWC** partner and U.S. asset and wealth management leader **Tom Holly**.

“If you look 18-months out, no doubt we’re going to see consolidation,” Holly says. “For the next 18-24 months, those managers that survive will most likely be the ones that can capitalize on the experience.”

The greatest stress on a manager’s margins will come from a decrease in AUM and small managers that only have one product offering will be more vulnerable than multi-asset class strategy shops, according to Holly. As for cost cutting, while Holly has observed managers slash travel and entertainment budgets, he has yet to see any rush towards layoffs. While investment professionals are a manager’s greatest expense, they are also a rare and unique commodity, and it is also unlikely to see mass layoffs among support staff either, he says.

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