BLOG

The COVID-19 crisis and asset managers – Survival of the smartest

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The World Health Organization (WHO) published the news about the COVID-19 outbreak on 5 January 2020, but stock markets globally were skyrocketing until mid-February and all indices were making new lifetime highs. Gradually, the number of infections started rising outside of Asia. On 24 February, the Dow Jones dropped by 3% and global markets followed suit. When WHO declared COVID-19 a pandemic on 11 March, the virus had spread to 110 countries and infected 110,000. Markets started reacting to this news and the Dow Jones recorded a 12.93% drop on 16 March, the largest single-day drop since the Black Monday stock market crash of 1987, and all global indices took its lead.

The subsequent lockdowns have had a significant negative impact on the global economy: production of major goods and services was halted, demand for non-essential products and services dropped to a new low and WTI crude oil futures tested negative prices for the first time in their history.

COVID-19 impact on asset management companies (AMCs): The pandemic has had a multi-dimensional impact on AMCs; for example, it has increased volatility, led to a liquidity crunch, and reduced AUM.

Market volatility – The CBOE Volatility Index (VIX) shot up by almost 575% in a month to reach 82.69 on 16 March from 14.38 on 19 February. Portfolios are generally built amid low to moderate market volatility. Managing volatility risk becomes very difficult when there is a sudden spike within a short period of time.

Liquidity crunch – The lockdowns have drained liquidity from markets and economies. The Federal Reserve has pumped USD2.3tn into the US economy, far exceeding its 2008 rescue plan, and Franklin Templeton wound up six of its debt mutual funds in India, with combined AUM of almost INR260bn.

Portfolio terminations – Market declines and the liquidity crunch have wiped out equity portfolio returns of the past few years. Many equity clients have decided to close their actively managed accounts due to poor performance and are trying to shift their money to either a fixed income asset class or index funds and passively managed funds.

Declining AUM – AUM of most AMCs has been declining due to market corrections, the liquidity crunch and account closure. This has a direct impact on their revenue, leading to cost pressure, especially on boutique asset managers.

How asset managers can survive the pandemic: Many health experts believe the second wave of COVID-19 will be worse than the first. A vaccine has yet to be developed and many are in different phases of trial, but WHO says there will likely be no vaccine until end-2021.

Darwin's theory of evolution speaks of "the survival of the fittest" as a law of nature, but we believe that in today's competitive world, being fit is not enough; one has to be smart to survive. Asset managers, too, have to deal with this pandemic situation smartly to survive because even the strongest balance sheet cannot be maintained for long amid such circumstances. Following are some steps they have started taking:

Automation – Many are investing heavily in technology to automate manual processes, which would ultimately save time and costs, and ensure quality and standardisation. Automation is neither easy nor effected overnight. Processes need to be streamlined first, and parts of a process automated wherever possible. Complete automation is not practically achievable due to the dynamic nature of asset management, but even 30-50% automation would go a long way in saving costs and time.

Competitive fees – Many have started to offer competitive fees for new clients and discounts on current fees to retain existing clients, as clients are now fee-sensitive because their portfolio returns have been wiped out by the recent market correction.

Strategies to absorb market volatility – Equity portfolios are exposed to very high risk due to the recent increased market volatility. Asset managers have started amending their strategies by using derivatives and continuing to adjust asset allocation and portfolio diversification based on prevailing market conditions to reduce the impact of market volatility on their portfolios.

Working from home – The lockdowns have moved many to work from home (WFH) to ensure business continuity. Many AMCs are operating completely via the WFH framework, and we believe they could use this model – where risk and complexity are low – permanently, as it would save paying for leased office space.

Onshore/offshore staffing – A mix of onshore and offshore staffing helps in terms of business continuity planning and ensures operations are run smoothly and without extra cost amid a short-term crisis affecting a particular city or country. In the current situation, many firms are leveraging onshore and offshore staffing to run their operations smoothly and effectively.

Outsourcing – In addition to onshore/offshore staffing, many have been outsourcing certain operations to offshore service providers who work as an extension of the onshore team. Outsourcing helps in many ways; for example, by reducing overheads, saving costs on infrastructure and technology, and providing a time-zone advantage, flexible staffing and increased efficiency.

No one knows when this pandemic will be over, but it has certainly taught us a new way of working and a new way of life. Charlie Chaplin rightly said, "Nothing is permanent in this wicked world, not even our troubles." We will survive the pandemic together.

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to mitigate your costs. Our established compliance capabilities will help you identify problems and opportunities to navigate through a challenging business environment.

Sources:

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