IMPERIUM CAPITAL

momentum

The Boutique Premium

Global Matters Weekly

14 February 2022

– **Gary Moglione**

There have been a number of academic papers that have examined the performance of funds managed by smaller "boutique" investment houses versus the much larger "asset gatherers". The outcome of these various studies is overwhelming; that boutiques tend to be the better performers with a consistent performance premium across various asset classes, ranging from 0.23%[1] to 0.62%[2] per annum net of fees. As a fund selector who has worked for one of the world's largest asset managers and one of the smallest, and having met with and analysed the portfolios of managers ranging from new fund launches to $50billion funds, I can provide some personal insight and views on the "boutique premium".

Larger funds may underperform for a variety of reasons. Firstly, a manager of a large fund has a shrinking investment universe as his or her fund grows. The result is they are precluded from investing in stocks further down the market cap scale. If a fund has £5 billion in assets, a 1% position will equate to investing £50 million. If you then want your investment to be less than 5% ownership of that company, you can only invest in companies with a market cap over £1 billion; removing huge swathes of potential investments from your universe. Smaller cap stocks have outperformed larger caps over the long term[3], so by excluding these stocks you are missing out on a strong potential alpha source. In addition to this, larger funds tend to have more holdings to increase liquidity further. Is a portfolio manager's 70th best idea really as good as their 20th? Then comes the manager's mindset. A large fund will be a cash cow generating tens of millions in fees and the asset gathering firm will have a huge marketing budget and well-resourced sales team selling it globally.

As long as it does not underperform too much, the brand and sales machine will keep it growing. The manager may be getting a huge annual salary and bonus to stay at the helm and the last thing they would want is to upset this perfect scenario, so the path of least resistance is to hold some of the larger index stocks to dampen down active risk. The result is likely to be a low conviction, low tracking error fund. Everybody wins, except for investors who are suffering poor performance.

> **"The one area in which bigger certainly may not be better is performance"**

A manager in a boutique fund will often have equity in the business and therefore it will not be the salary and annual bonus that motivates, but the chance to build up the company. If the business is a long-term success, they will have a much larger share of the upside. The manager within a boutique may have built the product from inception using their own process and philosophy formulated exactly how they think money should be managed. A manager within an asset gatherer may have inherited the fund and process and have to utilise a house "macro view". A smaller fund will be free of liquidity constraints so, when appropriate, can have a size skew towards smaller cap stocks. Free of liquidity constraints, the portfolio will typically be higher conviction as only the best ideas will be added to the portfolio.

I have no doubt there are lots of things in which bigger is better in asset management. Sales coverage, reporting, IT, marketing spend, brand etc all benefit from economies of scale.

The one area in which bigger may not be better is performance.

1. 0.23% Taken from Cass Business School study (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3542243)

2. 0.62% Taken from AMG study (https://www.amg.com/content/dam/amg/boutique-advantage/The_Boutique_Premium.pdf)

3. Fama & French as of 14.11.18

The **Marketplace**

- Global equities fell -0.7% last week
- President Biden yesterday spoke with Ukraine leader Volodymyr Zelenskiy and promised to act "swiftly" in the event of Russian aggression
- Brent crude rose +1.3% to $94.44 a barrel, an eight-week rally, over concerns that Russian energy supplies could be disrupted by a Ukrainian invasion
- Gold increased by +2.8% to $1858.76

Market **Focus**

US

- Benchmark U.S. equities declined -1.8% last week. Metals, Mining and Energy outperformed whilst Technology and Computer Services underperformed
- Goldman has cut their U.S. forecast for the year, projecting the S&P 500 will end 2022 at 4,900. That is down from a previous forecast of 5,100 but still represents a double-digit gain from current levels
- U.S. jobless claims +223k improved (vs 230k expected)
- U.S. Core C.P.I. for January came in at 0.6, stronger than 0.5% expected.

Europe

- European equities rallied +1.3% last week
- Christine Lagarde warned that the E.C.B. would harm the economy's rebound if it were to rush to tighten. Raising rates "would not solve any of the current problems". Three of the E.C.B. officials are pushing back against rate-hike speculation in June, Christine Lagarde speaks today. Euro Government bonds tightened by 1.0%.

UK

- U.K. equities rallied +1.9% last week
- Gilts tightened 1.6% last week
- GDP quarter-on-quarter for Q4 was 1% (vs 1.1% expected)
- Manufacturing production month-on-month was +0.2% (+0.1% expected).

Asia/Rest of The World

- The benchmark Global Emerging Markets index rallied +1.6% last week
- Japanese equities rallied +1.7% last week
- Chinese equities rose by +1.4% last week
- The White House is exploring providing additional economic aid to Ukraine. German Chancellor Olaf Scholz travels to Kyiv today and meets with Vladimir Putin in Moscow tomorrow. Russia has repeatedly denied its plans an invasion
- G-20 finance ministers and central bankers meet in Jakarta for the first time this year. The gathering, on Thursday and Friday, comes amid a surge in bond yields as the prospect of tightening cycles across developed markets gains traction
- The three-year yield on Australian government bonds hit the highest level since 2019.

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Asset Class/Region	Currency	Currency returns			
		Week ending 11 Feb. 2022	Month to date	YTD 2022	12 months
Developed Market Equities					
United States	USD	-1.8%	-0.3%	-7.2%	13.9%
United Kingdom	GBP	1.9%	2.5%	4.6%	23.9%
Continental Europe	EUR	1.3%	0.7%	-5.1%	14.5%
Japan	JPY	1.7%	4.6%	-1.5%	3.8%
Asia Pacific (ex Japan)	USD	1.6%	4.5%	-0.8%	-13.2%
Australia	AUD	1.4%	3.3%	-3.0%	9.3%
Global	USD	-0.7%	1.2%	-5.9%	9.8%
Emerging markets equities					
Emerging Europe	USD	2.5%	4.8%	-3.1%	7.2%
Emerging Asia	USD	1.1%	4.0%	-0.9%	-16.5%
Emerging Latin America	USD	5.1%	6.4%	12.0%	4.8%
BRICs	USD	0.9%	4.7%	0.5%	-21.5%
China	USD	1.4%	6.0%	0.4%	-33.5%
MENA countries	USD	1.1%	1.0%	7.2%	33.4%
South Africa	USD	4.4%	8.6%	11.6%	2.8%
India	USD	-1.7%	1.2%	-0.9%	11.8%
Global emerging markets	USD	1.6%	4.2%	0.8%	-11.3%
Bonds					
US Treasuries	USD	-0.3%	-1.2%	-2.9%	-3.9%
US Treasuries (inflation protected)	USD	0.0%	-1.5%	-3.9%	1.8%
US Corporate (investment grade)	USD	-0.4%	-1.6%	-4.9%	-4.5%
US High Yield	USD	-1.0%	-1.3%	-4.0%	-0.3%
UK Gilts	USD	-1.6%	-3.2%	-6.1%	-7.7%
UK Corporate (investment grade)	USD	-0.7%	-3.2%	-5.7%	-7.2%
Euro Government Bonds	USD	-1.0%	-3.1%	-3.8%	-6.5%
Euro Corporate (investment grade)	USD	-0.5%	-2.4%	-3.4%	-4.3%
Euro High Yield	USD	-0.5%	-2.0%	-3.2%	-1.2%
Japanese Government	JPY	-0.5%	-0.9%	-1.5%	-1.3%
Australian Government	AUD	-1.6%	-1.6%	-3.1%	-5.4%
Global Government Bonds	USD	-0.7%	-1.2%	-3.1%	-7.8%
Global Bonds	USD	-0.8%	-1.2%	-3.4%	-7.5%
Global Convertible Bonds	USD	0.2%	1.6%	-4.2%	-12.3%
Emerging Market Bonds	USD	-1.0%	-1.5%	-5.4%	-8.3%

Source: Bloomberg. Past performance is not indicative of future returns

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Asset Class/Region	Currency	Currency returns			
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Property					
US Property Securities	USD	-1.5%	-1.7%	-9.6%	21.2%
Australian Property Securities	AUD	-2.0%	0.6%	-10.3%	13.5%
Asia Property Securities	USD	1.9%	3.4%	4.1%	-3.0%
Global Property Securities	USD	-0.4%	0.1%	-6.0%	12.1%
Currencies					
Euro	USD	-0.5%	2.2%	0.1%	-6.0%
UK Pound Sterling	USD	0.5%	1.6%	0.5%	-1.5%
Japanese Yen	USD	-0.6%	-0.6%	-0.7%	-9.6%
Australian Dollar	USD	1.6%	2.7%	-1.3%	-7.4%
South African Rand	USD	2.5%	3.7%	5.7%	-2.9%
Swiss Franc	USD	-0.1%	0.6%	-1.6%	-3.8%
Chinese Yuan	USD	0.1%	0.1%	0.0%	1.6%
Commodities & Alternatives					
Commodities	USD	0.9%	3.5%	12.2%	43.8%
Agricultural Commodities	USD	2.2%	3.4%	7.0%	35.9%
Oil	USD	1.3%	4.9%	21.4%	54.5%
Gold	USD	2.8%	3.8%	1.6%	1.8%
Hedge funds	USD	0.5%	1.0%	-0.8%	0.7%

Source: Bloomberg. Past performance is not indicative of future returns

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