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Investing for a world of change

Ninety One's annual update on the health of the independent advisor market in SA

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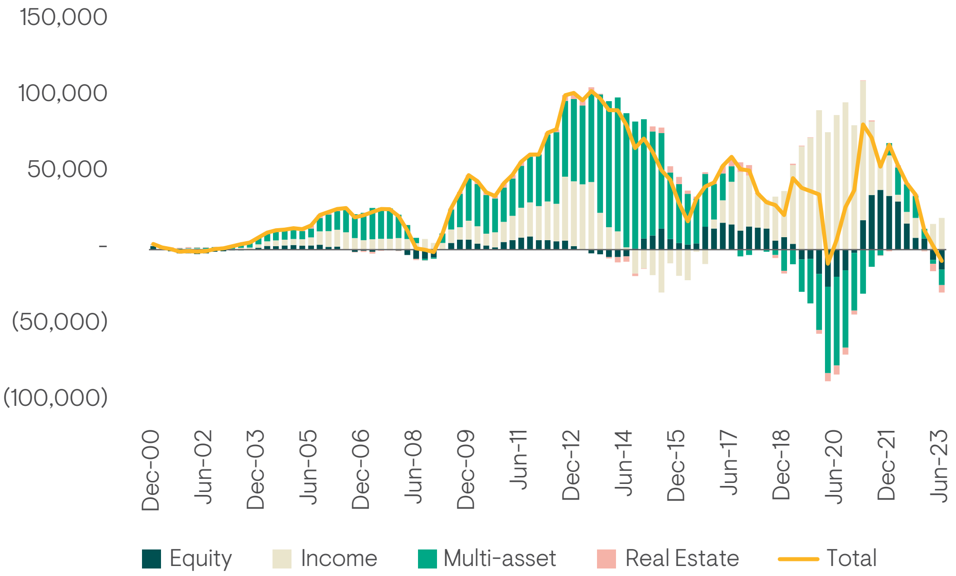
As we speed towards the end of the year, it is time to reflect on what was a once again a turbulent year for financial markets.

Whilst we all like to bemoan the state of the local and global economies, as well as the increasingly worrying global political developments with wars in Europe and the Middle-East, it is the impact of these developments on our businesses that often takes time to become clear. Below we share some thoughts and feedback from a few industry surveys on the financial advisor market in South Africa.

Flows and markets matter

The retail investment industry experienced a very tough 2023. Exactly how tough is illustrated by the following graph of rolling 12 month netflows for the South African Collective Investment Schemes (CIS) industry.

Figure 1: Rolling 12 month netflows

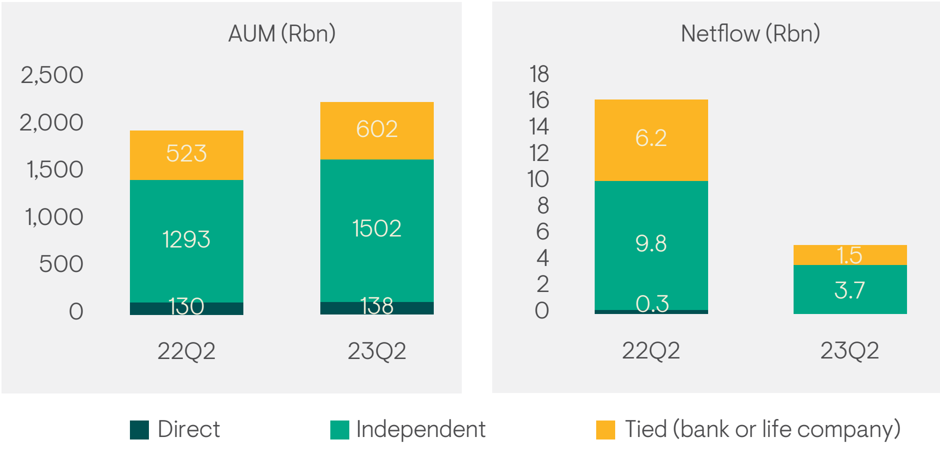


AUM for Retail & Institutional funds, both retail and institutional share classes. Excluding money market, hybrid broker funds and FOFs. Income includes MA Income sector and IB sector.
Source: ASISA, 30 June 2023.

Since 2000 the local CIS industry had only experienced aggregate net outflows on three occasions. The first two were in response to external crises (Global Financial Crisis of 2008 as well as Covid-19 in 2020). The third time was in the first half of 2023. For all players in the local investments industry, from platforms to CIS Mancos to financial advisors, 2023 has been a year where consolidation was either enacted or vigorously considered and business growth was only achievable if you grew your market share.

NMG Consulting does an annual Retail Savings and Investment Survey (RSI Survey). Their Q2 2023 survey clearly highlighted the drop-off in flows for the financial advisor market. The following graphic, from their report, is quite instructive and gives the year-on-year asset and flow experience for Independent Advisors, Tied Advisors and Direct (unadvised).

Figures 2 and 3: Assets under management and Netflows



Source: NMG RSI Survey Q2 2023.

The above graphs reinforce several key conclusions about the market conditions over the past year:

i. Markets helped grow assets by more than 15% between Q2 2022 and Q2 2023
ii. But netflow momentum stalled significantly over the past 12 months
iii. Whereas all channels experienced a dramatic reduction in netflows, tied channels experienced a more pronounced reduction.
iv. Direct (unadvised) investments remain a fairly small part of the SA savings industry and does not look to be in a position to threaten the advised investment channels.

The RSI study further polls advisors on the key areas of concern in their practices. In previous years advisor concerns focused on ever-increasing regulations or fee pressure as the biggest areas of concern. However, although not unexpected, this time round political risk, the state of the economy and client emigration were cited by more than 60% of advisors. The challenge facing advisors unfortunately, is that one can do nothing about the state of politics or the economy. They are distractions, and well-established advice firms know that the key in difficult markets is to ultimately focus on what you can control – high quality engagements with clients who are also concerned and looking for guidance on their financial affairs.

Financial performance of independent financial advisors

Every year, Ninety One tracks the financial affairs of approximately 35 independent investment-focused wealth advisory firms, ranging from single advisor lifestyle firms to large national corporates. We obtain basic financial ratios from the participants of the study reflecting the revenue and cost growth in their firms. This information helps us keep track of how these firms perform over time.

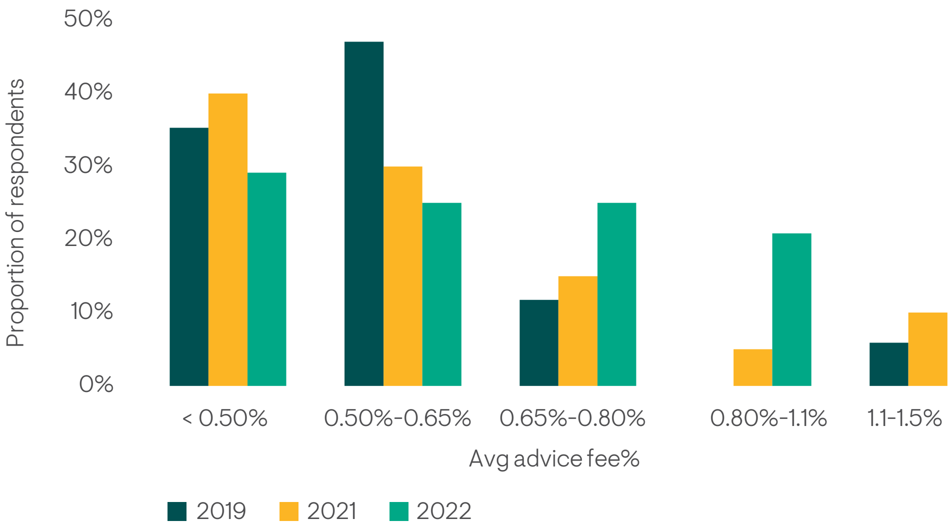
The results for 2023 (covering the 2022 financial year) have just been processed and give us a glimpse into how well advisor firms have weathered the impact of Covid lockdowns, as well as the difficult market conditions of the past twelve months. For the purposes of this article, we will look at the results for

i. fees as a percentage of assets, and
ii. revenue growth

as indicators of how well investment advice firms are performing financially.

The next chart compares the total practice fee revenue as a percentage of assets (i.e., fee rate as a percentage) for the participating practices between 2019 and 2022 (2020 review was not run due to Covid lockdowns)

Figure 4: Advice fees as % of AUM



Source: Ninety One Advisor Financial Survey 2022.

Rather than just showing average fee rates over the three years, the graph above shows the distribution of fees charged by the participants in the survey. There are several interesting conclusions from this graph:

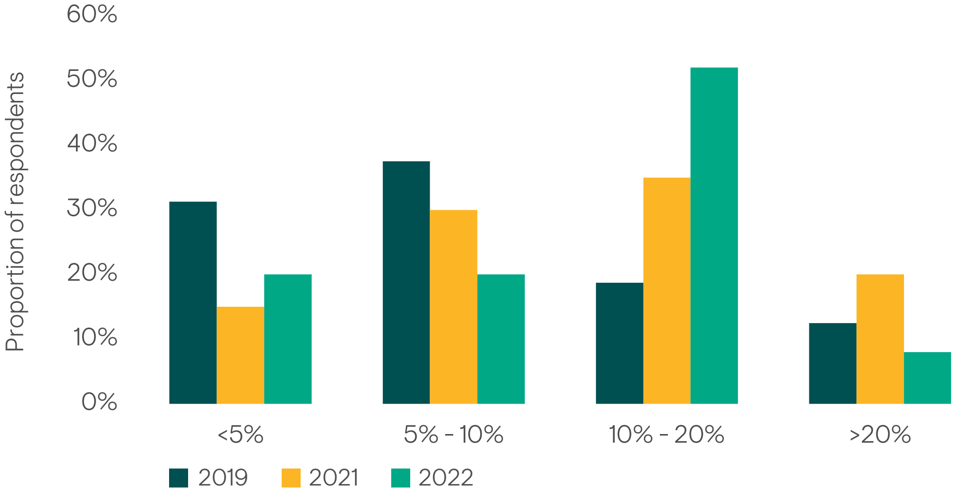
i. 2022 was the first time we had no advice firms charging an average fee of more than 1.1% pa in the sample group.
ii. At the same time we saw a reduction in the proportion of firms charging less than 0.65% fees pa.
iii. 46% of respondents indicated that their average fee is now above 0.65% pa – the highest proportion since the survey launched in 2016
iv. The combined impact has been for average fees across all respondents to remain flat at 0.64%.

There appears to be at least two fee and value propositions in the survey group.

i. The more conventional advice firms focusing on classic investment planning have a revenue margin that generally falls below 0.60% – some of the lower margin operators are experiencing fee pressure.
ii. Advice firms offering a wider array of services, including a family office proposition, capture a larger slice of the investment management margin. They earn a revenue margin of between 0.65% and 1% p.a. or higher and appear more able to defend their revenue margin.

We now turn our attention to revenue growth.

Figure 5: Revenue growth year-on-year



Source: Ninety One Advisor Financial Survey 2022.

In line with the NMG analysis of assets under management, which showed an increase in assets from market growth (despite low netflows), our respondent group also showed solid revenue growth in 2022, with 60% of respondents reporting double-digit revenue growth.

The average revenue growth across the entire group was reported at 12%, somewhat down from the 17% achieved in 2021, but still remarkable given the investment environment. These statistics emphasise again the healthy financials that underpin high-quality independently owned advice firms - in spite of low netflows for many top firms, these firms grow their revenue under most market conditions.

Conclusion

The data presented continues to support the thesis that independently owned financial advisor firms fare well under almost any market conditions. In difficult market conditions advisors should focus on what they can control – the quality of client engagements. When the environment gets tougher, clients require more handholding and more coaching. Advice firms who have mastered these skills have a competitive edge and will grow their market share in tough markets.

As South African investors remain wary and continue to hoard cash (with still around R1.7 trillion[1] of excess retail bank deposits in the local market waiting for investment opportunities), well positioned independent financial advice firms stand to benefit as conditions improve next year.

As 2023 concludes, we would like to thank all our business partners for their support throughout the year. Despite the challenging environment, we are happy to have had a positive netflow year, thanks to your support. Based on feedback from advisors it is clear that our Masterclass and Family Office product offerings have been of meaningful benefit to advisors in this difficult environment, and we have benefited in return.

We look forward to continuing our support to you in the new year.

1. Source: Estimate based on the South African Reserve Bank Quarterly Bulletin.

Important information

Contact information

Please visit our website at www.ninetyone.com for more information on our range of funds and portfolio products.

You'll also find application forms and other relevant documentation for offshore investing on the website.

For more information and assistance with investing, call the Advisor Service Centre Tel 0860 444 487.

Alternatively, please contact your Ninety One investment consultant.

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