



# Bouncing back, leaping forward

## The Australian funds landscape

Teresa Walker

**T**here is no escaping that the Australian funds industry has been through a challenging time. With investor confidence knocked by rising rates, rising inflation, and falling asset prices, inflows to managed equity funds were down by 62% in 2022 as demand fell away. Cash into fixed income funds saw an even more precipitous fall, down by 95%.

Yet there is good reason for the industry to look forward with a spring in its step. Despite slowing growth, there is some hope that inflationary pressures may be starting to ease, while Australia's distinctive geography and economy shield it from some of the coldest economic headwinds. These factors may also create new opportunities, with China's re-opening being a particularly strong one. Already this year we have seen its ban on importing Australian coal lifted, and the first trade talks between the two nations since 2019, after a period in which products from iron ore to lobster and wine have been off the menu.

Everyone wishes the economy was better and inflation lower, but it's also acknowledged that the situation could be a lot worse. The general sentiment appears to be that Australia will not fare too badly compared to many other economies: unemployment remains low, household savings are still above pre-pandemic levels, and industry confidence is solid: 59% of business leaders are optimistic about the Australian economy in 2023 and 78% about the performance of their own company.

There are still challenges ahead—notably the financial impact on homeowners exiting fixed-term mortgages—but if this is indeed the year in which inflation peaks and one of the country's most important trading relationships stabilises, Australia's fund managers can expect to be operating on a firmer macro-economic footing after a period of volatility. As the economy hopefully steadies, the question then becomes how the industry itself can evolve and return to growth.

### The distribution dilemma

Last year's collapse in fund inflows was strongly linked to the macro-economic backdrop but may also have been influenced by other factors. The last five years have seen not just economic volatility but an upheaval in Australia's funds industry, in the aftermath of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.

The impact of the changes introduced has been stark, particularly with adviser numbers falling from over 25,000 in 2019 to fewer than 16,000 last year, and several thousand more set to leave the industry this year. That would be a major change in any market, but especially so in Australia, where there is little established habit of investors buying funds without an intermediary.

As the adviser pool shrinks, the question of distribution has become pressing for fund managers. The Australian market remains traditional in its investment approach in many ways, with individual investors historically focused on direct property and domestic equities, although the former is becoming increasingly unaffordable. As

a consequence, the direct-to-consumer business has not matured to the extent of many other developed economies—where digital brokerages are widely used—or neighbouring Asian markets, where mobile consumption of investing is well entrenched.

Yet with the landscape having been so altered, funds can no longer avoid the question of how to diversify their distribution. For some that will likely entail trying to manage the relationship directly with investors through an owned portal, while others may look to create listed vehicles and work through brokers. There may also be appetite to attract more institutional investment, aiming to buck the trend of insourcing by the largest superannuation funds.

There is no one right answer, with all distribution routes containing trade-offs. A branded portal, for example, gives a fund manager the advantage of owning the customer relationship, but also the cost of having to acquire those customers in the first place and the requirement to provide a high level of service. The closer asset managers choose to be to the end user, the more they will need to meet high expectations and deliver an outstanding client experience. Increasingly, that means matching the kind of seamless digital service that people are accustomed to from consumer brands. Customer expectations of a digital experience are high and will not be easily satisfied.

This leaves less room for practices such as non-contractual settlement, a feature of the Australian market that compares poorly to customer-centric approaches elsewhere. Distribution is such a complex area exactly because many of the non-intermediated approaches are a double-edged sword—alongside new opportunities come fresh obligations.

## The rise of tokenisation

Despite this dilemma, our conversations with industry leaders suggest some clear areas of consensus around the future of distribution. One of the most important is regulation. “We’ve created more friction, not less”, was the observation of one panellist at our Connect Forum in Sydney last autumn. Compared to the forward-thinking approach of regulators in markets like Singapore, it has long been a complaint that the Australian system lacks agility and sympathy for balancing consumer protection with ease of access to services.

The role of the regulator will be especially important as a new trend rises to the surface—that of tokenisation. For Australian fund managers looking to reach new audiences and overhaul their customer experience, tokenisation—the reconstitution of an asset into tradeable digital tokens—could be an important catalyst.

Tokenisation is effectively several revolutions bundled into one. It allows any asset—from property to private equity and fine art—to be fractionally owned, including by small-time investors who would historically have been excluded. It enables the provider to work more effi-

ciently and lower costs. And it paves the way to providing personalised services to investors, in which the provider helps the customer to build their own basket of tokenised holdings, tailored to their specific interests and preferred level of risk. Once limited to the most wealthy, this kind of bespoke service could potentially become a mass market offering in the future.

For the Australian market, tokenisation could be a leapfrog opportunity. It promises both to engage with a rising generation of digitally-savvy and ethically minded investors, and to continue the progress towards efficient, low-cost investing that has already been realised through a combination of operational improvement harnessing automation, the rise in Exchange Traded Funds (ETFs), which bucked the 2022 trend by enjoying net inflows, and the significant level of consolidation within the super fund market.

Yet there is some way to go, and the implementation of this new approach will depend on a collaborative effort between the industry and regulators to build a market structure that works for all—an effort that Calastone seeks to support through our Distributed Market Infrastructure, connecting over 3,500 participants in global asset management, and helping managers to develop token-based collective investment products. Tokenisation is a revolution that will, and should, proceed in an orderly fashion.

## A story to tell

As fund managers grapple with new approaches to distribution, they are also turning their attention to a changing product landscape. One clear area of focus is Environmental, Social, and Governance investing (ESG). Australia has already made rapid progress in responsible investing, and accounts for an estimated 3% of the global assets under management in ESG products, ahead of its 1.8% share of global GDP. This track record is in part testament to the ability of the super fund industry—around 42% of whose assets are allocated to sustainable managers—to drive positive change. And with new products being launched all the time, that leadership is set to continue.

Yet fund managers cannot assume that providing the products and building the new distribution pipes alone will ensure success. Having relied on intermediaries for so long, those that choose to widen their paths to market will need to develop new muscles for the direct-to-consumer business. Managers that are accustomed to marketing their products on the basis of risk adjusted returns and portfolio construction must also embrace the bigger picture and focus on winning hearts and minds. That requires the ability to tell a story about an investment, its purpose and rationale as well as financial nuts and bolts. Creative approaches in the industry—such as halving the fee on an ESG product and donating the discount to a charity of the customer’s choice—are early indicators of more to come.



### The quote

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**Teresa Walker,  
Calastone**

As the managing director, head of Australia and New Zealand at Calastone, Teresa leads the team responsible for managing our client relationships, growing our footprint and driving into new segments within the region.

With more than 35 years of experience in the wealth management industry, she has a broad understanding of wealth markets in the UK, the US and Australia covering private clients, financial planners and bank segments.

**The quote**

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**Global to local**

As is the case globally, Australian fund management faces both a challenging and opportune landscape. Many of the issues are universal—from the need to protect market share and operating margins in a more competitive landscape, to the influence of younger customers with different consumption habits and investment preferences. Across the industry, the pursuit of new customers, new sources of efficiency and new routes to market is a common one. It will be underpinned by overcoming the challenges of legacy technology and embracing automation—helping fund managers to deliver information and execute trading in a timely manner, and to optimise the investor experience. That is the evolution Calastone works with clients every day to achieve.

For Australian fund management, some of the opportunities ahead are distinct. Tokenisation could help provide the answer to the industry’s need to reach new audiences, as well as unleashing the benefits of lower cost investing and democratisation. The underexploited direct-to-consumer market offers scope for growth, as managers seek to attract new customers in different ways. While in the priority area of ESG, the industry is already pushing at an open door.

Despite the macro headwinds that still exist, there is much reason for optimism as well as understandable room for concern. This could be the year that the Australian industry does not simply recover from a thin year but makes decisive moves towards a future that may look very different from the past. **FS**