McKinsey & Company

Global Asset Management Practice

The Great Reset: North American asset management in 2022

October 2022

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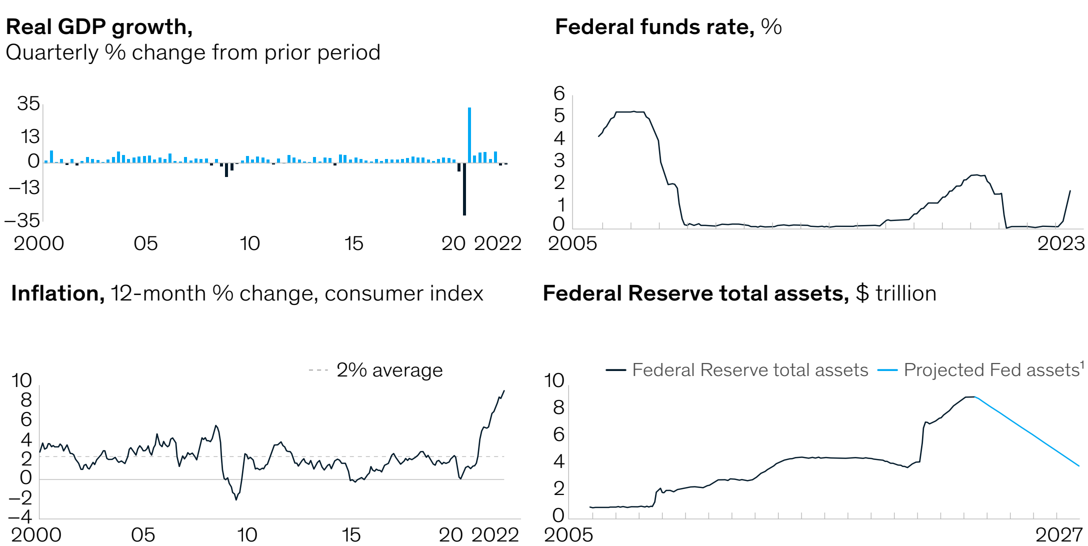
Introduction

Global markets hit an inflection point in 2022. A decade of relative calm following the global financial crisis—including two years of supernormal returns after the initial shock of the pandemic—gave way to a new reality of supply-side disruptions, geopolitical tensions, and surging inflationary pressures. These factors have triggered a fundamental reset of macroeconomic policy and a fading away of the familiar backdrop of rapidly globalizing trade and capital flows, lower-for-longer interest rates, expanding central-bank balance sheets, and accommodative fiscal policy (Exhibit 1).

As the persistent—and, some would argue, secular—nature of these shifts became apparent, asset owners and asset managers alike have recalibrated their assumptions about pricing risk across the investable universe. The reset button has been hit for nearly every major asset class. Equities retreated from their historical highs in late 2021, with the S&P 500 declining by 20.6 percent over the first six months of 2022, its worst performance since 1970. Fixed income, once a reliable ballast against market downturns, suffered a 10 percent decline in the same period in the face of inflationary pressures—

Exhibit 1

There was a major reset of macroeconomic conditions in 2022.



[1]Assets projected based on the Fed's announced monthly redemption caps to its portfolio of Treasuries and agency mortgage-backed securities.
Source: St. Louis Federal Reserve

by some accounts the worst half-year performance by bonds in over 200 years. The greatest reversals were inflicted on some of the ostensible winners of the pandemic era: the high-flying technology sector and emerging asset classes, with valuations of some prominent tech unicorns subject to drastic down rounds and cryptocurrency valuations more than halving as investors decided to “get real” with tangible cash flows and hard assets. Despite the recent bounce-back in asset prices over the early summer months, significant uncertainty remains.

This great reset of macro, market, and policy assumptions has had three major impacts on the North American asset management industry:

1. After two years of record growth and profitability, the industry hit a speed bump in its near-term economic trajectory, and significant questions remain as to which elements of its slowdown will be part of a new normal.

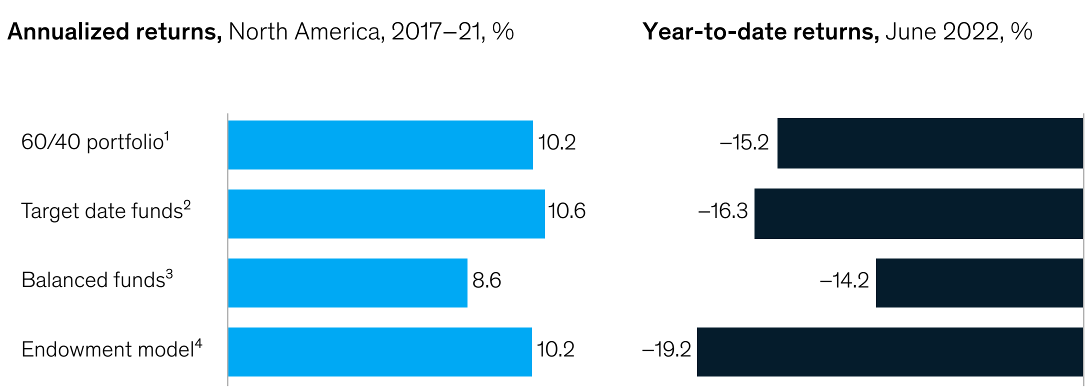
2. The industry’s clients—institutional and retail alike—are under pressure as they cope with reopened funding gaps and anemic asset class return forecasts, and they are questioning previously reliable recipes for portfolio construction and long-term investing (Exhibit 2).

3. The Great Reset of 2022 has loosened some of the foundational assumptions behind several of the past decade’s defining trends, including the internationalization of products, clients, and capital sources; rapid growth of risk-on and leverage-oriented business models; and a wave of commoditization borne out of the surging demand for bulk beta—assumptions on which the North American asset management industry had built its growth trajectory.

What impact will the Great Reset have on the structure, performance, and prospects for the North American asset management industry? To answer the question, this report begins by briefly taking stock of the industry’s starting position—its performance and health following

Exhibit 2

Traditional paradigms of investing have been upended.



[1]Simple average of mutual funds under the Morningstar Asset Allocation 50–70% Equity.
[2]Simple average of mutual funds under the Morningstar Target Date 2030 category.
[3]Simple average of the Morningstar Moderate Allocation Global category. Excludes funds under the 60/40 category.
[4]Based on returns for the Endowment Index in US dollars. Created by ETF Model Solutions to replicate the investment strategy of large university endowments.
Source:

two highly unusual pandemic-era years. We note that the experience of those years has created both opportunity and vulnerability. We then explore how the secular shifts of 2022 have affected the industry to date, as well as the impact they are likely to have on a set of familiar industry trends that have been playing out over the past decade. The early summer months brought a reprieve in the markets, but continued macroeconomic volatility creates new demands on asset managers for enhanced resilience and accelerated reinvention. In that spirit, we lay out an "all-weather" agenda for managers seeking to reposition themselves to thrive through the uncertainty of the years ahead.

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In the beginning, a position of (apparent) strength

The asset management industry entered 2022 in a position of unusual strength. With the robust market appreciation and net flows from the year prior, the global industry hit a high-water mark of $126 trillion of assets under management (AUM), a figure representing 28 percent of global financial assets, up from 23 percent a decade ago.

The industry's revenue pool grew to $526 billion, more than doubling in size from ten years ago (Exhibit 3). Growth to these new heights was supported by 2021 net flows of $4.8 trillion, representing organic growth of 4.3 percent—a record high for the decade in both absolute and relative terms—and $9.8 trillion of asset growth, reflecting the 2021 surge in equity and bond markets.

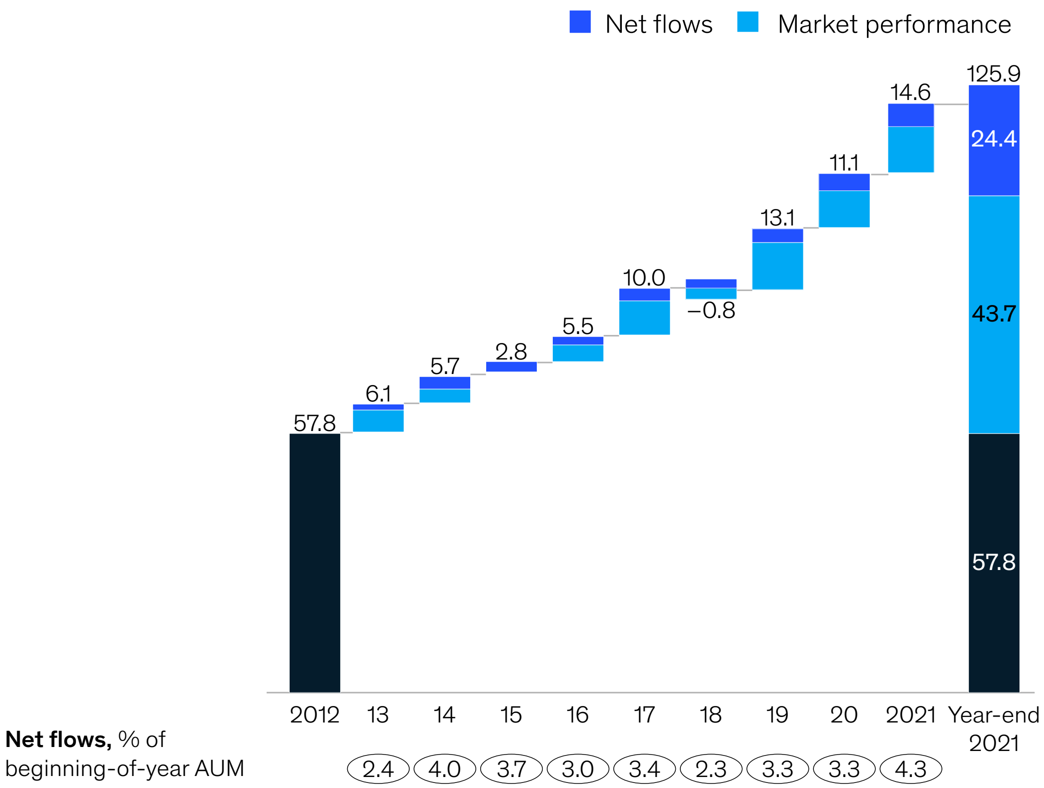
The industry's stellar performance was consistent across all major regions, with record highs in AUM, revenues, and profitability across North America, Western Europe, and Asia—Pacific. Largely because of the momentum in its capital markets, North America led the pack with 14 percent growth in AUM, 16 percent growth in revenues, and an improvement in operating margins of about 400 basis points (Exhibit 4).

The robust performance of the North American industry as a whole masks considerable dispersion in the performance of individual asset managers. The rising tide of the markets and the flood of new money did not lift all boats, or at least it did not lift them equally. Continuing a trend we have tracked over the past few years, the gap between the best and the rest continued to widen considerably. Nowhere was this

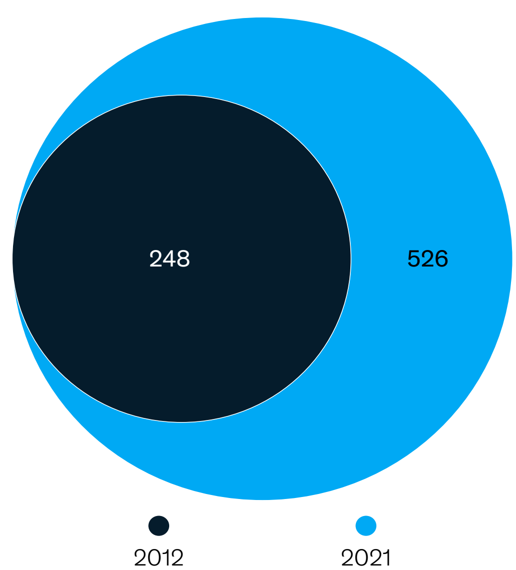
Exhibit 3

The asset management industry entered 2022 in a strong position.

Global 3rd-party managed assets,[1] year-end, $ trillion



Global industry revenues,[2] $ billion

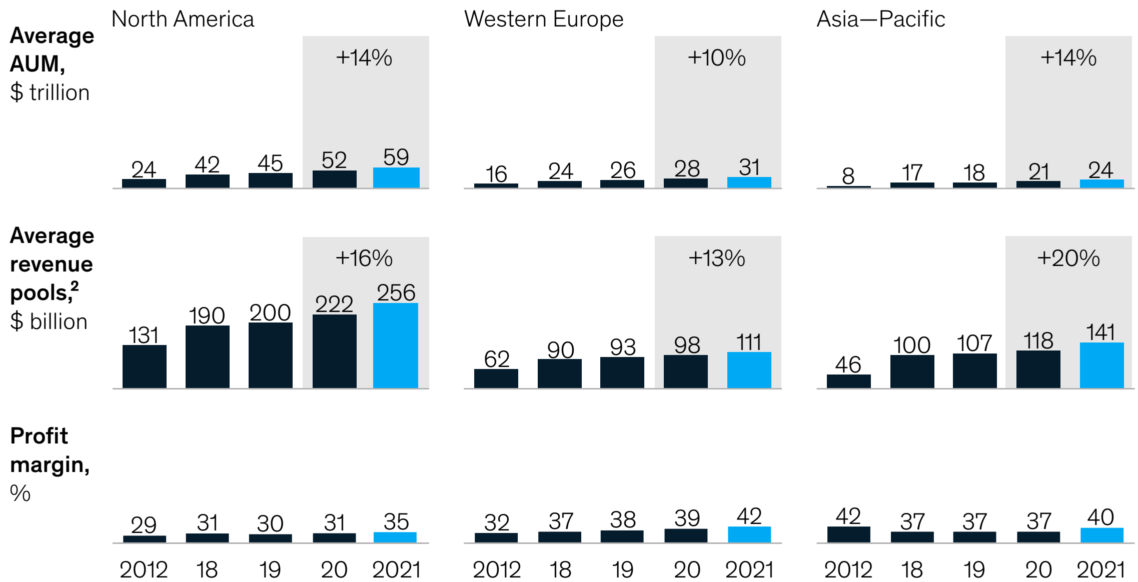


[1]Includes 42 countries in North America, Latin America, Western Europe, Central & Eastern Europe, Asia–Pacific, Middle East, and Africa.
[2]Includes 29 countries, representing ~98% of global assets under management.
Source: McKinsey Performance Lens Global Growth Cube

Exhibit 4

Growth was robust across all regions in 2021.

Global AUM (including alternatives),[1] 2012–21



[1]Includes 25 countries—2 in North America, 12 in Western Europe, and 11 in Asia–Pacific—representing ~95% of global assets under management.
[2]Revenues based on management fees; excludes impact of performance fees and carried interest.
Source: McKinsey Performance Lens Global AM Survey; McKinsey Performance Lens Global Growth Cube

clearer than in revenue growth: Asset managers in the top quartile outperformed their peers in the bottom quartile by 29 percentage points, relative to gaps of 19 to 20 percentage points in the last two years. While profitability improved for the asset management industry overall, the gap between the best and rest remained considerable, with a 37-percentage-point difference between top- and bottom-quartile performers (Exhibit 5).

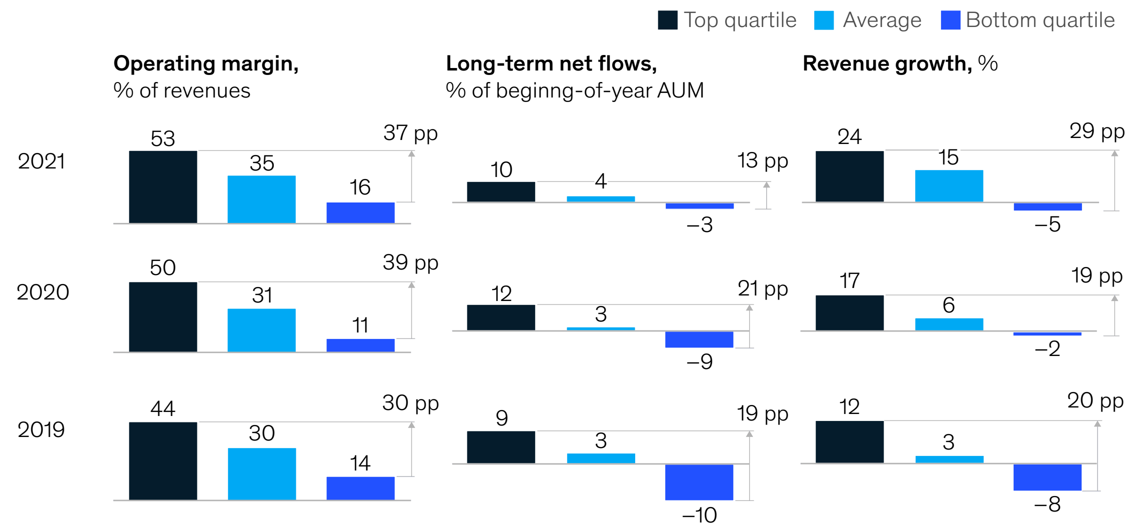
The unprecedented growth in industry assets and revenues brought with it a predictable ratcheting up of the industry's cost base. Over the course of 2021, costs of the North American asset management industry grew by $13 billion, reaching a new high of $167 billion (Exhibit 6). This increase, representing an annualized growth rate of 8 percent, was just over half the overall rate of the industry's asset growth, but it was almost double the industry's rate of organic growth. Categories that contributed most to 2021's cost increase were investment management (up $7 billion), technology ($2 billion), operations ($1 billion), and legal and compliance ($1 billion). In relative terms, growth in spending on distribution remained relatively muted (3 percent), in part because of natural efficiencies created by pandemic-induced remote sales.

An expanding industry cost base is a natural—and perhaps inevitable—corollary to a steadily growing base of industry assets. The conditions for steady asset growth have certainly been in place in North America, with its accommodative economic environment of the past decade. But the volatility of the first half of 2022 serves as a reminder that growth cannot be taken for granted, and the continued uncertainty in the macroeconomic environment raises a natural question: How much of that cost base can be supported in an era of more tepid

Exhibit 5

The gap between the best and the rest has widened since 2019.

Performance comparison of North American asset managers by quartile,[1] 2019–21

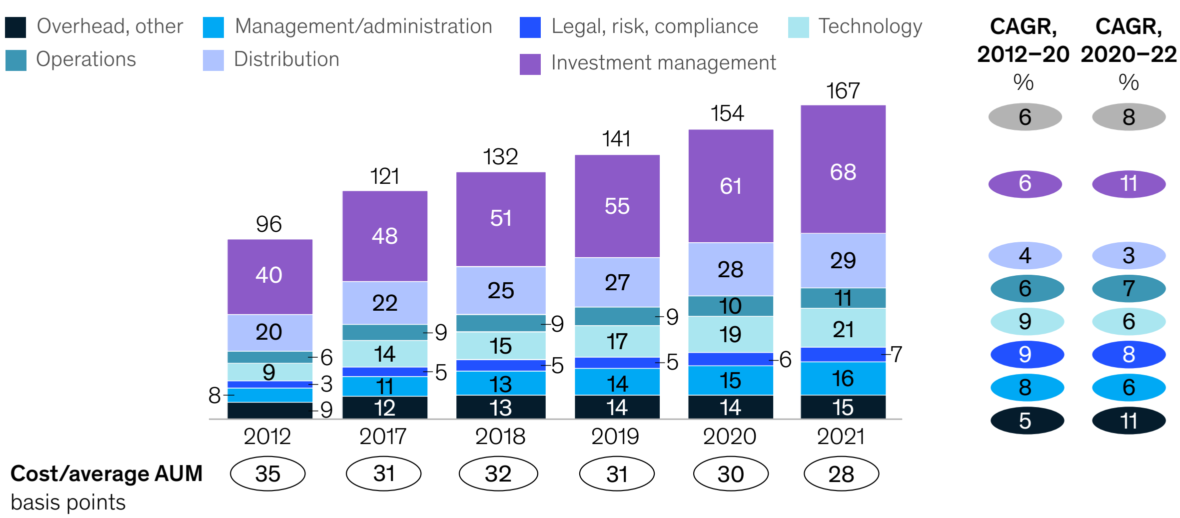


[1]Differences indicated in each graph compare the top-quartile asset managers vs those in the bottom quartile, measured in percentage points (pp).
Source: McKinsey Performance Lens Global Benchmarking Survey

Exhibit 6

Industry costs have been steadily increasing.

Total North American asset manager spend by function (estimate), 2012–21, $ billion[1]



[1]Figures may not sum to 100%, because of rounding.
Source: McKinsey Performance Lens Global Asset Management Survey

growth? The asset management industry's costs have been variable on the upside, but exactly how flexible will these costs prove to be on the downside?

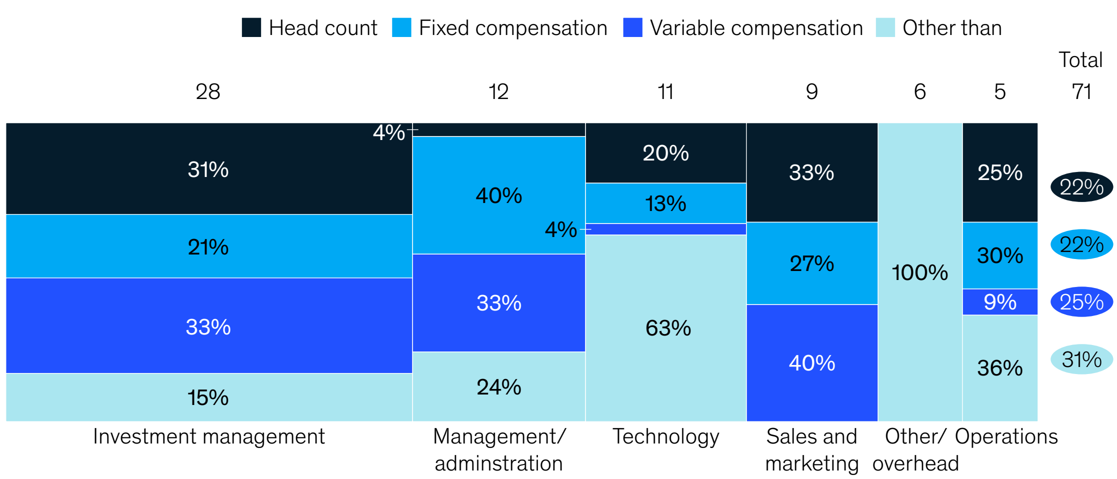
Answering these questions requires a look at the evolution of the industry's cost base over the course of the full economic cycle. In the past decade, costs in North America have grown by $71 billion (Exhibit 7). The industry has indeed generated some degree of positive operating leverage: In 2021, managing a dollar of AUM cost 28 basis points in North America, a slight reduction from the rate of 31 basis points in 2017 but perhaps not to a degree that one would expect when two-thirds of the growth of the industry's asset base has resulted from market appreciation. In the last ten years, the industry's cost base has grown at about 6 to 7 percent per year, double the organic growth of assets in the industry.

Disaggregating the sources of historical cost growth is instructive for understanding the industry's ability to manage through a more protracted downturn. Our analysis of cost data over the past ten years reveals a challenging reality of the growing cost of complexity in asset management business models. As investors have sought and asset managers have provided more complex solutions—product and vehicle innovation, usage of data and analytics, digital sales enablement, next-generation operating platforms—companies have a growing need for more, and more skilled, talent. In fact, nearly 70 percent of all cost increases for the industry over the last decade have been directly related to talent: Almost half of all cost growth was driven by increases in compensation (fixed and variable), and nearly an additional quarter of all cost growth resulted from increased head count. While asset managers have continued to invest in technology and seek greater scalability and efficiency in their operating models, the reality is that with greater business complexity has

Exhibit 7

Over the past decade, industry costs have increased by $71 billion.

Cost increases by function and type of increase, North America, 2012–21, $ billion



Source: McKinsey Performance Lens Global Asset Management Survey come growing cost of talent, in terms of both volume and price, and often in areas where costs are fixed in the near term.

Among the largest areas of cost growth, four stand out:

— *Investment management* represents $28 billion (or 39 percent) of industry cost growth, with close to a third related to increases in investment professional head count as the industry innovated with products—which require new teams and capabilities—and responded to client demands for an ever-broader range of specialized investment strategies. And despite the industry's focus on automation, data enablement, and scalability, costs of the investment management function especially have continued to rise in line with market performance.

— *Management and administration* are responsible for $12 billion (17 percent) of industry cost growth. These costs reflect the emergence of a new class of senior professional managers and business leaders who are required to lead increasingly scaled firms in an era of significant growth and greater complexity. While some of the increased management and administration costs are related to third-party spend—for example, finance outsourcing and third-party legal—a tremendous amount of the cost growth has resulted from compensation increases as this now well-established professional managerial class has become more senior.

— *Technology* represents $11 billion (15 percent) of the industry's cost growth, with a majority coming from non-compensation expenses—a mix of new systems and software spend required to support a more complex array of investment capabilities, growth in maintenance costs of supporting legacy systems, and early investments in digitizing their operating platforms. Technology investments are not simply one-time costs but instead are becoming a continuous and meaningful portion of the cost of operating a successful asset manager.

— *Sales and marketing* contribute $9 billion (13 percent) to industry cost growth. This function is where—on a relative basis—expansion of head count had the greatest impact on spending. Sales teams have been ramped up in size to capture robust growth of the past decade and to deliver on the more specialized and consultative requirements of sophisticated clients. Furthermore, given how robust gross sales have been over the past few years, increases in variable compensation have been a significant source of cost growth in the sales and marketing function.

The growth in the size and complexity—and the potentially increased rigidity—of the industry's cost base represents a key vulnerability for North American asset managers. With the cushion of consistent asset growth over the past decade, operating models have grown in complexity, and cost structures have ossified.

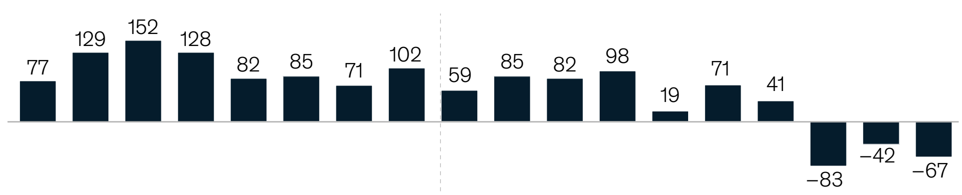
A turning of the tide in 2022

Against the foregoing picture of relative strength, the market disruptions of 2022 caused a radical shift in the industry's net flow dynamics. After an uninterrupted string of robust monthly inflows throughout 2021 (a minimum of $59 billion per month), uncertainty and volatility of markets in early 2022 caused a sharp reversal in the second quarter (Exhibit 8). In contrast to the record wave of $1.6 trillion in new money that rushed in for 2021, the first half of 2022 saw outflows of $281 billion.

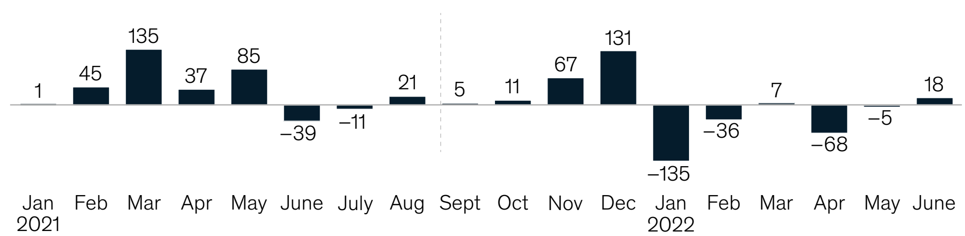
Exhibit 8

Market dislocations in 2022 have led to a broad-based pullback by investors.

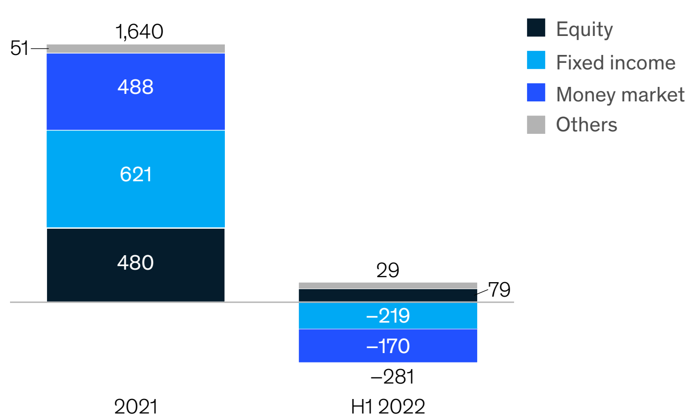
Long-term open-end fund flows,[1] North America, $ billion



Money market open-end fund flows,[1] North America, $ billion



Annual and first-half totals by asset class, North America, $ billion



[1]Includes open-end mutual funds, exchange-traded funds (ETFs). Excludes funds of funds.
Source: © 2022 Morningstar. All rights reserved. The information contained herein: (1) may not be copied or distributed; and (2) is not warranted to be accurate, complete, or timely.

Perhaps most notable in this reversal was the demand trajectory for fixed income, which was a highly reliable generator of positive flows over the last decade. In the first half of the year, $170 billion of fixed-income open-end fund assets came off the table as the weight of inflation and interest rate increases punished the returns of this asset class. Equities managed to eke out modest organic growth ($79 billion inflows) on the basis of rebalancing trades.

Patterns of demand also shifted within each asset class category. In fixed income, flows accrued to short-duration strategies, floating-rate strategies like bank loans, and inflation-protected ones (for example, TIPS and I bonds) with risk-on strategies (such as high yield), while long-duration products suffered capital flight. Within equities, domestic and value-oriented strategies benefited at the expense of emerging markets and growth-oriented strategies.

This sharp and sudden turning of the tide affected all asset managers through a re-marking of industry assets. In the first half of 2022, the value of US-domiciled equities and bond funds fell by almost $5 trillion. However, in the face of industry-wide pressure, there was significant variance in how the organic growth of individual asset managers was affected by the sudden shift in the environment. Over the past year, four clear segments emerged (Exhibit 9):

Exhibit 9

There was a changing of the guard in 2022.

Open-end fund[1] managers' net flows, North America

2021 flows, $ billion

2021 flows	H1 2020 flows: Net outflows	H1 2020 flows: Net inflows
Net inflows	**Bump in the road** Large fixed-income managers with exposures to inflation-sensitive strategies YTD 2022: −352 net outflows 26% of firms	**Consistent winners** Firms in the passive space with precision exposures and proprietary distribution YTD 2022: 258 net inflows 35% of firms
Net outflows	**Challenged** Active managers in low-performing, traditional strategies YTD 2022: −222 net outflows 28% of firms	**Rebounders** Midsize to small managers with a value tilt YTD 2022: 27 net inflows 11% of firms

H1 2020 flows, $ billion

[1]Includes mutual funds, money market funds, and exchange-traded funds (ETFs). Excludes funds of funds. Sample of 700 fund families listed on Morningstar.
Source: Source: © 2022 Morningstar. All rights reserved. The information contained herein: (1) may not be copied or distributed; and (2) is not warranted to be accurate, complete or timely; McKinsey analysis

- *Consistent winners.* An impressive 35 percent of firms were able to build on the positive flow momentum they had in 2021 and extend this to continued organic growth in the first half of 2022. This group collectively captured $258 billion in net flows, a majority of which was captured by large, diversified firms that had the breadth of offerings to seamlessly meet new sets of client needs, passive firms that drew assets from rebalancing and tactical repositioning trades, and firms that had the benefit of proprietary distribution channels.

- *Bump in the road.* Given the sudden shift in macro environment, it is unsurprising that a meaningful number of firms that were in growth mode for 2021 (26 percent of firms, to be precise) gave up some of their gains in 2022. As of mid-2022, this group had yielded $352 billion of outflows, equal to more than half their gains from the prior year. This group includes some prominent names in fixed income whose investment performance suffered with the sudden shift in the macro environment. Also in this group are asset managers whose prior growth was heavily focused on strategies that fell out of favor in the first half of 2022—for example, growth equities, long-duration fixed income, and emerging markets strategies.

- *Rebounders.* The share of firms that were able to take advantage of the shifting tide and rebound from a previous position of outflows is relatively small: just 11 percent of asset managers. The collective net flows for this group for the first half of 2022 was a relatively modest $27 billion. Firms in this category include asset managers whose investment strategies skewed in favor of value-investing factors, which the macro conditions of 2022 brought back into favor with clients.

- *Consistently challenged.* The final group of asset managers, some 28 percent of the industry, suffered from outflows throughout 2021 and the first half of 2022. This group largely consists of asset managers who were facing challenges in the investment performance of their flagship strategies. Managers who operated primarily in traditional product categories with low performance dispersion are heavily represented here. Outflows in this group accelerated meaningfully from $196 billion for the full year of 2021 to $222 billion for the first half of 2022.

The capital markets appear to have priced in both the more muted view of industry growth and the dispersion of individual managers' performance. In mid-2022, the average forward P/E ratios of publicly listed asset managers in North America declined to 10–12 times, some 50 percent below their level in 2010–18. However, top-quartile performers continued to trade at a significant and consistent premium to the industry average, trading with multiples in the range of 15–20 times, in line with their publicly listed alternative asset management peers.

Industry trends: Change, but much stays the same

How have dislocations in the market affected the well-established secular trends that have been reshaping the industry over the past decade? The answer, somewhat counterintuitively, is that the trends have not changed a lot. The most prominent trends—each of which we have discussed in reports from previous years[1]—have shifted in texture but not in their fundamental direction of travel.

Active management under pressure

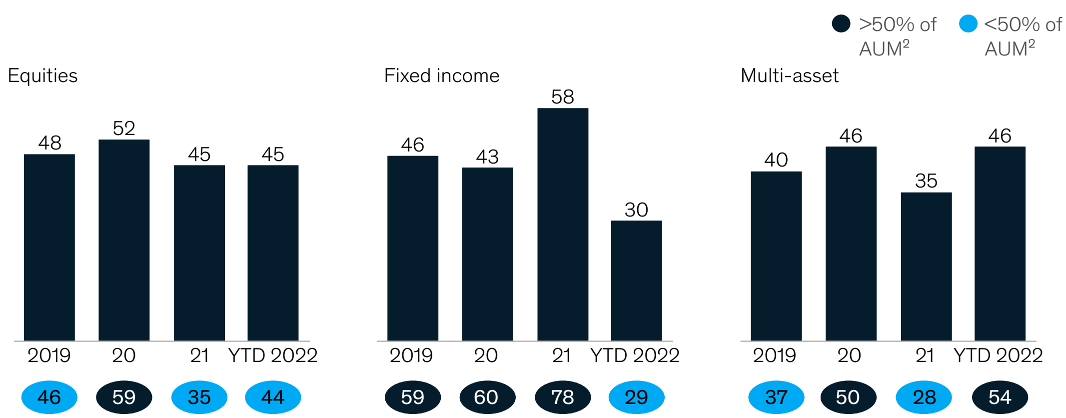
Much has been written on the challenges faced by actively managed funds in the North American market over the past decade. Some writers have attributed active equities' underperformance to the high-beta and low-dispersion market conditions of the past decade, arguing that a major shift in market regime would be the catalyst for a broad-based comeback of active management.

This story has not quite played out in the shifts of 2022, with roughly 55 percent of active equity managers underperforming their benchmarks, identical to their performance in 2021 (Exhibit 10). Clients have continued to vote with their feet: active equities experienced $130 billion of outflows in the first half of the year. In a further challenge to the industry, low performance extended to the world of fixed income, with 70 percent of assets underperforming in the first half of 2022.

Exhibit 10

Active managers' investment performance remains under pressure.

Active funds' performance by asset class, 2019–22,[1] North America, % of funds



[1]Year-to-date (YTD) results as of June 2022. Percentage of actively managed mutual funds outperforming primary prospectus benchmark. Analysis was done at the individual share class level and grouped into Morningstar Global Broad Categories.
[2]Based on the % of actively managed assets under management outperforming primary prospectus benchmark.
Source: © 2022 Morningstar. All rights reserved. The information contained herein: (1) may not be copied or distributed; and (2) is not warranted to be accurate, complete, or timely; Morningstar Active-Passive Barometer 2020

[1] Pooneh Baghai, Kevin Cho, Philipp Koch, Ju-Hon Kwek, *Crossing the horizon: North American asset management in the 2020s*, McKinsey, October 2021; Pooneh Baghai, Kevin Cho, Onur Erzan, and Ju-Hon Kwek, *North American asset management: A year of shocks but few surprises*, McKinsey, December 2020.

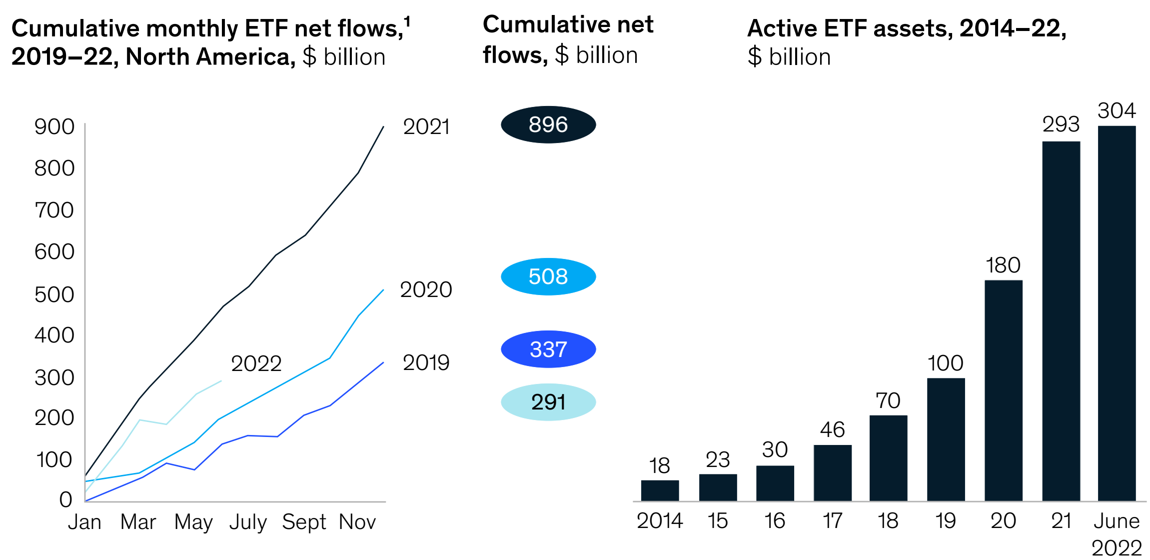
The rise and rise of exchange-traded funds

Exchange-traded funds (ETFs) set new records in 2021, with cumulative flows hitting almost $900 billion for the year (Exhibit 11). In a challenge to those who argue that ETF growth requires a risk-on environment, 2022 is proving to be another robust year, possibly the second-best on record, exceeding 2019 and 2020 results. ETF penetration continued to increase through the volatility of early 2022 as investors embraced ETFs as a tool for rapid portfolio repositioning.

A notable pattern emerged in 2022: outflows of active funds were followed by inflows in some corresponding ETFs in subsequent months, likely caused by retail investors using ETFs as a tool for tax loss harvesting. The year also marked the coming of age of the active ETF market, with record levels of new product launches and fund conversions from a diverse range of firms, increasing choice available to end clients. With more than $300 billion in AUM, active ETFs account for 5 percent of the market, represent 15 percent of flows, and suggest a promising pathway to growth for active managers.

Exhibit 11

ETF momentum has been sustained, and active ETFs are coming of age.



[1]Cumulative monthly flows for US-domiciled exchange-traded funds (ETFs). Excludes funds of funds.

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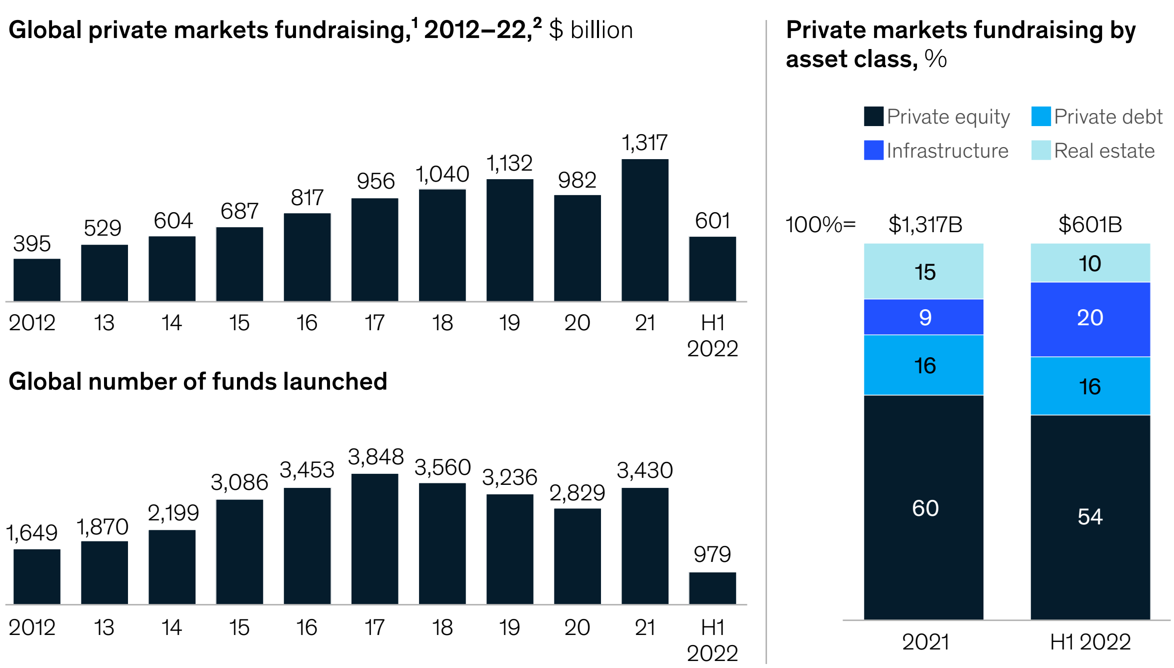
Pivot to private markets

The pivot to private markets may still be under way, but with record levels of fund-raising in 2021 and mounting macroeconomic uncertainty to date, the private markets in 2022 experienced a predictable pullback in their pace of growth. Falling values of public-market portfolios have led to saturated allocations through the denominator effect, and the slowdown of exits has reduced distributions that can be channeled toward new fund-raising. Still, the private markets have remained resilient in relative terms, with about $3 trillion of dry powder available for deployment, a stable pool of locked-in capital, and an active market for secondaries. Private-markets fund-raising through the first half of 2022 yielded a respectable $600 billion of new assets, and long-term investor demand remains robust in the face of public-markets weakness (Exhibit 12). In addition, mega private markets investment firms are continuing to invest meaningfully to further scale their platforms, in particular with the accelerated build-out of high-net-worth/retail franchises and the diversification of their capital sources with insurance-linked permanent capital.

The changed environment has caused the texture of private markets demand to shift. Investors are “getting real,” with a marked increase in demand for yield-oriented, inflation-protected, and rate-resilient strategies (for example, infrastructure, certain classes of real estate and credit) to meet the macroeconomic moment.

Exhibit 12

A pullback in private markets has been accompanied by a mix shift.



[1]Excludes secondaries, funds of funds, and co-investment vehicles to avoid double counting.
[2]YTD 2022 results as of June.
Source: Preqin

Spotlight on sustainability

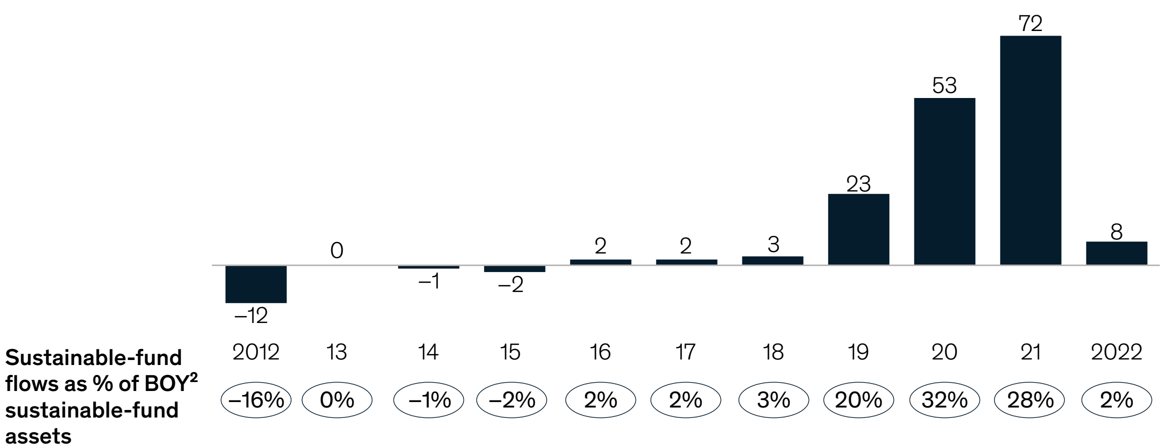
After three years of rapid growth, the market for sustainable funds in North America has reached somewhat of an interregnum (Exhibit 13). Geopolitical shocks, surging commodity prices, and rising interest rates have inverted the patterns of sectoral performance (for example, energy versus technology) that drove sustainability-related returns in prior years. In addition, rapid growth of sustainable funds has attracted both political attention and regulatory scrutiny, with several highly visible enforcement actions against alleged "greenwashing" taking place on both sides of the Atlantic and a regulatory push toward more transparent disclosures. The emergence of clearer standards and higher-quality data will ultimately be helpful for the long-term growth prospects of sustainable investing, but near-term uncertainty around rules will likely lead to a pause, at least in the regulated fund segment.

In contrast, demand for sustainable products continues unabated from some core institutional segments and asset managers. Differentiated thematic investment strategies providing exposure to decarbonization and the energy transition are finding a receptive base of clients, particularly in the private markets.

Exhibit 13

An interregnum for sustainable funds?

Net flows of total sustainable open-end funds,[1] North America, $ billion



[1]Sustainable funds based on Morningstar's label "Sustainable Investment overall," indicating an incorporation of a positive investment approach. Historic data can deviate due to reclassifications by Morningstar.
[2]Beginning-of-year.
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Expansion of portfolio solutions

In the past decade, a significant portion of the North American asset management industry has transitioned from the delivery of products designed around point exposures to the delivery of outcomes across the whole portfolio, whether in the form of multi-asset strategies, managed accounts, or advice delivered as a fee-based service. In addition, new demands of portfolio construction—including the integration of illiquid private-markets strategies at significant scale and the incorporation of environmental, social, and governance (ESG) criteria—have created new areas of client need. Demand for solutions-oriented offerings has typically spiked in times of volatility and uncertainty, and the Great Reset of 2022 will likely be no exception, creating a new set of catalysts in favor of total portfolio offerings such as model portfolios and outsourced CIO-like services (Exhibit 14). In addition, technologies related to direct indexing which allow portfolio customization at scale will extend the ability of asset managers to offer advanced portfolio solutions to smaller clients, including retail investors.

Exhibit 14

Portfolio-level solutions continued to gain traction.

Model portfolios

$4.9 trillion

Total model portfolio assets as of year-end 2021

> 18%

Average annual growth over the past 5 years

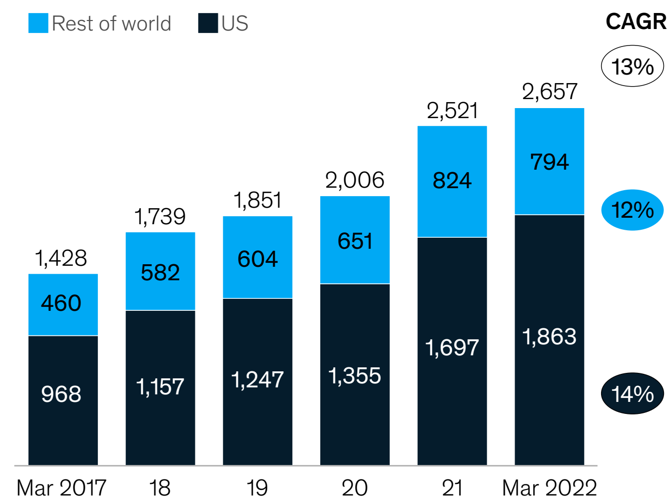
9 out of 10

Global share of advisors using model portfolios[1]

22%

Growth rate of third-party model portfolios from June 2021 to Mar 2022

OCIO[2] assets under administration globally, $ billion



[1]Based on views from 2,700 advisors surveyed globally between Mar and Apr 2022.
[2]Outsourced chief investment officer.
Source: Broadridge; Cerulli; *Morningstar Model Portfolio Landscape*; Natixis 2022 Global Survey of Financial Professionals; *Pensions & Investments*

Where do we go from here?

Current macroeconomic volatility generates significant industry uncertainty. Central banks around the world have begun an accelerated reversal of COVID-related monetary stimulus, and these actions will invariably bring a deceleration of economic growth. However, we do not know what pace, magnitude, and duration of monetary tightening will be required to curb inflation, what type of landing the real economy will suffer as growth slows, and where the wild card of geopolitics will drive commodity prices and supply chains.

To understand the longer-range impact of the Great Reset on the North American asset management industry, we have outlined three scenarios, each grounded in a historical analogy, to illustrate how the performance and health of the industry would be affected under different interest rates, inflation rates, and AUM growth rates (Exhibit 15). These scenarios are not meant as predictions per se but as examples to aid strategic planning in an environment of extreme uncertainty.

Exhibit 15

Three potential scenarios for the industry based on historical analogies.

Forecast, annualized through year-end 2026, North America

Scenario[1]	**AUM growth,** CAGR, %	**Average annual net flow,** %	**Revenues,** CAGR, %	**Equities**	**Fixed income**	**Money market**	**Alternatives**
Soft landing	7–12%	2–5%	5–10%	↑	→	→	↑
Stagnation	0–5%	–1–1%	–3–0%	↓	↑	↑	↑
Stagflation	–7–0%	–3–0%	–5–0%	↓	↓	→	↑

[1]The three scenarios are grounded in historical analogies, to illustrate how the performance and health of the industry would be affected under different interest rates, inflation rates, and AUM growth rates. These scenarios are not meant as predictions but as tools for strategic planning in an environment of extreme uncertainty.
Source: McKinsey Asset Management Practice; McKinsey Performance Lens

Scenario 1: Soft landing

In a soft landing, central banks are able to thread the needle in taming inflation while avoiding a prolonged downturn in economic growth. This scenario approximates the experience of the United States in the early 1990s, when a bout of monetary tightening was applied to a healthy economy, leading to a short-lived downturn followed by a rapid and extended bounce-back in growth. In this scenario, inflationary expectations remain tamed, and supply chain disruptions gradually normalize in the face of geopolitical tensions that are contained.

Predictably, the impact of this scenario leans positive. A stabilization of inflationary expectations and brisk economic recovery set the stage for a return to structurally low(er) rates, and thus for a reversion to a risk-on market environment with a steady flow of new capital. More stable geopolitical conditions enable growth of global trade and capital flows, widening international channels of growth for North American asset managers.

In this scenario, we expect organic growth of the industry to return to an average of 2 to 5 percent per year through 2026, with annualized revenue growth in the range of 5 to 10 percent, similar to the industry's prepandemic trend. Key beneficiaries in this flow environment include equities and growth-oriented alternative strategies, such as private equity and venture capital. Fixed income faces potential outflows in the earlier years (in response to initial monetary tightening) and a rotation of demand into rate-agnostic sensitive categories—for example, floating rate and alternative credit.

Scenario 2: Stagnation

The stagnation scenario involves aggressive tightening of monetary policy that succeeds in curbing inflation at the cost of a more protracted economic slowdown, which in turn requires a return to looser monetary conditions. These conditions are reinforced by secular trends of an aging population, which slows demand and drives down rates. Additionally, stalled globalization in capital markets mutes cross-border capital inflows. In effect, in this scenario, monetary policy overcorrects, likely curbing inflation but leading to a protracted slowdown in economic growth that might ultimately require additional fiscal stimulus to rebound.

The closest historical analogy is Japan in the 1990s, a period known as the Lost Decade. Japan at that time had experienced a nearly ten-year run-up of strong economic and capital market growth, but in the early 1990s, interest rates expanded from 2.5 percent to 6 percent, and asset valuations plummeted. The Nikkei, for example, fell by almost 70 percent over the ensuing decade. While policy makers quickly responded by lowering rates to near 0 percent, the country could not sustain the economic growth of the 1980s; instead, GDP growth averaged 1 percent annually with side effects of workforce wage depression creeping in throughout the 1990s.

In this environment, we expect low to no organic growth and a strong rotation toward income- and yield-generating assets. Private-market alternatives (particularly real assets) continue to be in high demand in this scenario, as investors seek to tap idiosyncratic risk and liquidity as a source of return enhancement in the face of depressed public-market valuations. In a stagnation scenario, money market funds would capture more than their fair share of flows as capital remains on the sidelines and investors seek yield over and above what is available from deposits. Multi-asset strategies could also benefit as investors seek to outsource asset allocation and look for creative sources of yield.

Scenario 3: Stagflation

The final scenario, stagflation, describes a world where inflationary expectations remain stubbornly above central banks' targets, reinforced by continued geopolitical tensions and their impact on commodity prices and supply chains. These conditions require central banks to continue ratcheting up interest rates over an extended period, resulting in slow-to-negative economic growth. The closest historical analogy here is the United States in the 1970s, when a confluence of factors, including a supply shock from the OPEC embargo, high budget deficits, and negative real interest rates, resulted in a boom in commodities prices, a spike in inflation that exceeded 10 percent, and unemployment levels that doubled to over 9 percent.

In this scenario, inflation remains stubborn, and high interest rates induce a sustained multiyear recession and significant downward pressure on the valuations of risky assets, leading to a protracted period of industry outflows, to the tune of –2 to –3 percent per year. A combination of depressed markets and outflows has a large effect on revenue pools: a 10 to 15 percent decline over the ensuing three to five years. However, the velocity of the decline in revenues would be somewhat offset by a rise in demand for higher-fee alternative strategies like commodities, real assets, and private markets. The impact of such a scenario on asset managers would likely result in a period of restructuring and consolidation within the industry.

Managing uncertainty with an ‘all-weather’ agenda

Given the potential industry scenarios, any of which carries a strong likelihood of volatility, how should asset managers seek to position themselves if they want to thrive amid an extended period of uncertainty? Our answer involves building an all-weather asset management platform that combines the attributes of flexibility, stability, and scalability—qualities required to deepen client relevance, deliver distinctive investment value, and grow with a high degree of operating leverage. Each asset manager’s all-weather blueprint will be unique, but each will have a similar set of core building blocks (Exhibit 16).

Exhibit 16

Building the ‘all-weather’ asset manager.

Strategic client partnerships

Account planning

Platform engagement

Customer success

Components

- Diversified alpha
- Alternative beta
- Thematic investing
- Efficient vehicles
- Tactical overlays

Portfolio solutions

- Inflation protection
- Income and yield
- Downside protection
- Liquidity
- Sustainability (eg, net-zero emissions)

Customization

- Model portfolios
- Values-based investing
- Tax efficiency
- Digital tools
- Monitoring and management

Scalable operating platform

- Single source of truth on data
- Streamlined technology chassis
- Analytics-enabled business processes
- End-to-end automation

Flexible capital

- Patient/permanent capital pools
- Zero-based capital reallocation
- Agility through M&As, joint ventures, and partnerships

Source: McKinsey Asset Management Practice

In the near term, we recommend a six-point agenda for North American asset managers to follow as they navigate the extreme uncertainty that lies ahead in the next 12 months:

1. *Strategic client engagement.* Market dislocations open a unique window of opportunity for deepening client relationships and positioning a firm as partner rather than provider. This opportunity requires new levels of discipline in strategic account planning and proactive outreach to a firm's top clients.

2. *Future-proofing the investment and product platform.* The Great Reset has created a volatile brew of market conditions that are new even to seasoned investors. To adapt to this new reality, investment teams will need to recalibrate their investment processes and approaches to risk management. Market dislocations also create opportunities for innovation—in particular, building the next generation of solutions targeted at new client needs, such as inflation protection, portfolio diversification, and liability management.

3. *Next-generation distribution.* Successful client engagement amid the uncertainty of 2022 requires the ability to move with both pace and scale. This is where new approaches to distribution—hybrid sales practices powered by technology, team-based client engagement models that deliver expertise, and data- and digital-driven sales enablement that facilitates both targeting and customization—will pay dividends. The disruption in talent markets, especially in the technology sector, creates opportunities for bringing in new types of talent, particularly in digital distribution.

4. *Resource reallocation.* Asset managers who strengthened their competitive positions in previous downturns typically embraced a through-the-cycle approach to investing in strategic growth priorities. The current environment requires a zero-based approach to resource allocation that re-underwrites and ring-fences growth investments and reins in the undisciplined pursuit of more.

5. *Boldness on structural costs.* Disciplined cost management is an inevitable part of resilience planning and a key lever for creating the degrees of freedom required to take advantage of dislocations created by a rapidly changing external environment. Near-term cost controls are important but can only go so far. Asset managers willing to take a bolder approach to structural costs—one that involves a more fundamental reengineering of their operating models, often enabled by technology—will be able to unlock a far deeper pool of resources while building enhanced scalability that will serve as a source of advantage in a recovery.

6. *Repositioning of the franchise.* Asset managers will need to maintain, if not accelerate, the repositioning of their franchises to benefit from the major industry trends that remain consistent amid the Great Reset—such as those toward private markets, new vehicles, and portfolio solutions. Uncertain environments typically unlock new possibilities for opportunistic M&A, talent/team lift-outs, and partnerships that can help accelerate these critical transformations.

The Great Reset is shifting the foundational macroeconomic assumptions of the last decade—effectively a phase shift in the rules that have underpinned the business of asset management over the past decade. These fundamental shifts will require more rapid restructuring and reinvention of North American asset management and could lead to radical shifts in the competitive landscape. But in times of significant change, opportunity abounds. Clients are facing once-in-a-generation challenges and are looking for true asset partners—not merely providers—to help them navigate the uncertain times ahead.

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