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Jamie Stewart's Perspective on Research

Jamie Stewart, Head of Independent Research at London-based Marex Spectron, plans to retire next year. Since he has worked in the research industry for three decades, we thought it would be instructive to get Stewart's perspective on the state of the research industry, its past and future. We know him to be an astute and articulate observer of the research scene. What follows is an imperfect transcription of our conversation—the Americanisms are ours.

Background

Stewart runs Marex Independent Research Services, which acts as consultant and intermediary between fund managers and independent research firms. MIRS has an estimated 500 to 600 active relationships with independent research firms and serves mostly hedge fund clients. Stewart, who ran Instinet's independent research distribution operation from 1999 to 2002, has successfully kept the core of the original Instinet formula alive in his subsequent roles.

Stewart, who turns 63 next month, plans to hand over responsibilities at the start of December, and remain available on a consultancy basis until April.

Stewart has worked in a specialist capacity in independent research for 15 years, first at Instinet and then at Eden Financial, which sold its global markets division to Marex Spectron in 2011. Before that, he spent 15 years working in global equities at various sell-side firms including Hill Samuel Wood Mackenzie, Barings and Morgan Grenfell.

Over his career he has been a research analyst, an institutional salesperson, a banker, and he has worked on syndicate desks and on trading desks. He has experience in European equities, Latin American equities, Eastern European equities and emerging markets.

Given Stewart's broad background, we recently caught up with him to get his views on the research industry. The following is a rough rendition of our discussion.

Growth of Independent Research in London

Independent research originated in the U.S. and for many early years there was none in London. Lombard Street Research, founded in 1989, was one of the first.

In Stewart's view, there were two driving forces behind the growth of independent research in London. A recognition that investment banks increasingly represented conflicted interests created a natural force seeking independent research while at the same time investment banks were encountering some resistance in the form of increased regulatory and compliance restrictions on their own in-house traditional research.

As a consequence, high-achieving, good-quality analysts left the investment banks and went independent. Over time, there has been a growing age-gap. Analysts who have moved out of banks have tended to be more seasoned while the bank analysts have continued to represent a more junior age-range.

According to Stewart, hedge funds have been instrumental in supporting independent research. As the hedge fund community grew in London during the 1990's, so did the appetite for independent research. Hedge funds value ideas which are contrarian, minoritarian and as close as possible to unique. Independent research firms tend to serve 20 to 40 clients rather than 2,000 to 4,000 clients, and are therefore better able to handle exclusivity and client-servicing.

The current environment

There has been a wave of creativity in independent research over the last 10 years, but nothing remains stable. We are now in a consolidation phase where only the fittest will survive.

Raising capital has become harder for asset managers. There are three success factors in terms of increasing assets under management for asset managers: 1) raising new capital; 2) making correct calls to grow capital invested; and 3) doing well enough to keep clients from redeeming funds, as often as not to transfer those assets elsewhere.

Given global deleveraging, there is decreasing free capital available for investment. When you look at it, there has been relatively little new capital invested. Mostly assets are being recycled from asset manager to asset manager.

This is putting pressure on the buy-side houses. Asset managers are looking more critically at independent research consumption. Do we need to have 20 different independent research firms? Can we still afford to pay forty thousand for a subscription? And don't forget the value added tax often charged in respect of independent research, which is an important negative for independent research.

Regulatory scrutiny of commissions

At the same time in the UK there is regulatory scrutiny of commission payments for research. Why is this? The simple answer is because of ethical and transparency concerns. Less well understood are the political pressures. The impetus is to protect the consumer wallet from extraneous costs such as spending commissions on research, unless it results in investments that perform better. There is less money in pensions and in savings and this must be preserved from extraneous costs.

The assiduity of UK regulators is in contrast to the US where regulation comes in fits and starts. US regulators tend to react to events. The UK regulators have developed a slightly more puritanical approach, the FCA moving ahead of the FSA's 'principles-based' regime of past years in this respect and tightening from day to day with the target of reducing the risk to zero.

Looking into the crystal ball

There are two major factors that will determine the future research landscape.

Investment banks are built around their core corporate advisory businesses. Looking forward, to what extent will corporate activity, which is so critical to investment bank growth and profitability, recover from the depressed levels since the crisis? It is difficult to say. The last six years have seen major changes in the financial health of corporate balance sheets. Companies no longer feel compelled to do transactions. If this persists, investment banks will find it difficult to grow and sell-side research will continue to languish.

The other major factor impacting research is the global deleveraging since the financial crisis. Debt /asset ratios globally may never get back to where they were before they gave way in 2005 and 2006. We may have another ten years – perhaps at least – of deleveraging, which will continue to exert pressures, albeit indirect, on asset managers. Buy-side internal analysts will become more of a luxury. Big houses such as Fidelity or Templeton will be able to afford them but the smaller houses will not.

So we may have an environment where there is less cross-subsidization within investment banks which will restrict growth in research departments, and fewer buy-side analysts. Although this means less external competition for independent research analysts, there will be competition among such independent providers. There will be survival of the fittest and more polarization: there will be fewer, stronger research firms.

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