How will technology change investment landscape going forward?

BY Yaelie Gang | June 16, 2020

While technological change is accelerating at a rapid rate, the financial system isn’t keeping pace, says Campbell Harvey, professor of finance at Duke University’s Fuqua School of Business.

Traditional systems make it difficult for those trying to raise capital or invest. Yet new technology is coming to market that can resolve many barriers and dramatically shift the financial landscape, says Harvey, noting it will allow people to invest in a decentralized way.

Financial technology will also replace middle layers with lower fee alternatives, many of which are fueled by algorithms, he adds.

Large banks understand what’s coming, but it’s difficult to act. “So somebody makes a presentation to the bank board saying, ‘Hey, we should do this.’ And the board members say, ‘Well, you’re saying we should spend all this money to basically cannibalize our business and make a lot less money?’ That’s a really tough sell.”

There will also be a shakeout in asset management, Harvey says, where having access to better data and the ability to interpret that data will be a key competitive edge.

Pension funds that use external managers should be asking questions about how many full-time equivalents those managers have on machine-learning teams. “And that answer better be more than one,” he says. “And if it’s zero, that’s potentially enough to walk away.”

But while fintech will be disruptive, it will also have very positive outcomes like reducing costs, which is the easiest way to create alpha, Harvey says.

Indeed, the reduction of costs generates positive alpha. “It’s often the case [that] you work really hard, you’ve got some forecasts, you’re able to do better than your benchmark, but that is just eaten up with cost. So it looks like you just meet the benchmark or maybe even underperform.”

The reduction in costs is very positive for pension funds in the long term. “If you think you can reduce costs by 50 basis points a year, you can do the math for somebody actually joining this pension, expecting to have some sort of value in 40 years — with compounding, that is huge.”

Fintech will also lead to the emergence of new types of assets, he adds. For example, traditional and non-traditional assets can be tokenized so pension funds can participate in these potentially attractive investment opportunities. “Some very large pension plans have the luxury of investing in things like infrastructure around the world, but many smaller pensions don’t have the scale to take bets like that.”
With fintech, these projects will be tokenized so small and large pension funds — and even potentially retail investors — will be able to invest, adds Harvey.

There may also be a tokenization of equity in certain companies, so anyone can participate, not just high-net-worth individuals. "The crowdfunding mechanisms — the tokenization of equity — is going to bring a lot more democracy to our investments so that anybody can participate and the fees are very modest to actually do that. Today, the fees are so large that it just isn't worth it for a lot of people."

While the world today is much more global than it used to be, there has been push back against globalization, which is in part due to the unequal sharing of its benefits, he says. "This push back may gain further steam with the aftermath of the COVID-19 crisis."

And many people may think globalization is at its end point, which isn’t the case, as many opportunities have yet to be unlocked in developing markets. Technology will allow 1.7 billion people to join the modern world and access financial services, notes Harvey. "This basically offers explosive growth opportunities as these countries go from developing to developed and also an unprecedented [surge] of human capital."

Campbell Harvey will be the keynote speaker at the Global Investment Conference on September 15-17 in Muskoka, ON. For more information on how you can attend, please contact Alison.Webb@tc.tcc.

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