The value of boutique investment managers

When considering the definition of boutique the image of a small shop selling fashionable clothes or products, often unique to them, comes to mind.

However, business soon adopted the term; and boutique business was therefore defined along the lines of a small business offering specialised products and services.

THE ISSUE OF SIZE

Research from around the world, including that of Standard and Poor's, suggests that size does indeed count, with smaller boutique type managers outperforming their larger counterparts by anything between 1% and 2.5%. This suggests that smaller firms with a specific focus area do better than large firms that try to be all things to everybody.

This outperformance is largely attributable to boutiques committing to remaining small and employing innovative tactics to keep operating costs low such as not having to occupy physical offices, but opt to use technologies such as cloud based services to drive costs down even further.

Companies like Google virtually offer a basic company service in a box for free. Being small and nimble is an important characteristic of a boutique company since the world has changed and the rules which govern the old world of investment strategies do not necessarily apply anymore. Boutiques are therefore far more flexible, and are able to react quickly to markets in order to adapt to their client's needs.

OWNERSHIP MAKES BOUTIQUES GREAT

Ownership is the most important ingredient that makes a true boutique manager; it gives boutiques a major advantage over their big brothers in that the portfolio managers have a personal stake in the business.

This bodes well for investors since they can be confident that the portfolio managers are locked into the business, and the interests of owners and investors are aligned. Because boutique fund managers are set up by experienced portfolio managers who have earned a reputation managing money elsewhere, they tend to specialize and focus on particular segments of the market that may not be well addressed by larger investment firms.

Boutiques also outsource many non-core functions such as fund administration and compliance allowing them to concentrate solely on investment activities. Because of their smaller size, boutique managers have much more personal relationships with clients than those offered by big asset managers.

ENTER PASSIVE MANAGEMENT BOUTIQUES

The world of passive management is most conducive to boutique firms simply because computers and sophisticated mathematical algorithms cost far less than employing large teams of expensive research analysts and in most cases deliver the same, if not better results.

This is quite evident in the fact that on average, only 23% of active funds that invest in equities managed to beat the FTSE/JSE Top 40 index over periods of one, three, five, and seven years respectively.

"Through highly scalable computer technologies and advanced mathematical algorithms and techniques, it is now possible for small teams of portfolio managers to manage the same sizes of funds that large managers do, but at significantly lower costs without impacting returns" says Justin Solms, CEO of passive boutique firm Sunstrike Capital.

Asked why he left the world of large managers to start a boutique firm Solms said that as a portfolio manager, he wants to own what he does and because together with his partners, they have significant ownership in their firm, motivating them to perform well for their clients.

Another reason why he opted to start a (passive) boutique manager is that large managers have certain constraints that force them to reduce their active share holding when funds become too big. This means that their funds ultimately start looking like an index but with high active management fees. Being a boutique passive manager means investors can still have great returns, but with far less fees.

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