The Boutique Premium
The Boutique Advantage in Generating Alpha
Executive Summary

Boutique active investment managers have outperformed both non-boutique peers and indices over the last 20 years.

While the debate over the value of active investment management has intensified in recent years, the outperformance of boutique managers has been overlooked. In an update of our proprietary study covering nearly 5,000 institutional equity strategies from 3/31/98 to 3/31/18, AMG has examined the performance of boutiques. Since our initial analysis in 2015, our study again demonstrates that:

- **Boutiques significantly outperformed non-boutiques in institutional equity categories**

Figure 1: Boutique Outperformance vs. Non-Boutiques: Boutiques Outperformed by an Average Annual 62 bps

![Average Annual Outperformance = 62 bps](image)

Source: MercerInsight® database utilized for return data.

- **Investing exclusively with boutiques would have created 16% greater wealth over 20 years**

Figure 2: Boutique Wealth Creation: Investing Exclusively With Boutiques Would Have Created 16% Greater Wealth

![Average 20-Year Excess Wealth Creation (Boutiques vs. Non-Boutiques) = 16%](image)

Source: MercerInsight® database utilized for return data.

- **Boutiques also generated substantial net excess returns versus indices**

Figure 3: Boutique Excess Returns: Boutiques Delivered 135 bps Average Annual Net Excess Returns vs. Indices

![Average Rolling 1-Year Index Return (1998-2018)](image)

Source: AMG proprietary analysis and classification of firms and strategies. Firms represented include AMG Affiliates. MercerInsight MPA™ database utilized for return data. AMG estimated net returns by taking one-year rolling gross returns for institutional strategies from 3/31/1998 to 3/31/2018 less estimated average boutique fee rates based on available data for each product category.

The Boutique Advantage

Sophisticated investors around the world are increasingly recognizing the ability of focused boutique active investment managers to outperform both non-boutique peers and indices. We believe that several core characteristics of boutiques position them to consistently outperform in return-seeking asset classes (active equities and alternatives), including:

- **Principals have significant direct equity ownership, ensuring alignment of interests with clients**
- **Presence of a multi-generational management team, fully engaged across the business**
- **Entrepreneurial culture with partnership orientation, which attracts talented investors**
- **Investment-centric organizational alignment, including careful management of capacity**
- **Principals are committed to building an enduring franchise, embedding an appropriately long-term orientation**
Seven Key Insights
(detailed analysis beginning on page 6)

1. Boutiques broadly outperformed non-boutiques

2. Top-performing boutiques added more value for clients than bottom-performing boutiques detracted

3. Boutiques created significant value versus indices

4. Top-performing boutiques generated exceptional excess returns versus indices

5. Boutique strategies, on average, had a high frequency of outperforming indices

6. Individual boutique strategies outperformed indices more often than not

7. Boutique outperformance versus indices was persistent
Primary Data Sources

The MercerInsight® global database was the primary source utilized for return data in our analysis, given its deep pool of performance data for institutional equity strategies offered by investment managers around the world.

Classification of individual investment managers (and their corresponding investment strategies in the MercerInsight® database) as either “boutiques” or “non-boutiques” was based entirely on AMG’s proprietary analysis, utilizing the SEC database and individual manager disclosures for background information on ownership structure, scope of business, and level of assets under management (“AUM”).

Scope and Process of Analysis

Our analysis incorporated more than 1,300 individual investment management firms around the world and nearly 5,000 institutional equity strategies comprising approximately $7 trillion in AUM. We analyzed rolling one-year returns for the trailing 20-year period ending 3/31/18, across 11 different investment product categories, on a strategy-by-strategy basis. More specific details regarding the data set behind our analysis are as follows:

- **11 investment product categories**: our analysis spanned the 11 broadest institutional equity product categories, as defined by Mercer:
  - Emerging Markets Equity
  - Global Equity
  - U.S. Large Cap Value Equity
  - U.S. Large Cap Growth Equity
  - U.S. Large Cap Core Equity
  - U.S. Mid Cap Value Equity
  - U.S. Mid Cap Growth Equity
  - U.S. Mid Cap Core Equity
  - U.S. Small Cap Value Equity
  - U.S. Small Cap Growth Equity
  - U.S. Small Cap Core Equity

- **Return-focused**: returns were the primary measure of boutique manager value creation utilized in our analysis. Gross returns, a primary metric reported by investment managers within the MercerInsight® database, were utilized for comparing boutique returns relative to non-boutique returns, given the minimal disparity of fee rates between boutique and non-boutique strategies. Meanwhile, we estimated net excess returns versus indices – incorporating boutiques’ available published or “rack” fee rates entered by investment managers in MercerInsight® – in order to approximate net value creation for investors.

- **Trailing 20-year time horizon**: our analysis is based on rolling one-year returns over trailing 20 years ending 3/31/18 (i.e., 20 individual measurements of 12 month periods ending 3/31 in each year 1999-2018). The rolling one-year focus ultimately yielded a larger sample size than rolling three- or five-year returns.

- **Equal-weighted basis**: importantly, our analysis represents a measure of performance by strategy, instead of performance by manager. In order to avoid bias to any one investment strategy, each individual strategy was given an equal weighting when aggregating results for each product category. Duplicate strategies (typically sub-advisory) were excluded from our analysis in order to avoid excessive weighting to any single strategy by double counting, although this had minimal impact on the results given the small number of duplicates broadly observed.

- **Accounting for survivorship bias**: our analysis captured each individual strategy reporting gross returns to MercerInsight® in all 11 product categories at any point during the trailing 20-year period, including deleted strategies (strategies and/or managers no longer in existence, or no longer providing data to Mercer). Thus, we minimize the impact of survivorship bias.
Classification of Boutique And Non-Boutique Investment Managers

Our proprietary classification of over 1,300 individual investment managers and their corresponding investment strategies in the MercerInsight® database as either “boutiques” or “non-boutiques” (Figure 4) was an integral component of the analysis. Boutiques ultimately accounted for 66% of the investment managers, but just 44% of the investment strategies captured in our data set.

Investment managers – and their corresponding strategies – were classified as boutiques in our analysis only if they fit each of the following four specific criteria:

1) **Significant principal ownership:** determined by whether principals held a significant amount of equity in their own firm, defined as a minimum of 10%. The 10% threshold was set to both exclude firms whose principals have received small amounts of equity as part of their annual compensation and to align with a cut-off point in the SEC database (individuals or entities with ownership below 10% appear as either “NA” or “A” in the SEC database). However, principals at the vast majority of boutique investment managers held a significant minority, majority, or 100% of their firms’ equity.

2) **Investment management is sole business:** investment managers exclusively focused on investing were the only firms eligible to be classified as boutiques in our analysis. This effectively excluded managers that were part of broader financial services platforms, including banks, life insurers, and wealth managers providing a broad suite of advice-based services.

3) **Manage less than $100 billion in AUM:** investment managers with over $100 billion in AUM were excluded from being classified as boutiques. While some investment managers with over $100 billion in AUM could certainly be considered boutiques, the purpose of this criterion was to increase the objectivity of the analysis while simultaneously eliminating certain firms that have accumulated large levels of AUM by offering a wide variety of products across various asset classes, styles, and geographic regions.

4) **Not exclusively smart beta or fund-of-funds:** managers exclusively offering smart beta or fund-of-funds platforms were removed from consideration as boutiques. Instead, the firms classified as boutiques in our analysis included active managers with teams focused on adding value through distinct investment philosophies and highly focused investment processes.

**Figure 4: Classification of Investment Managers:**
66% Boutiques, 34% Non-Boutiques

Source: AMG proprietary classification of investment managers in the MercerInsight® database.
Have Boutiques Added Value For Clients?

Our analysis of institutional equity strategy returns for the trailing 20-year period provides strong evidence that active boutique investment managers generated significant value for clients, both relative to non-boutique managers and to indices. The data also demonstrates that top-performing boutique strategies created tremendous value for clients; that the majority of boutique strategies outperformed indices on a net basis; and that boutique outperformance was persistent. Seven key insights from our analysis are outlined below.

1. Boutiques broadly outperformed non-boutiques

Over the past 20 years, the average boutique strategy outperformed the average non-boutique strategy in 10 out of 11 product categories examined, by an annual average 62 bps across all categories (Figure 7). Boutique outperformance was most significant in U.S. Small Cap Value Equity (+162 bps) and Emerging Markets Equity (+108 bps annually) strategies.

2. Top-performing boutiques added more value for clients than bottom-performing boutiques detracted

Our analysis demonstrates that top-decile and top-quartile boutique strategies outperformed their non-boutique counterparts by a wide margin (average annual 276 bps and 171 bps, respectively). However, just as notable was the fact that bottom-quartile and bottom-decile boutique strategies lagged their non-boutique counterparts by a much narrower margin (-65 bps and -119 bps, respectively). This suggests that any outsized boutique risk-taking didn’t necessarily result in excessive downside for bottom performers relative to non-boutique bottom performers.

3. Boutiques created significant value versus indices

In sharp contrast to industry reports finding that a significant majority of active managers have underperformed benchmarks, our analysis determined that boutique institutional equity strategies delivered significant net excess returns relative to indices over the trailing 20-year period. Across the 11 product categories examined, boutique net returns outpaced primary indices by an average annual 135 bps. In fact, the average boutique strategy outperformed its primary index net of fees—in 11 out of 11 product categories.
4. Top-performing boutiques generated exceptional excess returns versus indices

Our analysis also demonstrates that the top-performing boutique strategies added tremendous value relative to indices net of fees. Top-decile boutique strategies added an average annual 1,130 bps versus primary indices, while top-quartile boutiques added an average annual 581 bps (Figure 10). Similar to our analysis of average boutique outperformance, top-decile boutique outperformance was most pronounced in Emerging Markets Equity, Global Equity, and U.S. Small Cap Equity. Meanwhile, despite more modest levels of outperformance for average boutique strategies in the U.S. Large Cap Equity and U.S. Mid Cap Equity categories, the top performers generated significant excess returns.

5. Boutique strategies, on average, had a high frequency of outperforming indices

Across all product categories examined, the average boutique strategy outpaced its primary index 57% of the time over the trailing 20-year period net of fees. In addition, the average boutique strategy beat its primary index at least half of the 20 one-year rolling periods in 7 out of 11 product categories.

6. Individual boutique strategies outperformed indices more often than not

We also found that at least half of the boutique strategies in our data sample beat their primary indices net of fees in 8 out of 11 product categories (Figure 12). The proportion of boutiques outperforming indices was particularly high in the Emerging Markets Equity, and U.S. Small Cap Equity categories. Across all 11 product categories, on average, approximately 52% of boutique strategies beat their primary indices net of fees. This highlights the power of boutiques in creating substantial value, despite recent industry reports suggesting that a significant majority of active managers have underperformed indices.

Figure 12: Proportion of Boutiques Beating Indices:
At least 50% Beat Indices in 8 out of 11 Product Categories

7. Boutique outperformance versus indices was persistent

For the purpose of measuring the persistency of boutique net excess returns, we examined the percentage of boutiques beating the index in a year following one in which they outperformed. The results reflect favorably on boutique managers, as their strategies beat indices 54% of the time in years following one in which they outperformed (Figure 13). Further, boutique outperformance persistency was at least 50% in 10 out of 11 product categories.

Figure 13: Boutique Outperformance Persistency: Beat Indices 54% of the Time after Outperforming Previous Year

Entrepreneurial culture with a partnership orientation: key partners manage the daily operations of a boutique and are actively involved in business planning and building an enduring franchise. We believe talented investors are more likely to be drawn to boutiques that offer an entrepreneurial culture and allow them to have a direct impact on the future success of their business.

- **Investment-centric organizational alignment:** a boutique has an investment-centric organizational alignment, typically geared to a distinct investment philosophy (e.g., value-oriented with strong focus on purchasing securities below their intrinsic value) with a highly focused investment process (e.g., bottom-up stock picking). These investment considerations have primacy at a boutique, which we believe is more likely to manage towards optimal risk-adjusted returns, often setting capacity limits to remain nimble in its investment approach.

- **Commitment to building an enduring franchise:** key principals of the most successful boutique firms are committed to the long-term growth and success of the firm; in AMG’s experience, this quality is often signaled by principals’ willingness to sign multi-year employment agreements. A stable, long-term environment is ideal for generating investment success, and a group of principals bound together by long-term equity is well positioned to deliver this success.

**Figure 14: Boutique Model: Core Characteristics Giving Boutiques an Advantage in Generating Alpha**

- **Alignment of interests:** direct equity ownership ensures that key principals have a vested interest in the long-term success of a boutique. Many of the most talented investment professionals in the world are drawn to the boutique structure, where the incentive system allows them to own the results of their investment performance.

- **Multi-generational management:** the presence of a multi-generational management team, including a succession plan, is another core element of a boutique. This ensures that key principals will continue to remain motivated and highly involved in business development.

**Our Conclusion:**

*Core Boutique Characteristics Position Them Well To Add Value for Clients*

Analysis Reflects Favorably On Boutique Investment Managers

While a considerable amount of research has focused on the perennial active versus passive debate, our analysis focuses on an important industry subset – active boutique investment managers. Our analysis again illustrates that boutiques have outperformed non-boutique peers and delivered, on average, significant net excess returns versus indices over the long term. It also indicates that top boutiques generate significant alpha and that the strongest boutique outperformance came in the Emerging Markets Equity, and U.S. Small Cap Equity categories.

**The Boutique Advantage**

Sophisticated investors around the world are increasingly recognizing the ability of focused boutique active investment managers to outperform both non-boutique peers and indices. Many of these investors follow a barbell strategy, in which they complement their core passive exposures with allocations to active equity and alternative strategies managed by boutiques. We believe core characteristics that position boutiques well to consistently outperform in return-seeking asset classes include:

- **Alignment of interests:** direct equity ownership ensures that key principals have a vested interest in the long-term success of a boutique. Many of the most talented investment professionals in the world are drawn to the boutique structure, where the incentive system allows them to own the results of their investment performance.

- **Multi-generational management:** the presence of a multi-generational management team, including a succession plan, is another core element of a boutique. This ensures that key principals will continue to remain motivated and highly involved in business development.
### Figure 15: Boutique Strategies vs. Non-Boutique Strategies: Average Annual Outperformance

<table>
<thead>
<tr>
<th>Top 10%</th>
<th>Top 25%</th>
<th>Average</th>
<th>Median</th>
<th>Bottom 25%</th>
<th>Bottom 10%</th>
<th>Percentage of Years Outperforming</th>
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<tr>
<td>Top 10% Boutique</td>
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<td>108</td>
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<td>Top 25% Boutique</td>
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<td>(134)</td>
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<td>U.S. Mid Cap Core Equity</td>
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<td>47</td>
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<td>236</td>
<td>68</td>
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<tr>
<td>Mean</td>
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<td>171</td>
<td>62</td>
<td>48</td>
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<tr>
<td>Median</td>
<td>268</td>
<td>148</td>
<td>56</td>
<td>37</td>
<td>(63)</td>
<td>(134)</td>
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</tbody>
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### Figure 16: Boutique Strategies vs. Indices: Average Annual Net Excess Returns

<table>
<thead>
<tr>
<th>Top 10%</th>
<th>Top 25%</th>
<th>Average</th>
<th>Median</th>
<th>Bottom 25%</th>
<th>Bottom 10%</th>
<th>Percentage of Avg. Boutique Beating Index</th>
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