Asset Management in Canada: Dark Clouds on the Horizon

Description

Managing money for other people is one of the world's most profitable industries. As a firm grows its assets under management (AUM), costs do not grow nearly as quickly – as a result, asset managers with sufficient scale typically earn very attractive returns. In Canada, the story is even better, with relatively little price competition and high customer loyalty. But there are some dark clouds on the horizon.

A new report by Morningstar Equity Research highlights the challenges that Canada's independent asset managers face. The banks are competing fiercely, and stealing share. Competition for top talent is as high as ever. And perhaps most importantly, fees are becoming more of a concern for investors.

IGM: Lackluster performance

IGM Financial (TSX:IGM) is the largest independent asset manager in Canada, with $132 billion in AUM. About half of this is in Investors Group, the other half is housed in Mackenzie Investments.

Investors Group has done an excellent job building its internal sales force, which keeps clients very loyal; the redemption rate for long-term mutual funds averages only 9% per year. But that number could go up in future years, because the funds have not performed well. Only 12% of the funds were rated four or five stars by Morningstar, compared to 28% for the mutual fund universe overall.

Mackenzie's funds have performed much better, but the group has had more trouble holding on to clients. Organic growth has been negative for each of the last five years, with the banks taking much of that share.

CI Financial: Distribution concerns

CI Financial (TSX:CIX) has one of the best long-term track records in Canada. The company had the most funds rated four or five stars in the industry last year, and has ranked in the top two every year for the past 10 years. This has allowed the firm to enjoy much better growth rates than its large peers.

The concerns about CI primarily revolve around its distribution relationships with **Sun Life Financial** and Scotiabank. Sun Life is trying to build up its own asset management business, which means its advisors will likely be pushing clients to switch out of CI's products.

Meanwhile, Scotiabank has had numerous squabbles with CI, which only intensified after the bank bought DundeeWealth in 2010. If Scotiabank is able to wean itself from CI's products, even just a little bit, that could take a big bite out of CI's AUM.

AGF: The most troubled

The problems at **AGF Management** (TSX:AGF.B) are a great warning about what can go wrong in asset management. In 2012, the management team behind its AGF Emerging Markets fund left for a competitor. The firm has also had trouble with performance, with only 30% of its funds outperforming their respective benchmarks.

AGF did a decent job of holding on to assets, but the issues have started to catch up to the company. Institutional AUM has been cut in half over the last two years – in November, AGF lost $2.6 billion in AUM from a single client defection.

Foolish bottom line

While all of these asset managers face their own problems, they share two big ones. First, Canadian banks continue to use their branch networks to steal clients. Second, there have been growing calls for reform on fees, which are among the highest in the world and offer little transparency.

Investors should probably steer clear of these companies' shares. While they operate in a very attractive and profitable industry, the risks are just too great. And these risks will not disappear any time soon.

CATEGORY

1. Investing

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1. TSX:AGF.B (AGF Management Limited)
2. TSX:CIX (CI Financial)
3. TSX:IGM (IGM Financial Inc.)

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Date
2025/08/17
Date Created
2014/03/21
Author
bensinclair