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Charnley & Røstvold, Inc.

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Alternative Investments: Trends and Opportunities

Moderator: Don Steinbrugge, *Andor Capital Management*
Panelists: Ed Ho, *Merrill Lynch Investment Managers;* David R. McWhorter, *Henderson Global Investors*

***Andor Capital Management*, Don Steinbrugge – Hedge Funds**

- Alternatives market has become more competitive and fragmented. There is a move towards buying philosophy, process and people.
- Who buys hedge funds?

Investor Type	2001	2006 Estimate
High Net Worth	48%	37%
Fund of Funds	18	27
Institutions	19	25
Adviser/Private Bank	15	11

- Endowments and foundations are leading the way among institutional investors
- Important hedge fund manager attributes are:
  - Reputation and quality of investment professionals
  - Quality and consistency of investment process
  - Organization structure and reputation
  - Perceived future strong return potential
- Issues are:
  - Transparency will hurt returns due to the inefficient marketplace
  - Access to investment professionals
  - Risk management
- There are about 6,500 hedge funds. Some have blown up.
- A number of prominent hedge fund managers rarely meet with investors and potential investors
- 95% of Andor's business is gained through direct sales
- Consultants tend not to be very involved with picking hedge funds. Most consultants are using fund of funds.
- Blackstone understands hedge funds
- Brockhouse & Cooper is developing a database of hedge fund managers
- Hedge fund fees are not an issue and may be creeping up

***Merrill Lynch Investment Managers*, Ed Ho – Private Equity**

- There is an extremely high level of talent in the private equity business. The deal flows really come with the people. It's about trust.
- Merrill is seeing fairly significant foreign asset flows, predominantly from Germany and the Netherlands. It is difficult to find good venture capital and private equity managers because many have reached capacity. A typical venture capital company goes to market with a blind trust and raises capital, which then takes 3 to 5 years to invest. The company cannot raise more capital until they have invested at least 70% of the funds raised.
- In a normal market environment, a firm does 20 to 30 deals averaging $10 to $15 million each. When the market was strong, some venture capitalists raised $2 billion in funds, and the deal size increased. The environment has changed, and many venture capitalists are having a hard time putting money to work.
- Perkins is considered the best venture capital firm in the world. They will probably be out of the market for a long time. The investor's objective is to determine who will have the next best funds in the market.
- In 1980, there were 87 venture capital firms/funds; in 2000 there were 693. Expect to see consolidation in the future. Also seeing voluntary reduction in fund size. Blackstone and KK&R set up venture capital offices in Europe. The large buy-out market in the US is becoming efficient.
- Cambridge is one of the dominant consultants in private equity, due to their large endowment and foundation client base. Cambridge has one of the best private equity databases, but cannot share any of the information as it is provided to them confidentially for their benchmarks and indices. Databases are in various forms of development with other consultants.

***Henderson Global Investors*, David R. "Mac" McWhorter - Real Estate Investments**

- Core real estate is still driven by search consultants. Callan is a major player in this area. Non-core real estate is a more direct sell.

Client Service: Creating Client Loyalty

Presenters: Denise R. Cusick and Amanda H. Grant, *Curant Associates, LLC*

- The market is getting tougher, the clients are getting smarter, there's more change than ever and technology services are here to help. Client service can be an opportunity for you and needs to be a core capability. You can make client service a distinction of your firm, hopefully, a positive strength versus an offender. You can't rely on returns alone to attract and keep business, but client service is one crucial area of your business you can control. If you aren't going to be competitive in client service, your competitors already have the upper hand!
- There are four elements of client service you can control:
  - Business management
  - Relationship management
  - Communications
  - Administration
- You want to create client loyalty through your client service. How? Through partnership, trust and confidence. Why? The longer the relationship, the better the return. If you have a three-year relationship with a $10 million account at a 1% fee, it will pay $297,000. If you keep that relationship for 20 years and that account grows at 10% a year, you will earn $5.2 million in fees over 20 years – on a $10 million account! In addition, you are likely to get referrals. This success translates into the opportunity to have and keep dynamic and dedicated employees.
- But, client service can be an elephant. How do you move an elephant? Start today!
- The first thing you need to do is develop a mission statement and communicate it throughout your firm. Have the client service team develop a plan and be very clear about the priorities. You have to set realistic goals and keep working to achieve your goals.
- The first impression is critical. This is your "unparalleled opportunity" to distinguish yourselves. Structure the sign up of the new account in every way possible to create a positive experience for clients. Identify exactly who is responsible for each part of the client relationship and integrate the client service team in the sales process.
- You need to set up certain forms to assure the account inception process is positive. Have an action checklist that includes the documents that will be sent to and from a client and who will be responsible for completion. Get the written guidelines from the client or provide them sample guidelines from which to craft their own. Note

which documents will require internal review and who will be reviewing them by when. Have a Client Relationship Management form and complete it. Schedule an inception meeting with an agenda and checklist; include Sales, Client Service, Trading, Compliance and Operations. Do not leave out any detail.

- In terms of communicating with the client and consultant, you should ideally introduce the relationship manager at the sale or final. Make sure there is one point person and have them call to welcome the client and set up the first offsite meeting (that is not an investment review).
- Also, send a welcome letter from senior management and from the sales and service teams
- Be proactive on all fronts – make sure the client also has information on your entire scope of services so they understand what they will receive in working with you
- At the same time, keep your internal teams well informed and make sure all aspects of the relationship and paperwork are reviewed and are in order. Once client information is entered into your CRM system, make sure it is correct. Leave no stone unturned.
- What do you get from having a successful inception process? First and foremost, you eliminate potential chaos. You make a positive first impression. You start integrating all your firm's resources and people. You begin the process of "building trust, confidence and partnership."
- At the same time, you need to be defining a client service business plan that will enhance loyalty. The client service plan has to encompass your firm's business plan, involve other departments, financial and project-specific objectives and client-specific initiatives. Understanding the budget relative to the risk/reward of that client relationship is important. In that way, you can make smart decisions on your service level to that individual client. If you include a calling plan, it can become a good management tool that sets goals and is measurable as well. It should include a timetable, specific responsibilities and additional sales opportunities. Your checklist for an account status review should address the following:
  - Preparation
  - Who will conduct meetings; what will the agendas be?
  - Who will analyze input? What will the actions/outcome be?
  - Specific action plans
  - Integration into the business plan
  - Review and update the plan regularly

- With respect to the client presentations, again, preparation will make a difference
  - Is the content relevant to what they need/want to know?
  - How is it going to be delivered?
  - What is the follow-up?
- You want to be complete, consistent and informative. Suggested contents are:
  - Cover page
  - Table of contents
  - Investment objectives and guidelines
  - Investment performance
  - Portfolio characteristics
  - Attribution analysis
  - Organizational update
  - Portfolio holdings
  - Purchases and sales
- And finally, the whole process should be fun. If you are having fun working with your client, the likelihood of them having fun and being loyal is higher.

Straight Talk: The Consultant Roundtables

Consultants: Peter Kendall, *CRA/RogersCasey*; Jeffrey Slocum, *Jeffrey Slocum & Associates;* John Small, *Southeastern Advisory Services;* Barry McInerney, *Mercer*

***CRA/RogersCasey,* Peter Kendall**

- CRA and RogerCasey merged three weeks previously. Sixteen of RogersCasey's senior people left the firm, including several managing directors, five research people and some senior consultants. CRA/RogersCasey brought Steve Case back.
- The firm is headquartered in Chicago; however, the manager research group is moving to Connecticut. Sheila Noonan, head of the manager research group, is staying in Chicago for now. She can be reached at 312.575.1873. Sheila can provide names of contacts in each specialty area. Alternative investments will stay in Waltham, MA, which is where the Wellesley Group, purchased one year ago, is also located.
- One service RogersCasey provides that was not being provided by CRA is running web sites for 401(k) clients and getting paid large fees for it
- CRA has a ten-category manager analysis system; half of the categories are quantitative measures and half are qualitative

***Jeffrey Slocum & Associates,* Jeffrey Slocum**

- Clients include foundations/endowments, healthcare and corporates
- What's changed/is different for clients?
  - Clients are now focused on business issues and have reduced expectations for returns
  - For the last 15-20 years, investing has been a beta game; now, the shift in focus is how the manager is creating alpha. This is part of the reason more clients are moving to hedge funds.
  - Slocum's clients have had exposure to hedge funds for the last ten years (and today, there are over 6,000 hedge funds)
  - Due diligence and research time required by consultants of hedge fund managers creates a cost problem; therefore, they price alternatives differently than traditional placements. It is also a greater fiduciary responsibility.
    - Some hedge fund managers are indifferent to being discovered by consultants; therefore, it is difficult to find and know good hedge fund managers

    - Currently, Slocum is recommending individual hedge fund managers over fund of funds (to lessen double loss of fees)
    - They are also recommending clients allocate a 15%-20% to alternatives
  - Foundations are having a tough time; their rate of return need hasn't changed and they are having a hard time raising funds – absolute performance means something
  - Slocum sees aggressive managers not playing to win anymore; rather, they are playing to keep from losing (big dilemma in the marketplace)
- When new managers make it on their radar screen: Slocum uses a 3-year rolling graph and looks at the information ratio. They want to see a flat line consistently.

***Southeastern Advisory Services,* John Small**

- Southeastern's biggest challenge is convincing their clients that the S&P 500 returns for the last 2 years are typical and to stick to long-term investing
- Firm has five employees and 30+ clients, primarily in the $10 M to $100 M range. Founded in 1987, the firm is part of the Wilshire Cooperative and focuses on southeastern US clients. Southeastern is a full-service consulting firm. Amy Douglas handles most of the manager meetings. They use the Mobius database and generate performance reports from the Wilshire Cooperative.
- About half the firm's searches are for separately managed accounts and about half for commingled funds. Manager attributes they focus on include consistently good performance and good communication, especially when things aren't going well. A web site is somewhat important. Valuable web site content includes:
  - Performance
  - Assets under management
  - New clients
  - Professional bios
  - Research (e.g., white papers)
- Investment firms are at a disadvantage if they don't bring a portfolio manager to the final. John's perspective is that the marketer is typically there for the sales pitch, and most disappear after the firm is selected. Some marketers continue to call periodically to check in and see how the relationship is going, which is well-received. Suggestions include:
  - Find out to what type of clients your investment firm appeals
  - Explain reasons your firm is a fit for the clients
  - Make sure your presentation books are interesting to read
  - Always include your sell discipline

  - Buy and sell examples, both successful and unsuccessful, are important
  - Include reasons prospect/client should remember you
  - Include most recent portfolio (all holdings)
  - Be aware of your performance relative to the prospect/client's benchmark
- Southeastern is primarily seeing value searches. Indexing, index plus and core plus are attracting some interest. There is not much activity or interest in fixed income. It's hard for fixed income managers to differentiate themselves.
- Most of Southeastern's clients have 10% - 15% committed to international equity, including emerging markets. They're still committed, but are getting somewhat impatient for returns to improve. None of their clients are invested in hedge funds.
- Presentation tips:
  - Stock examples - the point of a stock example is to help the plan sponsor understand what you are doing. Give them a good, thorough example so they can tell it to others; shows they follow your process.
  - If you show a buy example that worked, also include one that was a failure and why
  - Include current portfolio in the appendix as well
  - Bringing a portfolio manager to meetings shows the Board/Committee that the firm thinks they are very important prospects
  - Perception is a big part of the picture; a product specialist is a product specialist
  - Prior to a presentation/meeting, verify your numbers/data with the consultant to confirm they are the same before the client reviews them
- Top three marketing mistakes
  - No sell disciplines in the book
  - Multi-product firm pitches all their products at once
  - Presentation books that don't fit in files
- Also, if you are part of a larger organization, remember to include where you fit

***Mercer*, Barry McInerney**

- Previously in Canada, Barry now heads Mercer's US practice. One of Mercer's competitive advantages is the firm's global scope – about two thirds of the firm's 600 employees are outside the US. Mercer has a fund of funds in Australia.
- The majority of Mercer's searches are equity (about 80% equity/20% fixed income in the US). Mercer has conducted more fixed income searches overseas than in the US. Have done a lot of long bond and core opportunistic searches. Only 10% of the firm's revenues come from searches. Manager monitoring is a core activity. The majority

of Mercer's clients are institutional; about half are defined benefit and half are defined contribution. The firm has 550 retainer clients in the US, of which about 250 are defined contribution.
  - Searches for 2002 are in-line to be around 650 in total; 2001 = 650; 2000 = 800 (800 was an unusually high number)
- Mercer has four geographic units. Manager research is both centralized and decentralized. Mercer ranks managers by their products; firms are given an A, B or C ranking. "Research-qualified products" are put forth for searches. To be considered, a manager must be on Mercer's Internet Access database, and a product must be rated an A or A- to be recommended. It is important for professionals in the Chicago office to know your firm. There is some discretion at the field level; the research analyst assigned to the manager has the discretion to reveal the manager's product ratings. About 20% of Mercer's manager research list turns over annually.
- Mercer admits that it is tough to get to know them and the key is that a manager needs to get to know the research group in Chicago
- Mercer's manager review process is challenging and once you are ranked, Mercer does not share with you how you are ranked (but most managers should be able to figure it out)
- Every quarter, a challenge committee meets to review managers' product rankings. Primarily Chicago directs this review. Mercer has asset class specialists. Mercer recently published the results of their manager research.
- Mercer's approach is to address overall asset allocation first. There is a lot of talk about hedge funds, but Mercer recommends a minimum allocation of 5% for an asset class to have an impact. John Frede in Chicago is Mercer's point person for alternatives. Less than 5% of Mercer's searches are alternatives.
- Frustrations managers may have with Mercer are accessibility and turnover of the consultants

How to Navigate the New European Market: New Landscapes, New Routes to Success

Moderators: Joe McDevitt, *PIMCO Europe Ltd.*
Panelists: Todd Rupert, *T. Rowe Price Global;* John C.E. Campbell, *Delaware Investment Advisers*

***T. Rowe Price Global*, Todd Rupert**

- Characteristics of non-US retail markets:
  - There are minimum and maximum investment restrictions country by country
  - The UK market is very consultant-driven
  - Sophisticated attribution is gaining interest in Europe
  - Third party distribution is key
  - It is important for managers serving these markets to have web sites and product sheets in multiple languages
  - You must be committed for the long term
  - You must be aware of the cultural differences
  - Your advertising must be changed market by market
  - Brand is important
  - Manager of managers (e.g., Russell, EAI) are well received
  - You need to hire locals; generally not successful for a US-based marketer to make periodic trips overseas
  - RFP responses need to be more contextualized, not just translated; must take a global perspective
- Europeans have a poor impression of Bush

***Delaware Investment Advisers*, John Campbell**

- Delaware is owned by Lincoln National and has two offices – Philadelphia and London. Ten percent of the firm's $85 billion AUM is subadvised.
- Glenn Nelson covers the non-US market. Their non-US team includes one marketing person, one client service person and one RFP person. Product specialists work with Glenn.
- There is generally less consultant influence in the non English-speaking countries. Mercer and Watson Wyatt are two of the dominant global consultants. Five of Delaware's 14 non-US clients came through consultants. They were in 25 finals to get the 14 clients. Investment style is also less important. Good, consistent investment performance is a must. An investment firm must also have outstanding

client service. Continuity of professionals is important. Delaware's London office has only had three out of 35 people leave, and one transferred to their Philadelphia office.

- In the subadvisor market, you need reciprocal arrangements. Brand is important. Major players are demanding more, so costs go up. Sometimes a manager has to make fee concessions.

***PIMCO Europe Ltd.*, Joe McDevitt**

- Initially, PIMCO flew someone overseas for a week a month to market. T. Rowe Price chose the Netherlands for their first overseas office. Once they opened an overseas office with client service, opportunities opened up, even with US-based, multi-national companies. Joe focuses primarily on the Skandinavian market. T. Rowe Price subsequently opened an office in Copenhagen. It was less expensive and had less competition (only Schroder) than Stockholm. Allianz brought PIMCO a presence in Germany, France and Italy.
- London is the one location you can pick that is neutral for a non-US headquarters (versus Germany or France, which can pigeonhole you). More traffic comes through London as well. The UK is the biggest pension fund market and is very consultant-driven. New accounting rules have brought massive change in the UK market. There is increased sensitivity to volatility of year-to-year returns, which has to be reported on a company's balance sheet. UK pension funds are lowering their allocation to equities from 85% to 60%, which has a big impact on the $3 trillion market. There is increased demand for fixed income. PIMCO took out full-page ads in some of the major publications in Europe. Netherlands has a big interest in real estate. Norway is showing a little interest in REITS.
- Reform in Spain is not going as quickly as expected; e.g., the ability of banks to open up to foreign subadvisors. Eighty percent of the funds used in Italian fund of funds are foreign.
- T. Rowe Price found a deep pool of compliance people in the UK
- European sponsors follow managers much more closely than they do in the US. They want weekly updates of transactions, which requires more resources from the manager.
- Technology is very important to working with non-US clients (more important than in the US). Video conferencing is well received. Clients want the portfolio managers to stay home and focus on performance. Clients want access to account information via the Internet.

Past, Present and Future: Industry Veterans Build On the Best of Both Worlds

Moderator: Victor A. Zollo, *De Prince, Race & Zollo, Inc.*
Panelists: W. Allen Reed, *General Motors Asset Management;* Eugene M. Waldron, *Jr., Capital Guardian Trust Company;* Ronald Peyton, *Callan Associates Inc.;* Laura Wallace, *NVPERS*

***General Motors Asset Management*, Allen Reed**
Macro factors for plan sponsors

- Market trends: know where your product fits in marketplace; know what's happening with your client prospect; sell when you are out-of-favor (need to be convincing)
- Structural changes in business: know what's going on at the plan
- Understand plan sponsors' problems: their responsibilities are vast; help them solve problems when you can
- Historical changes since Allen has been in the industry:
  - 1975 he was at Delta Airlines
  - ERISA created
  - 1975 – marketing timing decreased and boutiques emerged as an explosion of investment management firms
  - Mid-1980s brought an increase in real-estate; commingled funds had a lot of problems though
  - Next came Modern Portfolio Theory and Efficient Frontier thinking; international investing became attractive
  - Foreign companies looked attractive and domestic firms decided to build their international business, which was a big expense
  - 1990s saw increase in indexing as well as strategic alliances, which had a high cost association
  - 1997-1998 saw venture capital investing increase; all were based on relative performance
- Today brings:
  - Strategic relationships – provide a service
  - Single provider still does well (difficult as a start-up though)
  - Private Equity is going through major consolidation; expense loads are difficult without high (40%) returns
  - Absolute Return Strategies – there is a role for them somewhere; they address the number one problem (8-12% returns; low correlation of assets)

- Global/international returns will deliver 8% in next 5 years
- Mergers and Acquisitions – difficult to make a success; too transaction-oriented

***Capital Guardian Trust Company*, Eugene M. Waldron, Jr.**
Past, Present and Future – The Art of Marketing

- 1969, Merrill Lynch analyst
- 1970s – different world of marketing (limited conveniences)
- Times change with the advance of technology:
  - You can be offensive and defensive in one
  - Plan sponsors became more knowledgeable and sophisticated; makes marketing job easier
  - Convenience of Blackberrys, cell phones and laptops
- Challenges:
  - No decrease in competition
  - Differentiating yourself
  - Greater partnership between plan sponsors and consultants; disagrees that there are "strategic partnerships"
  - DC plans are not going to replace DB plans, which may even grow (resistance to DC plans is high after ENRON)
  - Fee pressure won't occur
  - Manager's "value added" still an issue
  - Bottom line is that even with all the technology, it all comes down to relationships – that's how you will get hired

***NVPERS*, Laura Wallace**

- What's new in the world of plan sponsors – from pain comes knowledge:
  - Granting more investment discretion
  - Rebalancing investment portfolios by design rather than by default
  - Manager searches are less clandestine
- What's new in the business world:
  - Portfolio manager meetings are open and less discriminating
  - Development of ethics policies and disclosures
  - Need leadership as plan sponsors and money managers
    - Be about something/take responsibility
    - It's about listening and being heard

- Courage to do the one thing you think you can't do
- Loyalty and humor

Portfolio Managers are From Mars, Marketers are From Venus: A Practical Guide to Bridging the Communication Gap

Moderators: Carol Allen and Liz Hecht, *Alpha Partners*
Panelists: Michael Beasley, *Strategic Investment Solutions;* Mariko O. Gordon, *Daruma Asset Management;* Lindsay Richardson, *State Street Global Advisors*

***Strategic Investment Solutions*, Michael Beasley**

- Communication is key; as much business is lost from poor communication as from poor performance
- Improving communications with portfolio managers:
  - Earn their respect; know your product – strengths, weaknesses, portfolio characteristics
  - Populate Nelson Information/Money Market Directory with your data
  - Keep plan sponsor asset allocation in mind
  - Benchmarks, peer groups and possible "at risk" managers are concerns of plan sponsors/consultants
  - Be able to distinguish consulting firms from each other; they are not all alike
  - Debrief following each meeting/trip; discuss what you learned and what you would do differently
- Plan your trip and your meetings
  - Prepare/educate your portfolio manager
  - Explain why the trip will be worth the effort
  - Focus on listening versus talking
  - Focus on educating versus selling – adding value
  - Follow-up; debrief after each meeting/trip
- Possible challenges ahead:
  - Excess capacity/mergers and acquisitions
  - Downsizing of manager rosters
  - Plan sponsor sophistication/experience
  - Managing distribution channels
  - Adding value
    - Take research reports/white papers to clients and consultants
- "Past experience, if not forgotten, is a guide to the future." *Chinese Proverb*

***Daruma Asset Management,* Mariko Gordon**

- Marketers need to work with portfolio managers to get "religious" about what they do
  - Need to remember that plan sponsors are so much more aware and educated that you need clarity when describing your process/product
  - Portfolio managers fear that if they make their process too clear, people will think it is less valuable; however, if the process is clear, it will help with client retention
- Daruma suggests you consider using props to explain your process
  - For Daruma's company name, they chose the name to help them tell their story of who they are. Daruma is a statue and they want people to think of it when they hear their name and remember them.
- As for process to performance "cradle to grave" examples, Mariko does not like them
  - There are philosophical differences about examples; some consultants say "no" to real-life examples while some plan sponsors say "yes" in order to see the real-life portfolio
  - Mariko suggests delivering the "three best" and "three worst" performers
- Lastly, slow and steady wins the race; can't be all things to all people

***State Street Global Advisors,* Lindsay Richardson**

- Product Engineers at State Street are marketing specialists with investment expertise
  - Their role is to bridge the gap between portfolio managers and sales
  - All Product Engineers have been portfolio managers and have investment expertise on buy and sell side; they are "technical" sales professionals
  - The role is very important for multi-product firms in order to have someone who can represent groups of products
    - In multi-product firms, portfolio managers are anxious to claim attention and shelf life in the sales group
- Teams work well together to remove the "ego"

***Alpha Partners,* Liz Hecht**

Five Ways to Bridge the Communication Gap

1) Create a culture of mutual respect – have a clear understanding of basic market requirements such as:
   a) Distinctive identity
   b) Well-defined investment process
   c) Examples that make the process come alive
   d) Performance attribution

2) Develop a mutually supportive compensation system
   a) Recognize the importance of portfolio management and marketing to the total well-being of the company
3) Define roles
   a) Delegate decision-making authority to specific people for specific disciplines with responsibility for supporting one another
4) Communicate vividly and systematically, to leverage one another's expertise:
   a) Participate in key marketing and investment meetings on a regular basis
   b) Share investment and marketing war stories
   c) Develop fresh examples of the investment process in action
   d) Rehearse presenting as a team, swapping roles often
   e) Post answers to frequently asked questions on your web site/intranet
5) Measure everything – not just investment performance, but also client satisfaction and success in marketing/sales

Who Wins A Search and Why: A Case Study

Moderator: Sabra Bartlett, *Middleton & Company*
Panelists*:* Dr. Peter W. FitzRandolph, *St. Lawrence University;* Ms. Kathryn L. Mullaney, *St. Lawrence University;* Millie Viquiera, *Callan Associates Inc.*

St. Lawrence University – Large Cap Value Search
Staff Liaison to Investment Committee: Kathy Mullaney
Endowment Trustee: Peter FitzRandolph
Consultant: Millie Viqueira, *Callan*
Moderator: Sabra Bartlett, *Middleton & Company, Inc.*

- St. Lawrence University began the search process with an asset allocation study. As a result of the study, the plan raised their international equity allocation from 5% to 10%, kept their US equity allocation at 65%, and reduced their fixed income allocation from 30% to 25%. Most of the plan changes were within the investment manager structure; St. Lawrence University hired/fired five managers.
- St. Lawrence University had no investment expertise on their staff, so they hired Callan to standardize the search process. The challenge was getting all the trustees together.
- For the large cap value search, Callan started with 400 large cap value candidates in their database. Criteria used to screen the universe included:
  - Consistently strong relative returns versus S&P 500 and Callan Value Style Universe
  - Asset base
  - Length of track record
  - Organizational and personnel stability
- Callan prepared a search book for each of six candidate managers and conducted a teleconference to review the candidates with the investment committee. The committee selected three of the six managers for interviews. The three finalists had the highest returns, ranked in the middle of the risk profile and had the lowest fees. In addition, all three managers were known to one or more of the trustees, which provided a level of confidence.
- Most of the finalists' presentations were similar in structure with two presenters - one marketer and one portfolio manager. The marketing professionals were all well

dressed and groomed. The portfolio managers were not always as well dressed or articulate. The marketers all presented first.

- Substance is what counted. The committee selected the firm they believed they would have the best working relationship with the portfolio manager. The portfolio manager was able to articulate clearly the investment process and respond to questions well, and the marketing person seemed very knowledgeable on portfolio management. The committee feels the portfolio manager and marketing person need to be equally knowledgeable and work well together. The marketing person should not come to the final unless they have a substantive role.
- St. Lawrence University also hired a fixed income manager. The manager they selected never opened the presentation materials, and just talked about what he did. He also spoke without jargon. Other attributes that were important in the committee's selection decisions were:
  - The managers must show passion for the business
  - Good chemistry between the committee and investment manager
  - Examples, such as a specific stock story and reasons they did/did not pick a stock, help
  - How quickly the managers do their reporting
  - How the reconciliation process is executed
- The committee decision was by consensus
- Negative attributes of the losing managers included:
  - Did not let the committee get a word in edgewise during the conference call; was one-way with no dialogue
  - Provided standardized presentations with no customization other than the cover page
  - Made little effort to learn about St. Lawrence University and their objectives
    - Suggested that managers call the consultant prior to the final to learn about the prospect's personality, objectives, etc., and not wait to do that until during the final
  - Were too married to their presentation books

Growth Opportunities in the High Net Worth MarketPlace

Moderator: Geraldine D. Leder, *LederMark Communications*
Panelists: Joe Fields, *Friess Associates of Delaware, Inc.* – investment management firm; Louis G. Moelchert, *Private Advisors* – independent advisor with fund of funds; Martha Staniford, *CIBC;* Mark Staples, *First Union-Consulting* – brokerage firm investment consulting

- The high net worth market is defined as $10 million or above, assuming that brokers serve the millionaire market. For the $1 million to $10 million sector, there are opportunities for firms that can offer multiple solutions under one roof. Targeting the larger accounts, there are 265,000 decamillionaires, who are much different than their predecessors. Today, 63% of the Fortune 200 earned, versus inherited, their wealth. The majority made their fortunes through their own companies, which means that they may have:
  - Restricted securities
  - Exercised options
  - Concentrated positions/substantial capital gains
  - Sold businesses
- They tend to be equity investors with high expectations for service. Being entrepreneurial and used to making decisions, they want to self-direct. They are likely to use a number of providers, although there is evidence of increasing use of a more holistic approach. Tax efficiencies are important. Only a handful of managers say they actually minimize taxes, and that gives them a competitive edge. 1838 is a good example. They will customize an account and are able to offer their service with a 75 bp fee. Long/short is more tax efficient, which is one of the reasons for that strategy's popularity. Decamillionaires are quite comfortable with the Internet and will communicate with each other via the Internet and e-mail and do manager research on their own.
- With respect to how they make decisions, their needs drive their decisions. Liquidity can be an issue. They will require solutions to complex issues and best-in-class products (including alternative investments). They look for the best people and expect high touch from them. They will understand and perhaps use technology tools on their own. With respect to multiple providers, they prefer open architecture, which allows them freedom of choice. Being businesspeople, they simultaneously seek competitive cost structure. There is definite fee pressure (one of the panel said they

treat all clients the same, whether $25,000 or $25 million – there is one fee across the board).

- For managers targeting the high net worth business, you have to ask yourself, are you in the investment management business or the wealth management business? Are you the best solution? Are you the manufacturer or distributor? The answers determine your approach. If you are in the wealth management/private banking business, you need to be vertically integrated, playing the role of both manufacturer and distributor. You will need to have professionals skilled in estate planning, tax planning and risk management. There should be access to trust services/donor advised funds/brokerage accounts. You will need to provide complete asset allocation and a full product array. To be competitive today, you need to offer non-proprietary investment alternatives to supplement your proprietary menu. Additionally, you need to think about offering online account access.
- You need to get to know the attorneys and other key advisors to this market; there are times when you won't interact with the investor. Joe Fields maintains that the days of a one-stop shop are gone. The asset allocation models have transcended down, and it is not assumed that one manager is proficient in all areas. At the same time, there is more competition and focus on fee pressures. Freiss focuses 100% on rapid growth with a valuation sensitivity. His shop is a team-oriented group with no titles and the motto "We all do the windows." Compensation is tied to how well the client does.
- Freiss develops much of its business through its research business. It gives CEOs a first-hand view of the quality of the investment decision-making process. Their research analysts follow up every meeting with a letter on the firm's performance and strategies. They do no advertising and rely on word of mouth. Consultants have also become clients of Friess. They are a high touch firm with their clients.
- Louis ran the endowment at University of Michigan for 25 years and immersion in hedge funds led him to start his company. Today, they advise to $1 billion and have 17 people. His clients are equally divided between insurance companies and high net worth (over $10 million to $100 million). His firm only invests in non-traditional investments.
- The high net worth market is different from the insurance companies in one area – they are mostly very smart but they do not have a clue what to do with their money. They do not have asset allocation plans like institutions do and that's the most important thing you can do for them – develop a viable asset allocation plan that addresses their needs.

- Louis believes that a fund of funds format is the best way for high net worth clients to invest. The market, however, is extremely inefficient and getting access to high net worth clients is a challenge. Business either has to come in the door directly, or you have to use third-party marketers or brokers. You lose control of the client, but you can grow your business effectively this way.
- Mark Staples covered what First Union looks for in a manager. His program is the fourth largest wrap program in the business. In fee-based business for a 2001 five-year growth rate, they expect 23.2% for wrap managers; 34.8% for mutual fund wrap managers; 32.4% for financial advisors and 82.2% for fee-based brokerage accounts.
- First Union stresses the people and the process. He wants to see consistency in the people, the process and the results. The more you can show rolling performance periods, the better. He doesn't believe in the style purity "gibberish." He believes that there are great managers that haven't been found yet, and they like to find them. They use PSN/Mobius. He will accept a less than five-year record if it is an experienced manager and they can do the research. He also likes a unique investment style. When you meet with them, you should show your "special sauce."
- You should develop a marketing plan on how to best roll out your product and share those plans. Only 50 brokers out of 5000 are successful in the over $10 million market. The ones that are successful focus on the client experience. They "benchmark the beach house," which means they understand what the client wants to achieve with their assets. Reporting is less on performance and more on the progress toward meeting that client's goal, whatever it is.
- Mark expects big growth in manager's multiple styles in one account – DMAs. He predicts we will see greater concentration in these types of accounts. One goal is to simplify the paperwork and having one manager firm with multiple styles in an account will do that.

"A Lot Can Happen In 25 Years" – Mutual Funds and the Institutionalization of the Financial Markets

Speaker: John C. Bogle, Founder and Former Chairman, *The Vanguard Group*

- In the past quarter century, America's GDP has risen nearly six-fold, from $1.8 trillion to $10.2 trillion. Corporate earnings have grown almost as fast, from $100 billion to $500 billion.
- The stock market has soared four times as fast as profits. The market value of US stocks is up from $850 billion to $12.5 trillion, and the Standard & Poor's 500 Index has risen from 100 to above 1100.
- Institutional ownership of US stocks has grown from $330 billion to $8 *trillion* – from 39% of all stocks to a dominant 60% ownership of corporate America
- Active managers have watched asset *non-managers* move to the forefront. Passive market-indexing strategies now account for more than 30% of total institutional assets, compared with less than 0.1% at the end of 1976. Today, four of the eight largest money managers focus primarily on indexing.
- Annual turnover in the US stock market was 23% in 1976; in 2001 it was 134%. Institutional investors played a major role in this upsurge, with equity mutual fund turnover rising from 30% long-term *investment* to 110% short-term *speculation.*
- There's been a massive transfer of investment risk of retirement plans from the *corporation* to the *employee.* Assets of defined benefit (DB) plans, more than 70% of retirement plan assets back in 1976, have declined to 45% of assets, and the end of that shrinkage is not yet in sight.
- Today, some fifty million families own equities, and there are 8,346 mutual funds
- The mutual fund industry became a giant: Equity fund assets were $40 billion a quarter century ago and 12% of the institutional total, they have grown to $4.1 trillion, comprising 40% of all institutional holdings of US stocks
  - In 1976, the three largest firms (IDS, Fidelity and Capital Guardian) controlled 35% of the total assets of this elite group. By 2001, the three largest firms (Fidelity, Vanguard, Capital Guardian) controlled almost 60% of the total.
  - In the coming era, mutual fund managers will have to focus on two elements
    - Negative impact of *financial intermediation costs* on retirement plan investors
    - Increased attention to *asset allocation*
  - Both trends will be accelerated by the fact that the financial markets will *not* repeat their remarkable generosity of the past quarter-century

- Bogle's suggestions for how *not* to think about future returns:
  - Do *not* believe that the stock market is an actuarial table
  - Do *not* accept that the past is prologue
  - Do *not* succumb to Monte Carlo-itis (trying to assume what particular returns might be earned in the future)
- Cost Matters: two ways to minimize costs are (1) Reduce fund *transaction costs* by slashing portfolio turnover; that is, by *investing* on the basis of long-term *corporate value* rather than *speculating* on the basis of short-term *stock price*; (2) Reduce fund *expense ratios* by operating more efficiently, and by cutting the level of management fees.
- Asset Allocation: asset allocation will be given far more attention in DC plans
  - Bond funds will explode upward from their present 3% share of the assets of retirement plan participants
- Private Retirement Plans: those who are saving, are not saving enough. A recent study reported that the typical employee in a DC plan would earn retirement income, including social security, equal to only 48% of previous income, compared with 60% for the typical employee in a DB plan.
  - Although we can't change the pension funding situation, we can change other things:
    - Institutional managers and consultants can help by discussing the proper balance between DC/DB plans with their clients
    - We all must work with our clients to help educate their employees in the simple principles of investing, in understanding risk, and in the critical role played by investment costs
    - Work together to encourage them to increase their savings in order to assure a comfortable retirement