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[Active Equity Managers Share Tips to Fight Passive Tide]

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January 29, 2018

Like their mutual fund counterparts, actively managed U.S. equity separately managed account (SMA) managers face tough competition for advisor attention against low-cost passive products.

Despite the headwinds, some managers have been able to continue to draw in positive flows by positioning their strategies as complementary to passive exposures and highlighting differences from their benchmark.

Legg Mason's ClearBridge Investments has seen strong flows into several of its U.S. equity SMA strategies over the past four quarters, including the firm's Large Cap Growth and All Cap Growth strategies.

ClearBridge has found success marketing its strategies as complementary to, rather than in competition with, passive products, says Vinay Nadkarni, head of global business development at ClearBridge Investments.

"Passive isn't something that we try to compete against," Nadkarni says. "Our solutions, which are focused portfolios that don't own the broad market [and] have good tracking error, tend to be good complements to passive."

ClearBridge's Large Cap Growth SMA grew to $8.2 billion by the end of Q3 2017, after four quarters of successive net inflows totaling $1.9 billion, according to information from the firm. The ESG version of that strategy also achieved four quarters of positive flows, growing to $900 million by the third quarter of 2017. The firm's All Cap Growth SMA strategy grew to $5.5 billion by Q3 2017, after four quarters of positive net inflows totaling $415 million.

Nadkarni also attributes the success ClearBridge has had on the three strategies to consistency in messaging.

"We talk about these strategies consistently and their focus on marrying concentrations or focused portfolios with more moderate tracking error," Nadkarni says.

Kayne Anderson Rudnick Investment Management has also succeeded attracting flows to several of its small- and mid-cap equity strategies in recent quarters.

Kayne Anderson's Small-Cap Quality Value strategy, **Small-Cap Sustainable Growth** and **Small-Mid Cap strategies** all achieved positive net flows over the past four quarters, data from the firm shows.

A lot of the interest the firm is seeing from advisors and distributors reflects the concentrated, high-active share approach the strategies feature, says **Jon Christensen**, portfolio manager and senior research analyst at **Kayne Anderson**.

"Really it comes down to the active share that we have," **Christensen** says. "When you buy us, you're buying a very different look than the benchmark."

Delivering a product that is differentiated from the benchmark is key, **Christensen** explains.

“You have to have your head in the sand to say [the rise of passive investing is] not a threat in general, but the way we think about it is if we just continue to deliver a unique product versus the benchmark... we think we are very well positioned to make a difference and be unique,” **Christensen** says.

SMA equity managers are not immune to the pressures posed by the growing popularity of passive investing, but they may be better positioned compared with their mutual fund peers, says Steven Miyao, president of DST kasina.

In the actively managed U.S. equity category, SMA managers are better positioned than mutual fund managers, from a sales and distribution perspective, because of their relatively lower fees, Miyao says. With lower fees comes a lower bar for adding value beyond a passive product.

“I think SMAs are in a much better position because they’re much cheaper,” Miyao says. “When you are low fee, there’s maybe a little bit less fee pressure, but in every part of the industry fees are going down.”

Still, in order to survive in this tough environment, firms have to be able to perform and to accomplish what they set out to accomplish, Miyao says. While managers historically may have been able to get away with mimicking a benchmark, that doesn’t cut it anymore.

“There’s still a lot of product in the marketplace that still has a very, very high beta share in their portfolio where the primary [source of returns] is beta, and those kinds of products will struggle or will continue to struggle going forward,” Miyao says.

Active share is becoming more important because the industry has grown more transparent and advisors are putting more focus on justifying fees, he adds.

Miyao also points to the growing importance of landing placement in distributor asset allocation models. When looking to include an actively managed U.S. equity strategy in a model, distributors often look for concentrated, high-active share products, Miyao says.

Only 36% of advisors at broker-dealers make their own investment decisions. The remainder are to some extent using models or firm recommended lists to guide their decisions, says Miyao. Getting into a sleeve of a model can be a great way for active equity managers to gain flows.

Being able to offer the same strategy across multiple vehicles has also been helpful to building relationships with distributors, says Nadkarni, of ClearBridge.

“All of these strategies have another vehicle that our sales team can talk to clients about,” he says.
In an environment where distributors are reducing the number of funds and SMAs they make available to advisors, some have a preference for strategies that come in multiple wrappers, he says.

“If they like a strategy, they want it to be in as many vehicles as possible,” Nadkarni says.

One area of opportunity that still exists in the U.S. active equity space, is for more nimble managers that can create highly-customized products to meet the demands of a particular broker-dealer, registered investment advisor (RIA) firm or family office, Miyao says.

“That’s a big opportunity for boutique firms to make their organizations more nimble and then be able to build much more custom solutions for particular broker-dealers, or RIAs or family offices.”