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Change in the Industry: A Sea of Challenges and Waves of Opportunities
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Preface

The magnitude of change in the institutional investment industry continues to accelerate, creating a sea of challenges and waves of opportunities for investors, consultants and investment managers alike. In 1980, total pension assets were less than $1 trillion. Today, one firm alone manages over $2 trillion dollars and at least seven firms manage in excess of $1 trillion each.

▪ **UBS AG Zurich**	**$2.4 T**
▪ **Barclay Global Investors**	**$1.8 T**
▪ **State Street Global Advisors**	**$1.8 T**
▪ **Merrill Lynch**	**$1.6 T**
▪ **Blackrock**	**$1.1 T**
▪ **Fidelity Investments**	**$1.2 T**
▪ **Vanguard**	**$1.1 T**
▪ **JP Morgan**	**$1.0 T**

Source: Nelson Marketplace, data as of December 31, 2006

Today's institutional investors face an increasingly complex task in managing their investment programs, achieving risk/return objectives, and meeting their actuarial assumptions or payout and income needs. Investment managers face escalating costs of doing business, fierce competition, deeper scrutiny and cumbersome regulatory requirements. They also benefit from new asset allocation tools, an abundance of innovative investment instruments, breakthroughs from academia, technology and mathematical science, and globalization. It is a whole new world we all face.

Our article is a random walk through seven major changes that are literally transforming our industry as we write.

- **Restructuring of Investment Plans – *Out with the Old; In with the New***
- **Evolving Investor Skills and Preferences – *The March to Higher Ground***
- **Globalization – *Expanding Competition and Broader Opportunity Set***
- **Specialization in Professionals' Roles – *Creating Barriers to Entry and Opportunities for Growth***
- **Advances in Technologies and Systems – "*Penny-Wise or Pound-Foolish?"***
- **Proliferation of Consultants and Their Changing Roles – *Gatekeeper, Competitor…Friend or Foe?***
- **Distribution Opportunities – *"Two roads diverged in a wood, and I took the one less traveled by, and that has made all the difference" ~ Robert Frost***

Our observations and discussion will be a history lesson for those of you early in your investment careers, and a walk down memory lane for you who are industry veterans. For all of you, we hope it will be instructive in what to consider in positioning an investment management firm for success in the future.

"It is not the strongest of the species that survives, nor the one most intelligent, but the one most responsive to change."
~ Charles Darwin

Restructuring of Investment Plans – *Out with the Old; In with the New*
Perhaps the most profound change in the last decade has been the redistribution of retirement assets. Defined contribution and the growing pool of Individual Retirement Accounts (IRAs) and employer-sponsored defined contribution plan assets have overtaken defined benefit plans, which ruled the institutional investment arena for decades. Total retirement assets were $16.4 trillion at year-end 2006, up 11.6 percent from 2005. IRAs and DC plans are the largest components, representing $4.2 trillion and $4.1 trillion, respectively, at year-end 2006. The total financial assets in private pension funds' defined contribution plans were $3.3 trillion in 2006, and the total financial assets in private defined benefit plans were $2.3 trillion (*Source: Federal Reserve).* In 2005, IRA assets experienced their third consecutive year of growth reaching $3.67 trillion. The 2006 number is expected to come out in May, but is estimated to top $4 trillion (*Source: EBRI).*

While many have predicted the demise of defined benefit plans, a sizeable asset pool of 2.3 trillion in 2006, remains, and some even forecast modest future growth. Defined contribution and IRA assets are projected to win the future asset growth race by a wide margin. (*Source: www.icifactbook.org, Investment Company Institute, 2007 Investment Company Fact Book, Released May 7, 2007)*

Projected Growth of Retirement Market Assets ($Billions)

Year	Retirement Markets		
	Defined Contribution Plans	IRA	Defined Benefit Plans
2004	$3,245	$3,458	$2,022
2005	$3,461	$3,778	$2,117
2006	$3,623	$4,127	$2,221
2007	$3,951	$4,580	$2,334
2008	$4,211	$4,952	$2,465
2009	$4,485	$5,480	$2,581
2010	$4,756	$5,941	$2,735
CAGR 2006 – 2010	7%	9%	5%

Source: FRC

The transition of the ultimate investment decision from defined benefit plan sponsors into the hands of defined contribution (DC) plan participants has slowly led to a whole new set of investment solutions and challenges. With defined benefit plans, employers make all the investment decisions – from investment policy, to asset allocation to manager selection and termination – frequently with guidance from consultants expert in investment policy and manager research.

Initially, oversight of the DC plan was often the responsibility of the company's HR professionals. Bundled providers who could offer plan administration, investments and participant communications were favored. DC investment offerings commonly included company stock, "safe" capital preservation vehicles such as money market funds or stable value funds (often as defaults), and some traditional equity and fixed income options. Little attention was paid to investment policy or specific asset allocations. The growth of the investment option-only business expanded the number and breadth of investment options for DC participants, which became overwhelming in many cases.

Today, DC plans offer participants an average of 16 different investment options. Participants make their own asset allocation decisions and manager selections from a menu of available options. Employers walk a fine line between educating their employees and giving advice out of fear of lawsuits if the employee falls short at retirement. Results have been murky. No surprise.

The 2006 Pension Protection Act (PPA) contains provisions that will affect the entire retirement system including defined contribution, defined benefit, hybrid plans and IRAs. For defined contribution plans in particular, the PPA is seeking to create a more reliable way for DC participants to accumulate retirement assets. As many as 30% of individuals who are eligible for 401(k) plans do not invest in them. The 70% of individuals who do invest in 401(k) plans have not fared well overall due to poor asset allocation decisions, market timing, cash flows and lack of access to the diversity of investment opportunities available to defined benefit plans due to the need for daily valuation and liquidity.

The PPA offers 404(c) protection for qualified default investment alternatives (QDIAs) that can be used with automatic enrollment. The PPA's new criteria for QDIAs are that they must provide capital appreciation as well as capital preservation. If the new Department of Labor guidelines are adopted, there will be a rapid and dramatic shift of plan assets from capital preservation funds to target-date funds, balanced funds, and managed accounts. The Department of Labor's draft guidelines for QDIAs require that default options must be a target-date fund, a balanced target-risk fund or a managed account to qualify for safe harbor protection. The new guidelines exclude stable value and money market funds from QDIAs.

Target-risk and target-date funds, also commonly known as lifecycle or lifestyle funds, are attracting significant assets, and are the fastest-growing mutual fund category with $180 billion in AUM, and projected to grow to $400 billion by the end of 2009. If the new DOL guidelines are adopted, the shift of plan assets from capital preservation funds to target-date funds, balanced funds and managed accounts will be accelerated and dramatic. This shift will create significant asset growth opportunities for managers with both core and specialty strategies. Many target-date funds will make greater use of specialty strategies such as emerging markets, REITs, high yield securities, TIPS, and even hedge funds. Since these strategies are rarely used as stand-alone investment options in defined contribution plans, managers of these strategies who previously stood on the sidelines, can position themselves to participate in the target-date funds embracing the diversification benefits of these strategies. In addition, new features and product innovations will increase the demand for these products beyond 401(k) plans.

Changes at the plan and investment program level are not limited to migration from defined benefit plans to defined contribution plans. Public plans, endowments and foundations, and union plans are all undergoing enormous change and pressures. Defined benefit plan sponsors are grappling with actuarial assumptions, matching assets and liabilities, asset allocations, rebalancing, too much money chasing too few alpha opportunities, education of new board and committee members, and political pressures. Questions on plan sponsors' minds include: can their active managers achieve their investment objectives, or should they move more to quantitative and indexing strategies to save costs and achieve consistency, predictability and transparency? Should they go into alternatives, or is it too late, too risky? Are they doing the best job of allocating the investments they already have? How frequently should they be adjusting the asset allocations? How can the plans get more returns?

How can the investors become better educated to make smart investment decisions, select the best managers, and successfully oversee investment programs that will fulfill their investment promises?

The endowment and foundation investors, perceived by many as the leading edge investors, really fall into at least two camps – both of which have their own demanding challenges. High profile mega endowments and foundations gained attention for their early advance into alternatives to capture high returns. But as defined benefit plans and other institutional investors follow their lead, eleemosynary investors are pushed to find the next great waves of alpha…a feat not easily accomplished with the large assets under management at these giants. At the same time, there are hundreds of mid-sized and smaller endowments and foundations left out of their larger brethren's joyful exploitation of alternative investment strategies. They too need cost-efficient investment solutions that can reliably fulfill their needs.

Other important influences at the investment program level are:

- Sensitivity to the political environment, both for and against benefits. Will the public entities be able to fulfill their investment promises? Will public entities perceive the benefits programs as too enriched?
- Continued refinements to plan structure and asset allocation, further loosening of constraints and the departure from traditional asset allocations. Many plans are conservative, and although an investment option may appeal on a logical basis, the unknown risks prevent many from proceeding to more innovative structures and investment options.
- Increased attention to fees and costs. Even without the high fees of hedge funds, institutional investors and consultants are all too aware of the costs. Control of costs will be mandatory in a future of compressed returns, and continued high actuarial needs.
- Changes in board and committee members, which fuel the need for educational materials and seminars. White papers, and timely topical papers addressing economic, political and social events and impact on financial markets, have become a victory flag to managers who provide perspective, conviction and understanding of complex investment choices.
- Outsourcing of investment management, in many cases, to manager-of-manager platforms. Providers who offer investment policy assistance, asset allocation, portfolio construction, manager selection and monitoring, risk management, as well as shared fiduciary responsibility, are a compelling solution for small- to mid-sized plans.

What has not changed is the relentless need for reliable, repeatable investment results at increasingly precise risk levels. It is in all our best interests to see this need fulfilled in our lifetimes. While much progress has been made, it is reassuring to see many brilliant minds focused on yet more refined solutions.

Evolving Investor Skills and Preferences – *The March to Higher Ground*

While defined benefit assets were predominantly invested in traditional balanced accounts, stock strategies in style boxes and conservative fixed income strategies in the 1970s, ERISA ignited change. A change that seemed slow at the time, but now looking back over a mere three decades, was the spark of a wildfire. The Prudent Man Rule demanded that institutional investors evaluate opportunities and risks in an informed, in-depth manner, spawning the birth of the independent consultant community, performance measurement and portfolio analytical tools, and an ever expanding universe of performance benchmarks. The 1980s brought academic studies to the forefront, creating the emergence of index funds, quantitative approaches and specialty strategies like small cap and mid cap equity, and closed-end real estate funds. Non-traditional investments such as emerging markets debt, private equity and venture cap gained steam in the 1990s. Academia joined with investment practitioners to develop increasingly sophisticated and rigorous investment solutions.

Simultaneously, massive investment education, and tracking of flows and results in the defined contribution market led to the unfortunate realization that too many choices and too little education failed to produce desired results. In the high net worth market, generational wealth transfer and wealthy entrepreneurs encouraged the growth of family offices and financial advisors. The large endowment and foundation market embraced a whole new way of investing – stepping out of the band of traditional reward/risk constraints, and moving into the brave new world of alternatives.

When traditional asset returns flourished, providing double-digit returns for much of the 1980s and 1990s, most investors – institutional or otherwise – stayed true to more traditional stock/bond/cash allocations. Then along came the tech bubble and various global market events, and what investors thought were well-diversified plans turned out to be less diversified than needed. With outlooks for stock and bond returns in the single digits, looming problems concerning unfunded liabilities, and difficulty meeting income needs or fulfilling spending obligations, institutional and individual investors sought other opportunities.

Alternatives, including real estate, private equity, hedge funds and hedge funds of funds, with glorious and very public accomplishments on behalf of some of the nation's most prestigious endowments and families of great wealth, had an almost irresistible appeal. Hedge funds, offering prospects of more reliable and consistent alpha, absolute return, less downside risk and low correlations to traditional assets, presented nearly heroic solutions. The result? A swoon by individual and institutional investors. Hedge Fund Research reports that the hedge fund industry saw net inflows of $60 billion in the first quarter of 2007, representing about half the industry's inflow for all of 2006 *(Source: www.fundfire.com, May 10,2007).* Aggregate assets in the hedge fund industry are nearly $2 trillion. Much of the recent growth has come from pension funds, endowments, foundations and other institutions looking for alpha, or excess return, to diversify their traditional investments. A Casey, Quirk & Associates/Bank of New York study projects that retirement plans will account for the majority of asset flows into hedge funds by 2010, and will represent more than 40% of total hedge fund assets by 2010 *(Source: The Bank of New York/Casey, Quirk, & Associates October 2006 Thought Leadership Series White Paper: Institutional Demand for Hedge Funds 2; www.bankofny.com/htmlpages/index.htm; www.cqallc.com).* Experts predict that the rapid growth of hedge funds will continue, and foresee a multi-trillion dollar hedge fund industry, dominated by a few large players. Morgan Stanley reported that the 100 biggest hedge funds with at least $1 billion control about 70% of the money in hedge funds worldwide, compared with 50% at the end of 2003 *(Source: Fundfire.com, April 20, 2007; www.morganstanley.com)*.

"…We are seeing signs of hedge funds evolving from entrepreneurial alpha hunters to institutional product developers." For investors, it is critical to discern the difference. "The hedge fund industry is at its core a talent pool, and talent is not scalable and cannot be cloned," says Robert Discolor, head of hedge fund strategies at AIG Global Investment Group. *(Source: "A History Lesson for Hedge Funds," Institutional Investor's Alpha).*

Alternative investments flooding the market also include a whole new evolution of innovative asset allocation and security selection strategies. Sophisticated investors now separate management of the different return elements of a portfolio – alpha and beta. Core-and-explorer investment programs using passive management coupled with skill-based management have become popular. ETFs, appealing to investors for their flexibility, liquidity and inexpensive sources of beta, are stealing market share from index funds. Constraints are being lifted on the quantitative side as well as on the traditional active management side. While some plans stay married to traditional programs, many are becoming better educated and more opportunistic to achieve their goals. This trend will persist, particularly as academia continues to contribute, both on the practitioner level and at the college level, graduating the next generations of gatekeepers, portfolio managers and plan sponsors.

Corporate plan sponsor concerns about matching their assets and liabilities have sparked renewed interest in liability-driven investments (LDIs). At today's interest rates, however, these investments are much less attractive than they were in the 1980s when interest rates were in the teens.

At the same time, the growing population of retired and semi-retired baby boomers in the US is driving an increasing need for high income, low risk investments. IRA roll-overs, inheritances, trusts and foundations will multiply, with current demand for growth at controlled risk levels supplanted by an appetite for high income at minimal risk. Financial advisors will grow in both prominence and power as the demand for their guidance explodes. As an increasing number of participants retire, roll-over assets continue to increase and life expectancy expands, investment solutions will be forced to evolve yet again.

Globalization – Expanding Competition and Broader Opportunity Set
Globalization is a growing force – in both the competitive pool for institutional investment managers and the opportunity set.

The drive for growth of assets and the recognition of strong competitive positioning, lured many US managers to expand their sales efforts outside the US in the early 1980s, but US managers found it difficult going at first. Did they set up shops in Europe, Australia, Asia? Did they partner with global distribution partners? As consultants started to position themselves as "Consultants without Borders," sharing databases and research on managers, strategies and innovative approaches, opportunities for US managers to build their presence in non-US markets grew. Such global consultants have become very influential in introducing managers in different regions of the world.

The easing of restrictions on allocations to domestic and non-domestic investments by countries such as Canada and Australia, created additional opportunities and attracted the attention of US-based asset management firms seeking to grow their businesses. Simultaneously, more managers from outside the US have been targeting the lucrative US institutional market. From Nomura Capital Management and Phillips & Drew's successful entries in the early 1980s, to firms currently vying for market share including: Paribas, F&C Asset Management, Fortis, Robeco, Degroof and Pictet, the investment management community is truly global. One of the major players spreading its global wings is Principal Global Investors. The heart of J. Barry Griswell's (CEO of Principal Financial Group) strategy for Principal was to build its asset management business into a substantial and truly global operation. Jim McCaughan's (CEO of Principal Global Investors) goal is to bulk up PGI's non-US institutional assets and strengthen the Principal name in Europe and Asia. "Growing our international business is a top priority."

An example of a brand-new entrant to the US market is Investec – an investment firm with South African roots, offices in London and a true global contender. Having attracted the attention of the global consultants and the London market, Investec set up a New York office to concentrate on large US institutional investors. Why do they think they can compete? A strong, competitive record, a well-defined investment philosophy embracing a powerful blend of quantitative and active management, and strategies covering traditional and unconstrained mandates. Adding an experienced team for US distribution and a New York office positions Investec well for future opportunity, despite being a late entrant to the highly competitive US market.

Globalization translates into a greater need for strategic and organized marketing. An investment firm's messages need to be consistent in every market. Different markets, however, have slightly distinct needs in materials and presentations. The US, Australasia, Europe and the Middle East all have their own preferences. Systems help delivery and production, but personalization is still key to standing out in a particular market.

The impact of globalization is not limited to investment management asset-gathering. The first impetus in the early 1960s and 1970s for managers to move beyond US borders was the need for research. Setting up global research initiatives then led many of these firms to recognize a business opportunity.

Global mandates, long the norm in non-US markets, but quietly ignored in the US market, are gaining momentum with US institutional investors. Fixed income has been a global proposition for decades, and now globalization is finally influencing equities – in both passive and active mandates, and in both traditional and alternative investments. A reality we all may face, which could change investments significantly, is should investments in US securities become less competitive, asset flows to non-US markets will mount considerably. The impact of such a change is not clear. Casey, Quirk & Associates, the Darien, Connecticut-based money management consultant's latest institutional product review shows global equity strategies garnered $27 billion in net inflows during 2006, a sharp contrast to the $91 billion in net outflows for US equity products. Emerging markets equity and international equity gathered assets as well, with inflows of $7.1 billion and $6 billion, respectively *(Source: P&I, March 19, 2007)*.

As with equities, US investors looked abroad for fixed-income opportunities. Casey, Quirk & Associates' latest institutional product review shows that in 2006, global and international bonds enjoyed net inflows of $16.7 billion, and emerging market debt took in $4.8 billion. *(Source: P&I, March 19, 2007)*. Just as countries like Canada and Australia eased their pension plan restrictions to enhance their diversification and return benefits, so will US institutional investors move opportunistically to the investment opportunities offering the greatest risk/reward potential**.** Numerous opportunities will be open to investment firms able to expand their offerings to global mandates.

Specialization in Professionals' Roles – *Creating Barriers to Entry and Opportunities for Growth*

In the 1970s and 1980s, most of the investment companies were run by investment professionals who were also responsible for client service, presentations, finals, and in many cases, RFP responses. Today, business leadership, client service, compliance, sales management, consultant relations, marketing expertise, operations and administration – all have developed into professions in their own right. Firms, even start-ups, without strong business leadership and infrastructure, lacking expertise in the above areas, are at a strong competitive disadvantage in the institutional investment arena.

- ***Investment Management Business Leadership*** One of the most challenging roles is that of business leadership. A leader who brings the right combination of vision and voice, effective alignment of resources, management and motivation of the firm's professionals, and strategic thinking, is needed to grow an investment firm. As many founders and leaders of investment firms retire, a company can find itself in a perilous position.

  A client shared with us that a mark of a quality business is one where the debt ratio is neither zero nor too high. If it is zero, then management does not understand how to allocate capital to grow. So do you replace the original founders with a person who has a strong understanding of growth in an investment management business with all that entails? Or, do you find yourself with a leader focused on cost controls, limiting compensation packages of investment talent and looking for places to cut more? A true success story is that of NWQ. As Dave Polak and other senior members retired, leadership was turned over to Mike Mendez, who joined NWQ in 1989. A career-long student of industry changes, he had a clear vision of what growing an investment management firm in the 2000s would require. He defined his strategic plan, attracted talented individuals to join the initiative, built a powerful distribution platform and executed flawlessly. Today, NWQ with $35 billion in assets under management is an affiliate of Nuveen Investments, which is a collection of companies managing over $160 billion.

- ***Client service***, when strong and strategic, can make the difference between a company's growth and stagnation. Understanding and addressing clients' changing needs, achieving investment objectives, and serving as an educational resource to fulfill needs beyond just performance, earn an investment company a reputation and role as leader in the industry. Firms that rank high in client service have teams of experts with long, successful experience in fulfilling communication needs and serving as invaluable resources to their clients. Supporting them are product specialists, client service administrators, systems, and marketing that address client needs as well as developing growth initiatives.

- ***Compliance***, formerly a part-time role of a skilled administrator, is now a required role for every registered investment advisor, and can contribute to the success of an investment management firm. Mutual fund and market-timing scandals gave rise to increased regulation. As laws and regulations multiplied, intense scrutiny of performance, marketing and client service materials became a given. The SEC dictated the role of Chief Compliance Officer. The best have become knowledgeable on the broader aspects of the industry, serving as strategic advisors on how a firm can grow and best serve the investment community at large. Today, for the first time, you will see compliance officers as partners.

- ***Sales management and consultant specialists***, again, frequently just one of many roles of the founding partners of investment companies, are now specialists in high demand. When defined benefit assets were experiencing double-digit growth, strategic sales planning was not that necessary. Sales professionals targeted the low hanging fruit for direct calls, focused on a select group of consultants, and/or zeroed in with "hit list" marketing, soliciting clients of competitors who were in trouble. Those days are over. There is no low hanging fruit in the defined benefit market. Managers have to take market share from other defined benefit providers. They need a strategic sales plan with talent and resources clearly aligned to the markets where they will have the greatest success. Today's most successful growth firms have very experienced, strategic sales professionals leading sales forces, focused on specific target markets, multiple sales teams or diverse distribution forces, leveraging a firm's infrastructure.

  Consultant firms, very powerful in the institutional investment industry throughout its history, have evolved from two to five consultants, to large entities with multiple professionals involved in the manager research and consultant initiatives located either across the nation or worldwide. And the number of consultant firms that can make a difference in your growth efforts has multiplied significantly. Surveys show that the emergence of consultant specialists has been exceptionally well received by the consultant firms, who appreciate having one knowledgeable point of contact. The role of consultant specialists does not replace the sales professionals' relationships with consulting firms. It brings consistency in contact, clarity in messaging and proactive communications in building relationships with the consulting firms, whether global or regional. The consultant specialist is also typically responsible for defining the strategic plan of action for consultants. Which consultants are critical to the firm’s business, who should be second, third or fourth priority? Which firms are not appropriate for your strategies? What level of activity and communications is appropriate for each firm? What are the individual firms' preferences? Who are the best people to build the relationship with each consultant firm? Surveys, as well as growth of assets of firms with consultant specialists, demonstrate the success of the role.

- ***Marketing*** In the 1970s and 1980s, managers frequently wrote their own marketing materials and presentations, completed consultant RFPs and decided marketing strategy. Today, with multiple target markets and products, and a high level of activity, the need for cohesive marketing messages and support has led to the development of strong, well-resourced marketing departments. When marketing works well with business leadership, client service, sales and investments, you can see firms that increase market share and retain a strong reputation in the industry. Whether a global firm that needs to integrate multiple visions or a US boutique, marketing becomes the voice to the market and critical to growth.

Firms cannot afford to be complacent about their communications. Quality, clarity and consistency of messages are key. Materials can be neither a shabby hodgepodge evoking a past decade, nor so slick that they cost more than most clients' annual reports. Consistency of communications among your firm's professionals on key messages, asset management approach, and the firm's priorities is essential to success. Your key messages must be aligned with your strengths, and someone must make certain that those key messages are incorporated into all communications from introductory materials to websites to databases to final presentations to client service materials. Seasoned professionals, separate from portfolio management and sales, are assuming these responsibilities at most investment firms. PAICR, the Professional Association for Investment Communications Resources, was founded in 1997 to provide a forum for professional development, continuing education and networking for professionals in these roles.

- ***Operations and Administration Infrastructure*** are the foundation for a firm's ability to account for its clients' portfolios, effectively assimilate new accounts and assets, deliver timely communications and achieve institutional quality across all areas to compete. Many firms have failed to pay attention to the importance of infrastructure, and clients instantly recognize firms with growth problems. Reports are slower, inaccuracies begin to appear, trading is not competitive, and portfolio managers are without tools that competitors have. The infrastructures of firms offering alternatives are under especially high scrutiny. Will they be able to handle growth? A majority of the hedge fund firms that have closed to date have gone out of business due to operational failures, not due to performance problems.

The evolution of investment firms as true businesses has demanded the specialization of roles. These demands in turn produce higher barriers to entry. The risk/reward still attracts entrepreneurs, but the days of hanging up a sign with high numbers and having buyers flock to your door are over. It is the *business* of investment management that can make the difference between earning a living and achieving true success.

Advances in Technologies and Systems – *"Penny-Wise or Pound-Foolish?"*
Automation of our industry has truly revolutionized how people work. Emergence of new or advanced technologies are changing the way investment firms support marketing initiatives, as well as the way that managers are measured and monitored. In the 1970s, index cards were a marketer's CRM system. Today, relational databases are critical to the sales and client service process. The Money Market Directory in hard paper form was the green gospel for prospect information, and detailed information on a manager's competitors was hard to come by. Today, dozens of databases and the Internet provide a plethora of information on prospects, consultants and competitors. Global communications have become seamless with the evolution from overnight mail

to fax machines to email, “webinars” and videoconferencing. Managers leveraging technology have an enormous advantage, while those unwilling to invest or those who lack the vision to employ it are at a stark disadvantage.

Performance measurement and attribution analysis have evolved dramatically. It is no longer just about absolute and relative performance. Increased attribution tools present challenges to active managers, as they show which managers are adding value versus just managing beta. Clients will be able to discern value-added management easily over time, and weed out traditional active managers just managing beta.

The majority of firms today use a blend of quantitative and qualitative disciplines to discover high-probability-of-success investment candidates for their portfolios. Institutional investors followed suit, embracing similar tools to assist in their searches for high-probability-of-success managers. Today’s consultants and clients can assess managers’ performance against a variety of quantitative screens and metrics such as: information ratio, alpha, beta, Sharpe ratio, R^2, and more. What used to be a labor-intensive process, screening managers against specific criteria can now be executed in minutes. Once you define your quantitative criteria, you simply select your database, enter your search criteria and a list of qualified managers is at your fingertips.

Then what happens? Some clients take their lists and visit managers’ websites to find qualified candidates. Managers need to take these new tools seriously, populating and updating the databases in a timely, complete and accurate way. Websites should be more than “brochureware.” Yes, surveys commonly show that 50% or less of plan sponsors and consultants visit websites, but those that do, do so with purpose.

Systems to support marketing are also advancing, making it easier to support sales and client service professionals around the world, and to leverage your senior management and compliance professionals. One example, Proposal Software, offers a system with one databank, and multiple levels of users (e.g., User, Supervisor, Administrator) with different levels of access. The system is offered both as a resident system and on-line. While traveling, you have access to all your marketing documents, from RFPs to presentations to client reports to answers to tough questions. You can type in your client list and access all related materials and notes. You customize the dashboard to your needs, to your target markets, by product or geographical location or by size of assets. You have 250 fields from which to design a system that supports your needs. The system will support your compliance effort, your review and update cycle, your reporting needs, all with no programming. You can develop content with a portfolio manager and writer, and then instantly update your whole team. You can design reports that help you track activity, accountability, results. You can, with a click, access what you need when you need it.

Proliferation of Consultants and Their Changing Roles – *Gatekeeper, Competitor…Friend or Foe?*

Currently, there are about 300 consulting firms listed in Nelson's database. Public pension plans using outside consultants rose to 95% in 2006, up from 88% in 2005. A Casey, Quirk & Associates study, published in March 2007, estimated that the consulting firms who use eVestment Alliance's database conducted between 3,500 and 5,000 searches in 2006, placing between $150 and $250 billion in assets. Casey, Quirk & Associates expects to see a significant increase in search activity in 2007, and small and mid-sized consultants expect to see a larger increase in search activity than the larger firms. A large number of alternative searches are occurring, and the capital is coming in many cases from traditional equities and fixed income.

The consultant community has no immunity from change. Experienced, progressive consultants are well positioned to benefit from the changes in investment programs and investment offerings. Specialty knowledge and resources are limited qualities; consultants provide investors, sophisticated or not, both. It is challenging and expensive to restructure investment programs, and even more difficult to find strong skill-based managers who can deliver consistent results. Consultants, again, can help investors with both.

The traditional consultant's business model, however, is labor intensive and difficult to leverage. Many consultants, seeking ways to enhance the profitability of their business model, are abandoning their own proprietary databases and subscribing to independent industry databases such as eVestment Alliance, Nelsons and PSN/Mobius. The answer for some – expansion into the investment management domain. With so many investors grappling with the same issues – need for higher, more consistent returns, less risk, more education – many consultants rose to the occasion, some better than others. A number of the larger, more recognized consultants developed manager of manager and funds of funds programs and limited partnerships, which in turn translated into more successful business models for the consultants and simultaneously fulfilled the needs in particular of mid-sized and smaller institutional investors. In a beautiful case of irony, some of these consultant firms now have consultant specialists of their own to call on other consultants to introduce their manager of managers, funds of funds and transition management programs to other consultants.

At the same time, regional consultants, family offices, specialists by markets and specialist consultants in alternatives, have gained and continue to garner market share via expert knowledge in territories neglected by the major consulting firms. Many managers started leaping into the consultants' territory, becoming more consultative in building deeper relationships with their clients, and providing them educational tools and resources. Managers with the capabilities to do so are moving into the asset liability business.

The outcome? A stew of possibilities as consultant and managers compete, as the number and type of gatekeepers proliferate, and the number of investment firms and strategies multiply like rabbits.

With consultant power continuing to ascend, and the number of consultants proliferating, how does a manager address the consultant's needs for research and insights, and achieve the manager's goal of a strong, mutually productive relationship? The answer is simple: those that view the consultants as allies or conduits to success, and support the consultants' initiatives for education, manager research and contact, will have greater success. That assumes one thing, that the manager is competitive – in its disciplines, clarity of approach, and consistency in fulfilling investment objectives.

One last note on consultants – white papers and timely, topical pieces have emerged as important tools to position a manager as an expert in the consultant and plan sponsor communities. Those that produce white papers serve as an important educational resource to a community that is overworked and underappreciated. In survey after survey that we have conducted, we ask the question – what do best-of-class managers do in communications? The answer is proactive calls and meetings, white papers and quality research shared with the consultants. The givens: timely and thorough database completion, meetings with the research team, and understanding and following the consultant's product approval process.

Distribution Opportunities – *"Two roads diverged in a wood, and I took the one less traveled by, and that has made all the difference" ~ Robert Frost*

In the early years, most managers focused their business by client type (institutional or private client), asset management style (balanced, equity or fixed income), and perhaps geography. They concentrated on direct calls, using the Money Market Directory, and targeted a few consultants emerging as influential gatekeepers. Today, managers can leverage a variety of distribution channels including: consultants, brokers, financial advisors, subadvisory platforms, manager of manager and funds of fund platforms, databases, and of course, there is still the good old fashioned approach of direct calls.

Market leaders serve virtually every client base, leveraging multiple distribution channels, offering a broad spectrum of investment capabilities and services around the world. Target markets have become much more specialized. The institutional market, while to some degree still generalized, has specific needs for the various segments: large public funds, small to mid-sized public funds, large endowments, large foundations, small to mid-sized endowments and foundations, Taft-Hartley funds, corporate defined benefit, corporate defined contribution, public deferred compensation, insurance and re-insurance, hospitals, operating cash and variations. Managers need to establish what their client service promise will be for each type of client. What resources and systems will be needed to support that client service promise?

The consultant and intermediary industry has segmented as well – with plan type specialists, global consultants, regional firms, brokerage firms, financial advisors and others. Individuals' assets are now segmented into high net worth, family offices, bank clients, financial advisors, SMAs and brokerage firms. Subadvisory markets, funds of funds and managers of managers all offer viable ways to grow assets under management. With such a spectrum of distribution opportunities, the need and demand for strategic marketing explode on multiple fronts. On which markets and countries do you focus? Which products will you take to which markets? How do you know where you are competitive? How should you organize your resources? Will you distribute directly? Are you willing to participate in distribution channels that require fee discounts? If you align with external distribution, who will provide you the distribution you need and what requirements will that entail? Will you need to give up ownership or equity to achieve the distribution you need? Even a few years ago, it would have been unheard of for a start-up alternative shop to have its first distribution partner in Japan. Today, it can well be the most advisable strategy to garner assets quickly.

Next you have to decide tactical issues. What collateral materials, resource support and systems do you need for each market? In what technologies do you invest? In what databases do you participate? How do you achieve consistency of messages? How do you attract, train and retain marketing talent to support and implement your initiatives? How do you keep your messages strong, competitive and fresh?

Each market and distribution partner is likely to require a different level of communication and service. It is essential that you understand what those levels are before committing to new channels. If you make the commitment, you must have the knowledge, people, resources and systems in place to succeed.

Summary

With so much rapid change on so many fronts, and unfolding opportunities with virtually every change, tomorrow's investment leaders need to aspire to all the following attributes:

- Flexibility and foresight to adapt to and serve shifting asset pools – from defined benefit to defined contribution to IRA accounts
- Innovative investment solutions to meet changing investor needs
- Ability and resources to capitalize on global investment and distribution opportunities
- Strong, well managed business on every level – business leadership, investments, marketing, client service and sales, legal/compliance and operations/administration
- Commitment to invest in new tools, systems and technologies to enhance alpha generation and business efficiencies, and to lower costs
- Collaborative relationships with clients and consultants
- Strategic, focused, well-managed marketing, sales and client service efforts

We believe that strategic client service and marketing will be the most pivotal attributes for an investment firm that has competitive investment offerings. As performance and investment management become more of a commodity, exceptional client service and astute marketing are essential. Appropriate distribution, competitive positioning, clarity and power of messages, effectiveness of communications both internal and external, experience and training of client-facing professionals – all will become the currency of the successful investment firm. The growth leaders in our industry have a clear vision for their future courses, and strategic plans they are implementing with energy and enthusiasm. They will direct their resources and talent appropriately and lead their own firms, clients and prospects through successful evolution. As Darwin said and we are here to echo, "Success will belong to the one most responsive to change."

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