Industry Trends: What's on the Horizon?
Martha Spano, *Phoenix Investment Partners*; Diana Jackson, *AON Consulting*; Michael Laven, *Canterbury Consulting*

Diana Jackson, *AON Consulting*
Plan Trends: 401(k)/Defined Contribution

- Increase in requests for immediate eligibility for plan participants
- Increase in automatic enrollment and online registration
  - This raises participation rates; however, it is not good because the participants are put in 3% Stable Value to begin, and then end up staying there rather than reallocating
- Of the ten largest 401(k) plans, only 8% of the funds would pass a typical due diligence screen
- Need for advice to participants has increased
  - Recent Vanguard study shows that 85% of participants in 401(k) plans want more advice
- Investment Trends
  - Retirement plans with 15 or more options are less diversified
    - To address this, plans are still investing in multiple "life cycle" funds, which are customized to the individual participant. Further education is needed though, as participants are still investing in multiple life cycle funds outside of their funds as well (indicating that they do not understand the design of the funds).
  - Some companies, such as 7-11, have taken away the self-directed plans and placed assets in separate accounts; plans are now performing better (in down times)
    - This will only be a trend with large companies as only large plan sponsors can afford separate accounts
  - Equity accounts are down – there were half the amount of inflows to equities in 2001 vs. 2000
  - Retail investors have inflows to fixed income, while institutions have outflows to fixed income
  - The 401(k) market will survive because companies can't afford defined benefit plans; therefore, education is key
  - 401(k) plans are not allocating assets to alternative investments
  - WRAP programs will continue to grow
    - WRAP programs will garner assets from those who felt burned/who want to invest their money with the "hot manager"

Michael Laven, ***Canterbury Consulting***
Plan Trends: Defined Benefit

- 1990s period of "relative performance was king"; now the trend has moved from "return of capital," which was the 1990s phenomenon, to "return on capital"
  - The crash in 1987 taught everyone to buy on the dip; same as with the Gulf War, the Asian downfall and Long Term Capital failure
  - Change came when you bought on the dip after first quarter 2000, then in 2001 and still lost; now in 2002, it's "sell on the rally" or "get me out of this mess"
- Reality today for Canterbury's clients (corporates, endowments/foundations) is that they want anything not tied to market drops; therefore, interest in alternative investment/absolute return strategies is high
- It's important to recognize that when markets go down, investors want what won't go down; when markets go up, investors want what's going up
  - Canterbury regards a hedge fund as another investment vehicle/structure
    - Currently, there is a lot of capital seeking hedge fund returns; many are willing to meet this demand
- The institutional market has outflows to fixed income (retail investors have inflows to fixed income)
- An allocation of 60% equity and 40% fixed income is currently optimal
- Canterbury is finding managers need to:
  - Adhere to their investment style/disciplines
  - Be "nimble"
  - Be conscious of capital preservation
    - It is probably not a good idea to be too aggressive right now. Managers need to recognize that clients/consultants understand that you need capital with which to invest.
  - There is more leniency for cash holdings and style drift (which can be problematic) to preserve capital. "For how long will this be true… until it isn't."
- Increase in manager due diligence, although no major changes in policies
- Concentrated portfolios were great in a rising market; however, not any longer
- Some managers who have more diversification are more popular
- Canterbury doesn't have a scoring card to measure their value-added – no two clients are the same – they use target models though

Keynote Presentation: The Keys to Success: A New Direction for Growth
Joan Payden, *Payden & Rygel*

- The investment industry can be easily compared to the healthcare industry
  - Both are drowning in bureaucracy and forms
- Bottom line – has it changed?
  - For healthcare, it used to be about patients, now it's a financial consideration
  - For investment managers, business and service are being commoditized and disparity has changed
- The investment industry is a personal, service-oriented business
- If you have 20 minutes to present to a new firm, you only have 20 minutes to convey stability, expertise and trust
- When considering technology and communication, think about:
  - Does the overload of technology impede or help communication?
  - Are we using technology to the advantage of our clients?
  - Perception and trust are key in this industry, but we are heading towards the impersonal
  - Investment management is not an exact science, use art element vs. science
  - Problem solving and intuitive experience is key
  - Focus people in the direction you want them to move
- Globally, investors are looking for all different firms
  - For expertise, you need different resources
  - Managing expertise – centered in the US; US needs to be aware of the different cultures, including their corporate and academia cultural differences
- Language skills are important
  - Joan's team worked on an RFP written in Italian that was sophisticated and lengthy
  - Translated the RFP and realized the Italians are coming from a different viewpoint
- Work should be done with enthusiasm – it's contagious
  - "Enthusiasm is the engine of life" – *Carnegie*
- Trends – people are scared; fences are being broken down and they want assurance to know you care
  - Payden & Rygel is responding by getting right people in the firm (those who think outside the box with common sense – an inexact science)
- Globalization: London offers great opportunity for growth; Payden & Rygel just opened an office there
- Advice for young professionals – passion and enthusiasm; commitment and liking what you do
- Translate message of trust and perception across cultures

- People are people – transmit trust, which is transparent over any language
- Need to be more sensitive to non-US cultures and aware of people's differences

Discerning Trends from Chaos
Chuck McKenzie, *OFI Institutional;* Jane N. Abitanta, *Perceval Associates, Inc.*

Chuck McKenzie, *OFI Institutional*
- Searches are down in terms of numbers and size. Why? Because people are frozen and they don't know what to do yet.
- Sales salaries are down – retention is an issue; not many firms are willing to guarantee salary increases
- Client service – firms are willing to keep client service
  - All goes back to the statistic "it is 9 times as expensive to earn $1 as it is to keep $1"
- Asset allocation: as of 9/30/02, defined benefit plans were 57% equities; defined contribution plans were 62% equities
- Employer stock – legislation to date mandates that all pension funds have an employee on the investment committee
  - Definition of a fiduciary is expanding – record keepers now have fiduciary responsibility
- Funding ratios: 75% of employers have to make contributions to fund their plans
  - Ratios have deteriorated due to market decline and interest rate decline
  - Historically, one was supposed to balance the other; not this time – it is all a new experience for plan sponsors
- Government actions: new NASD and NYSE rules; new laws
  - Similar actions in other major world markets (including Canada, UK, Japan and Continental Europe)
  - Less than 2% of sell-side analysts are members of AIMR
  - Now, need to make available full-disclosure when you mention a stock to buy. Point is – there is a difference in what you *can* do vs. what you *should* do.
- Today, sales support and client service have never been more crucial to the business…volatile markets mean clients and sales reps need your best effort.

Jane N. Abitanta, *Perceval Associates, Inc.*
- What does it take?
  - Branding your "story"
  - Positioning target markets

- Communicating constantly (internally and externally)
- Discipline and process
- What's your story?
  - Rethink the following to get to the values of your organization:
    - Who are you?
    - Why are you?
    - What value do you bring?
    - How committed are you?
    - Passion and conviction
- What skills must you have?
  - Active listening – what's not being said tells volumes, too. Those with strong egos have even stronger egos when they are under stress and afraid; ask "why" even more.
  - Flexibility
  - Organization
  - Authenticity – acknowledgment that this is a tough environment
  - Empathy and a "sixth sense"
- How to stay positive
  - Keep focused – focus on what your mission is
  - Talk to competitors
  - Find internal and external support – PAICR provides an excellent external support
  - Broaden reading/resources – avoid noise
  - Value your relationships – internally and externally
  - Check in with yourself

AIMR-PPS: New Developments in Performance Presentation
Moderator: Sharon Castro, *Roxbury Capital Management*, *LLC*
Panelists: Matt Forstenhausler and Andrew MacLeod, *Ernst & Young*

Executive Summary
- Changes in Level I and Level II designations
  - Level I will be referred to as AIMR Verified
  - Level II will be referred to as AIMR Examined
- Proposed changes to WRAP/managed accounts
  - Would require managers to include WRAP accounts in their institutional composites

- Would require managers to maintain all account records, which are frequently kept by the sponsor
- Recommending managers group all like WRAP strategies in a Super Composite
  - Would require showing performance net of all fees (management, custody, operational, commissions), over which most managers do not have complete control

- Time period requirements for showing dispersion
  - Clarified that quarterly disclosures must include updated performance, as well as dispersion for that time period
    - Dispersion must be updated for each time period represented, rather than just annually

Matt Forstenhausler, *Ernst & Young*
AIMR vs. GIPS Compliance

- If compliant with AIMR standards, you are complaint with GIPS; however, the reverse is not necessarily true
- AIMR requires a management firm to have 10 years of information, or from inception
- GIPS requires 5 years of information
- AIMR country guidance statements are more restrictive than GIPS
- Compliance relates to the firm. Compliance is 100%; whenever you use performance numbers, you must meet all requirements under the standards. Once you mention AIMR-PPS in a one-on-one presentation, you have to meet the standards.
- You can find current AIMR requirements at aimr.org
- Level I and Level II relate to levels of verification, not compliance
- The IPC is the governing body over AIMR
- AIMR compliance is not a one-time approval; you must maintain compliance on an ongoing basis

Carve-Outs
After 2005, no carve-outs will be permitted. For example, for balanced accounts, currently you can have one cash account and allocate to the stock and bond portion of the account. Effective in 2005, you will have to maintain separate cash accounts for the stock and bond portions of balanced accounts.

Composite Requirements
The overall guiding principal of AIMR is “no cherry-picking.” If you use a third-party marketer or do joint marketing, you must be clear on what firm is being presented.

Composites can include discretionary accounts only. You only need one account to have a composite. Discretion, or the ability of the manager to implement their investment strategy, is the requirement. Restrictions, such as no sin stocks, directed trades and inherited stocks, make accounts non-discretionary. You can create a minimum asset level, e.g., $1 million, which allows you to keep accounts out of your composite. You cannot then go out, however, and market to accounts under $1 million. That would show that they are not "nuisance" accounts, but a significant part of your business and would prevent you from eliminating such accounts from the composite.

For balanced accounts, it is best to set ranges (e.g., stocks will range from 50% to 70%, and bonds will range from 30% to 50%) to avoid having to move accounts in and out of your composite. Previously, you could not remove accounts from composites due to a drop in market value. Now, you can take them out for a couple of quarters; however, AIMR prefers you take them out at the end of a period. If a client withdraws money from the account, however, you can take the account out of the composite at the beginning of the period.

Andrew MacLeod, *Ernst & Young*

Advertising

Advertising includes: brochures, web site, letters, ads and anything going to the public. There are two different provisions, for ads with no performance numbers and ads with performance.

1. If you mention you are AIMR compliant, but include no performance numbers, that's fine, but you must include a definition of the firm.
2. If you mention AIMR and include performance numbers, you must provide all disclosure information.

Condensed Disclosures

Condensed disclosures are permitted as long as you have a presentation with the full disclosures. In one-on-one presentations and RFPs, you can show gross numbers; that's an SEC rule.

Change in AIMR Designations

Effective January 2003, the terminology, Level I and Level II, will be replaced with AIMR Verified and AIMR Examined.

Managed Accounts
There are proposed changes to Managed Account requirements. AIMR put out a proposed guidance statement requiring managers to include WRAP accounts in their institutional composites where the investment approach and team are the same. This would require the manager to maintain all the account records. The problem with Managed Accounts is that, in many cases, the manager doesn't keep the records, the sponsor does. The manager was either dependent on the sponsor for returns or had to do shadow accounting. Currently, you can exclude Managed Accounts from your performance composite as long as the definition of the firm is clearly different. You have to say you are a Managed Account manager and a non-Managed Account manager. If you use the same investment approach and team, the two are not distinct. In many cases, excluding Managed Account assets excludes a significant percentage of a firm's assets under management. October 31, 2002 was the deadline for managers to write a comment regarding the proposed Managed Account requirements, but comments are usually considered for a month beyond the deadline.

You can have a super composite for all Managed Accounts with the same strategy. The objective is to prevent firms from cherry-picking. They are recommending net performance, net of all fees (management, custody, operational, commissions), even though the manager of the Managed Account assets does not have control over all of the fees.

Time Frame for Data in Flash Reports
Managers are allowed to give out Flash Reports if they have a compliant presentation with full disclosures. All the information must be updated. For example, dispersion must be shown for the period in the Flash Report (e.g., quarter or year-to-date), not just for annual periods. To be verified on a quarterly basis, you have to put in the short-period data.

Portability
It is easier to get AIMR compliance with a lift-out rather than acquiring a firm. With a lift-out, you have to bring over all the decision makers, and they have to operate as they have in the past and have all the supporting documentation. If you buy a firm, they have to bring over almost all their accounts to obtain AIMR compliance.

High Net Worth Market
AIMR is not as important in the high net worth market as compared to the institutional market. AIMR compliance is less prevalent among hedge fund managers.

Marketing to Win – From Start to Finish

Moderator: Jillian Rudman, *J Rudman & Associates*
Panelists: Reese Lackey, *PIMCO*; Jennifer Lynch, *AdHoc Communications*

Jennifer Lynch, *AdHoc Communications*

- Build a compelling, memorable story with your team from start to finish
- Provide roadmap to get started and set the stage:
  - Set goals for project – what are we trying to do here?
  - Discuss expectations
    - Budget, deliverables, deadline, resources, measuring success
  - Identify partners
  - Identify audience
    - Prospective clients, current clients, strategic partners, candidates, press
  - Set the tone – what voice best speaks to your audience, e.g., professional, warm, aloof?
  - Select media type
  - Confirm project scope and gain consensus
    - Continually check to ensure goals/expectations are being met along the way
  - Get to work!

Jillian Rudman, *J Rudman & Associates*

- Make sure everyone is on the same page; have them identify their firm's strengths/weaknesses
  - Ask "discovery questions" – how do they want to be perceived?
  - You'll find out not everyone is on the same page – what one person sees as a strength, another views as a weakness
  - Identify key players/decision makers and get buy-in
  - Need to back up strengths with proof points, stories
  - Turn your weaknesses into strengths
- Branding – understanding your firm's culture
  - What attracted you to the firm?
  - What do you want your clients to experience?
  - What distinguishes your firm?

    - Who are your competitors and how do you distinguish yourself from them?
- Need to examine the internal, but outside the firm as well

Reese Lackey, *PIMCO*
Case Study:
- Direct mailing program targeting 3,500 Registered Investment Advisors (RIAs)
- Had to consider people, time and budget constraints
    - Only two associates worked on the project (were going to get in touch with RIAs through phone calls, but needed to come up with an alternative since they had to reach so many)
- Approach: take advantage of opportunity of large institutional investors and reinforce PIMCO's tagline "Authority on Bonds"
    - Partnered with Fortune magazine
    - There are approximately 150,000 fixed income options – too many for investors to research
    - PIMCO took the turn-key, one-stop-shop approach
    - 12% response rate; considered a success

Managing Teams – How to Help Your Group Become More Successful, Savvy and Sane
Facilitator: Jill Plumb, *Capital Guardian Trust Company*
- Try to maintain a balance on your team of short/mid- and long-term employees
- Think of other departments/roles for those who no longer mesh with your team or those who have been on your team too long to move up, but are still valuable
- Provide your team members with honest reviews
- Meet once a month for 15 minutes – what you observe on a regular basis instead of letting it all pile up for the "dreaded" annual review
    - Opens lines of communication on an ongoing basis
- Move from "friend" to "supervisor"
    - One roundtable participant took each member of her team out to lunch to discuss on a one-on-one basis
- Outline role of a manager – what's expected. There are criteria to follow if that's the path you want to take.
- Balance tasks
    - If someone always works on RFPs, give them another task to break the monotony
    - Let them try something new – it's encouraging
- Use incentives as motivation

  - Give away vacation "value" time
  - Spot awards – highlight an accomplishment on your team at an off-site or meeting
- Team building
  - Find activities that the group as a whole would enjoy to increase participation
  - Schedule during work time, possibly off-site
  - Build activities around books – discuss "Fish!" or "Who Moved My Cheese" as a team
    - "Fish!" also comes in video

Roundtable: Communicating Your Firm's Intellectual Capital
Facilitator: Robert Schmidt, *Brandes Investment Partners*

- Intellectual capital is the human element of your firm and entails sharing your expertise, from a non-product-specific perspective
  - Ask, "Who is your firm?" rather than, "What is your firm?"
  - Intellectual capital (research) does not have to be original, it just has to be relevant
- Challenges of communicating your firm's intellectual capital:
  - Harnessing all the good, relevant research available
  - Gaining a commitment to communicating intellectual capital from the top of your firm
  - Marketing your firm's intellectual capital internally as well as externally
    - Need to excite internal teams about the intellectual capital your firm has to offer to enable them to communicate the firm's strengths externally
- Ways to communicate your firm's intellectual capital:
  - Develop a Client Advisory Board to allow clients to voice their concerns and share their perspective; offers the manager an additional opportunity to share their expertise with top clients
  - Host educational roundtables for clients and the consultant community
    - Schedule internal as well as external experts for topical, versus sales-oriented discussions
- Use surveys, as well as telephone and in-person conversations with clients, to measure their perceptions and monitor the effectiveness of your firm's intellectual capital campaign

Presentations from the Consultant Perspective
Facilitator: Kerry Shanley, *Jennison Associates*

- Ideal length of a presentation for consultants
  - You are usually given 45 minutes for a meeting
  - Session participant presentations range from 10 to 60 pages, with the majority in the 20- to 25-page range
  - Most presentations have an appendix section with an additional 10+ pages, including bios, fees, performance disclaimers and current portfolio in one case
  - One participant commented that consultants "zone out" if the book is too long
- Presentation contents
  - Firm overview
  - Philosophy
  - Process
  - Portfolio structure/characteristics
  - Performance
  - Attribution
  - Outlook/market environment
  - Updated information
- The best way to differentiate your firm is to give a concise message early on in the meeting/presentation and reinforce it throughout your presentation; e.g., three key messages
- Participants were divided on use of stock examples in the presentations
- Recommended design
  - No clip art
  - Use graphics
  - Consistent look and feel with other firm materials
- Common question
  - Where are you getting your performance from?
- Conclusion of session: There is no uniform consultant presentation. Length, content and design vary across investment firms. Most important are differentiating yourself, and building trust and conviction that the process is consistent and repeatable.

Getting the Business: What Does it Take to be Successful?
Moderator: Janet Acheatel, *Brandes Investment Partners*
Panelists: Joseph Ashwill, *Wedbush Morgan Securities*, Garth Flint, *Beacon Pointe Advisors*, Brian O'Sullivan, Rhoni Seguin, *INVESCO Institutional*, Teri Smith, *Capital Guardian Trust Company*

Manager Search & Finals Preparation Process
Garth Flint, *Beacon Pointe Advisors*
What Consultants Look For in a Manager
- Numbers – look back as far as possible using Zephyr quant screen
- Managers fill out questionnaire on Beacon Pointe web site
  - They like employee-owned firms
  - Consistency of process
  - Look closely at how stocks get into the portfolio; just hired an analyst to focus specifically on this
- Manager should know the consultant, their clients and their philosophy
  - Beacon Pointe's philosophy is preservation of capital
- Recommends managers go to client's facilities (museum, hospital, etc.) to learn about their organization

Joseph Ashwill, *Wedbush Morgan Securities*
Investment Manager Evaluation Process
- Aim is to not be unduly influenced by a single factor
- Believes that the market is inefficient and investment managers will exploit market mispricings
- *Skill* is the number one ingredient of a successful active manager
- Information advantage results from proprietary research
  - Valuation model superior to others' valuations
  - Society of intelligence greater than the sum of its parts
- Believes organizational instability is lessened with employee ownership
- Managers should emphasize investment management over product development and distribution – plan sponsors want to see the business focus on money management
- Manager's score weighting based on:
  - Performance = 60%
  - Product = 20%
  - Organization = 20%

Rhoni Seguin, *INVESCO Institutional*

Preparing for a Final & Gathering Information

- Learn about the overall plan, in addition to the portion of the plan you are pitching
- Gather standard information from prospect:
  - Prospect name
  - Common client
  - Primary line of business
  - Finals date
  - Time and length
  - Location
  - Plan size
  - Size of opportunity
  - Product
  - Benchmark
  - Copy of investment guidelines (may not always be possible to get)
  - Names of competitors
  - Any fee issues
  - Pre-send or hand-deliver materials
- Gather information from consultant:
  - Coverage history – consultant and plan sponsor relationship
  - History with firm/product
  - Is database current?
  - Was RFP issued?
    - More and more, INVESCO is seeing searches coming through consultant database information rather than RFPs
  - Major objectives for this plan/search
  - Reason for search (e.g., someone fired, more money available)
  - What is prospect trying to accomplish with search?
  - What will it take to win?
    - It doesn't hurt to ask this of the consultant!
- Information Reconnaissance
  - Why were we selected for the final?
  - What is prospect's view of asset class?
  - Describe competition
  - Current managers
  - Current asset allocation
  - What performance information/date ranges has prospect seen?

  - Sophistication of prospect
  - Prospect's existing perceptions, including knowledge of your firm and opinion about your firm
  - How active is the consultant?
  - Who are key decision makers; what are their backgrounds?
- Preparation for finals
  - Know your audience, strengths and weaknesses
  - Show prospect that you want the business

Teri Smith, *Capital Guardian Trust Company*
Making Due With What You Can Get
- Once you get all the background information, what do you do with it?
- Prepare yourself and prepare the portfolio manager
  - Prepare for battle
  - Review what you bring to the table versus the competition, but do not badmouth them
  - Win the business on your own merits
  - Competitors give you an indication of what the plan sponsor is looking for
  - Find out if one of your analysts knows someone at the company from their research; utilize this connection
- The book is not the presentation, YOU are
  - Materials support what you say, but are not the foundation
- Give your portfolio manager a game plan for what you've learned, in a condensed version
  - If you do not have time for a full run-through, spend time on the phone preparing the portfolio manager
- Debrief and send a memo after meeting

Brian O'Sullivan
Materials Preparation
- Finals are won based on the quality of answers to questions
- Understand how a consultant structures the search
  - Will the consultant line up three identical managers in a competition or three very different managers?
- Have a handout to address questions that you do not want to spotlight in your presentation

Mock Presentation Feedback, Next Steps in Decision Making Process

- Garth Flint's recommendations
  - Cover process as soon as possible in presentation; the process demonstrates a managers' uniqueness
  - Be passionate about what you do
  - Share stock examples; one that worked and one that didn't
  - Garth weights passion over performance
  - Tell a story; it shows personalization, especially for the High Net Worth arena
- Joe Ashwill's recommendations
  - Professionalism and appearance do make a difference
  - He looks at performance in down markets
  - Organization of thoughts and delivery of message can make or break a close competition
  - Prefers to see performance numbers net of fees
- Consultant advice to plan sponsor on manager selection
  - Consultant points out the uniqueness of each firm
  - Focus on the best fit with existing manager structure

Questions & Answers

- How do you split the time in the presentation between the sales professional and the portfolio manager?
  - Sales rep covers the organization and firm
  - Portfolio manager covers the process, stock-specific stories
  - Sale rep recaps and asks for the business
  - Important to have back and forth dialogue/rapport between the sales rep and the portfolio manager – this shows team focus. Do this by:
    - Building rapport over time
    - Working towards a common goal
    - Avoiding "piling on" or reiterating an answer the portfolio manager has just given