

## The Future of Investing

**Speaker:** – Lindsay Tomlinson,  
Barclays Global Investors

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The FS club, the London forum for forward thinking in Financial Services continued its 2006/7 season on Monday September 25<sup>th</sup> 2006 by welcoming Lindsay Tomlinson, the Vice Chairman of Barclays Global Investors, BGI. Lindsay has been a fund manager for 25 years and has been with BGI for the last 20 years. He felt that he and his team had experienced a continuous existential crisis about who we are and what we do. BGI is not part of Bar Cap as has a completely different and fiduciary role, with BGI acting as agents.

Lindsay started by affirming that investment is at the heart of the capital market activity, but is still a real Cinderella activity that doesn't even have its own EU directive.

### Background to investment industry

The investment industry is in essence a two generation industry emerging from the 1960s onwards as increasing wealth became available for investment purposes. Thus emerged 3<sup>rd</sup> party fund management activities for use by both institutions and individual investors. Investment emerged from the back office of brokers and banks. It first became pension fund focussed. It has continued to grow, change and become more professional.

### Where are we today?

The industry is unrecognisable from 25 years ago. It is now an industry like any other. It is a knowledge based industry very dependent on and reactive to technology transformation. It is primarily economic, not regulatory driven. It has to work out where its value added arises. If an activity doesn't add value it will get exposed attacked and eroded.

### So what are the Economic Drivers?

Each will be examined in turn.

These are:

- Consolidation
- Globalisation
- Dis-intermediation
- Democratisation and changing client needs
- Technology, transparency and speed

### What is happening with consolidation?

There are economies of scale. As elsewhere it is good to be big or small and in a niche, it's a tough time being in the middle. There is only room for a few big global players. The industry matures as it consolidates. Technology, regulation and branding is driving consolidation which produces a relentless squeeze on the middle ground.

### **Globalisation is having what effect?**

The world is Globalising in many industries. The investment universe is globalising. The clientele are thinking globally. Benefits of scale extend across national boundaries. This leads to the view there is only room for six to ten global managers. National brands are no longer relevant. Top down asset allocation is becoming less and less meaningful. This leads to a wholesale recasting of national markets, indices, stock exchanges and so on. In Lindsay's view there will be two big global outlets – the US for primarily US companies and London for the big international business.

### **How is dis-intermediation taking effect?**

The chain link starts with the person in the street who has a pension contribution that goes into a fund. The fund has a fund manager who uses an investment bank that in turn services the issuer. All elements in the chain are showing signs of seeking to dis-intermediate each other to increase their take. For example structured products bypass fund managers, hedge funds cut out investment banks and investment banks are buying out pension funds. Not only are the goalposts moving so is the whole playing field.

### **What about the democratic effects?**

The person in the street now has to worry about investing. The traditional final salary scheme known as defined benefits –DB is no longer being issued although its legacy will last for another 30 or more years. This change has been led by 401K in the states, with global pension funds now going to DC – defined contribution. The next generation has to worry about DC as this will be the only general pension scheme available. This is leading to the professionalising of the retail space, thus brand recognition is becoming a big deal.

### **How are client needs changing?**

The pension funds view of risks has changed. Managing risk is now a key investment management task. New accounting standards require pension fund deficits to appear on company balance sheets, thus giving rise to liability driven investment strategies or LDIs.

### **What impact is technology having?**

There is now no place to hide. Sources of added value are being relentlessly exposed. There is now increasing specialisation in the constituents of an investment service. Alpha and beta are being separated by mainstream investors. Alpha is the added value component and beta is the market exposure. Such specialisation means it is difficult to add value in mainstream activities. Suppliers must look for value in the niches with different sectors having different styles. There is a massive increase in use of derivatives which in turn require complex systems to support them. Technology has also created and facilitated the use of huge data sets.

Lindsay gave an example of the evolution of the alpha/beta concept. Investors used to buy a total package. Now they separate the alpha and beta. The beta i.e. the market exposure is scalable and cheap and is now provided by such operators as State Street. The alpha which is the added value is capacity and is elusive; it is provided for example by the Man Group.

### **Alternatives are also available**

Investors are increasingly looking outside the mainstream; they are using private equities, hedge funds, commodities and in some cases are actively seeking illiquidity.

### **So What does this all mean?**

Investment managers have to be very clear on the sources of added value and then focus on it. They have to build partnerships, cover the weaknesses and must no longer think just pension funds. They have to think DC, think China, think India.

Investors have to think about their objectives. Increasingly they are also concerned about non-financial objectives such as ethical investments. Investors are buying an alpha and beta wrapped up in different packages. They need to look through the wrapping to understand the underlying strategies.

### **Who will be the winners and what trends are discernable?**

To win you must add value. The middle ground is not the place to be.

Distributors will probably squeeze manufacturers.

End investors and indirect investors should prosper.

London remains in a strong global position.

For a young person their strongest asset is their human capital, even though they have university and housing debt for many years. When will their savings regimes start? Probably many years out from the historic position.

It is now clear that risk has been wrongly priced.

Expect to see a rise in interest rates.