The Boutique Premium

by 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.

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.

Sources:
1 - 0.23% Taken from Cass Business School study
https://www.amg.com/content/dam/amg/boutique-advantage/The_Boutique_Premium.pdf
2 - 0.62% Taken from AMG study
https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3542243
3 - Fama & French as of 14.11.18

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