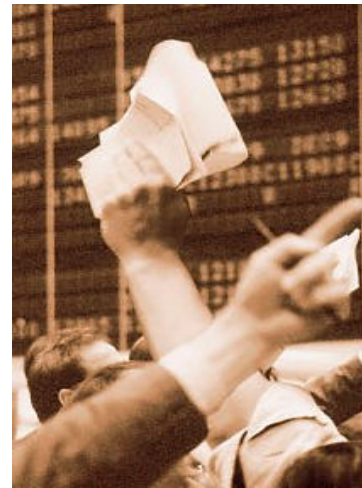
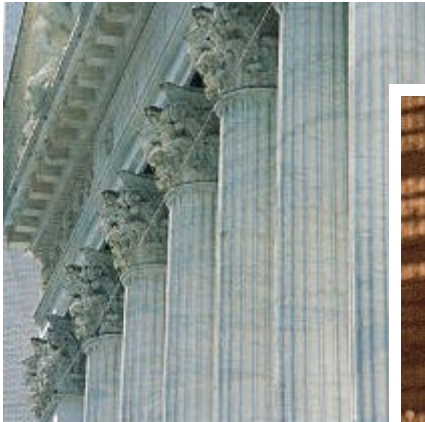


The Asset Management Industry in 2010: Bigger, sometimes better – and the best pulling away



Alok Kshirsagar
Salim Ramji

October 18, 2006



Setting the stage – Continued performance strength, but significant changes in the offing

Looking ahead – Eight major trends that will shape industry growth and profitability

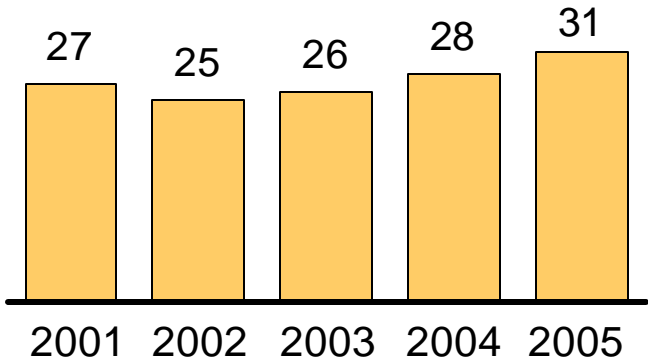
The asset management industry in 2010 – Wide-ranging changes in industry structure and dynamics

The path ahead – Key questions for asset managers to address

A CONTINUALLY HEALTHY INDUSTRY DURING A DIFFICULT PERIOD

Stable profit margins

Profit margin
Percent

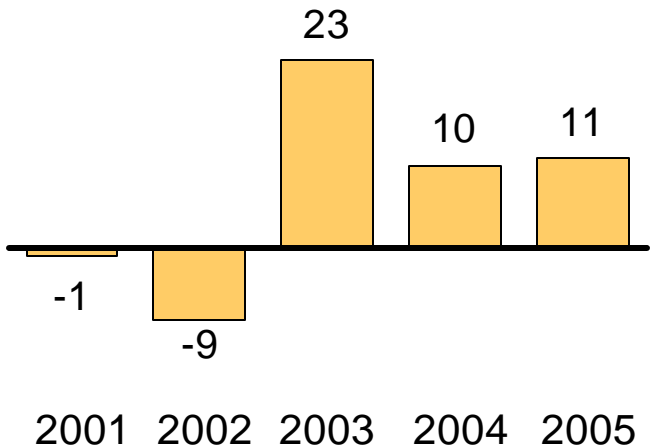


Share of managed assets
Percent

Year	Share of managed assets (Percent)
2001	52.7
2002	53.5
2003	53.8
2004	54.8
2005	56.2

Recovering asset growth

Asset growth
Percent



Long-term net flows as percent of BoY AuM

Year	Long-term net flows as percent of BoY AuM
2001	n/a
2002	1
2003	2
2004	2
2005	2

BUT CHANGES AHEAD FOR INVESTORS OF ALL STRIPES

Institutional investors

- Persistent **underfunding** threatening viability of current plans
- **Lower return expectations** leading to search for new sources of alpha
- More **scrutiny** from employees, regulators, and other stakeholders

Retail investors

- **New risks**, real and perceived – longevity, health care, social security
- Lower **market expectations**
- Risks and concerns amplified by **demographics**
- Greater demand for **advice** – explicit or implicit – to address new risks

Setting the stage – Continued performance strength, but significant changes in the offing



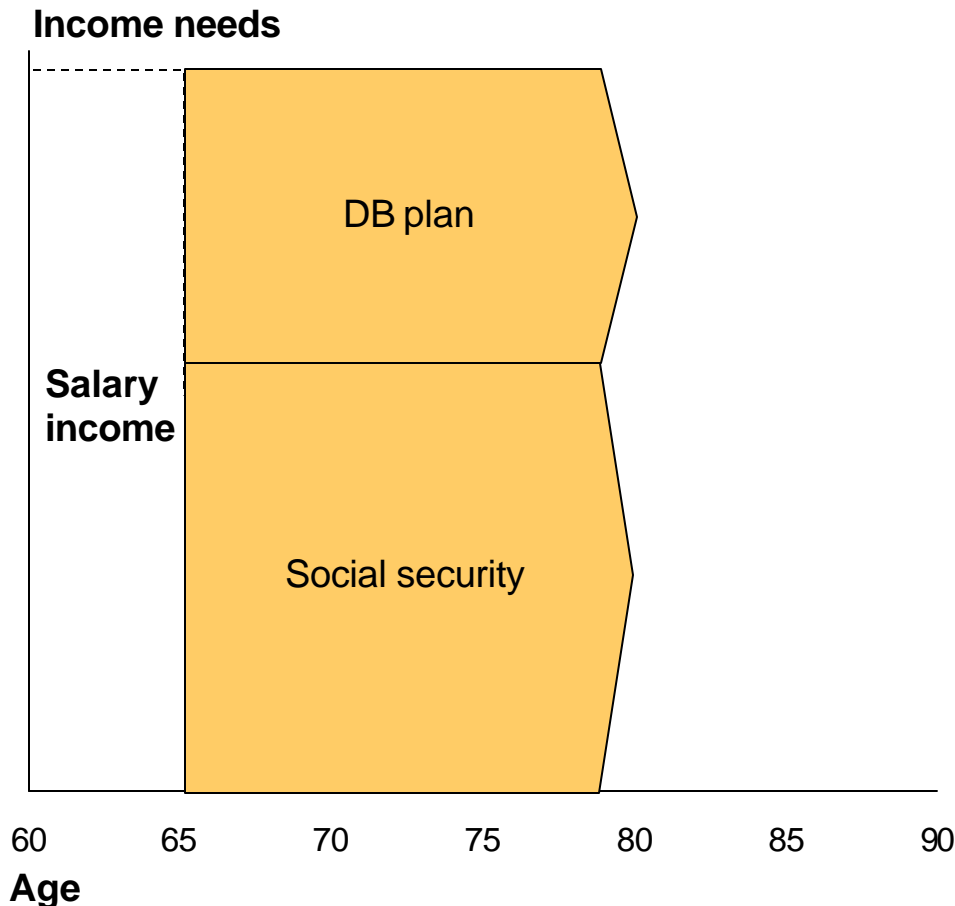
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1 MOVE FROM ACCUMULATION TO INCOME AND RISK PROTECTION

Illustration of sources of retirement income

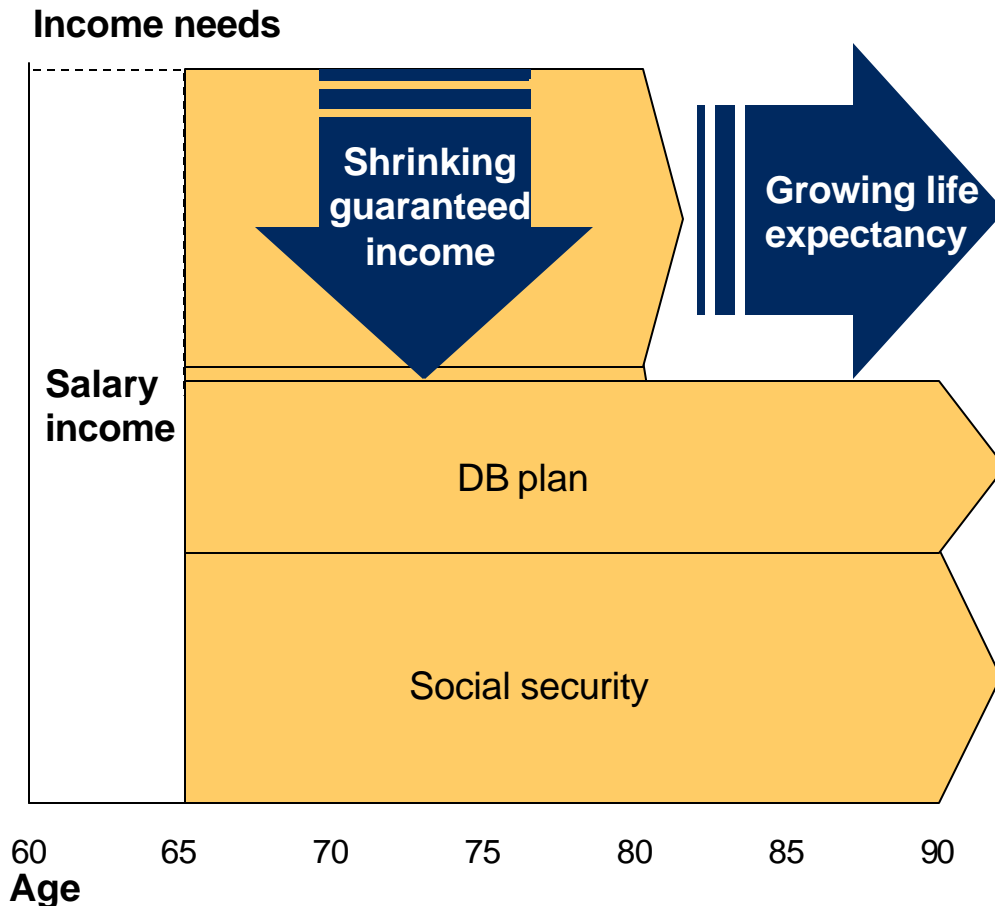


1986

- 65% of retirement income came from Social Security
- High quality DB plans covered 53% of HHs
- Healthcare expenses largely covered by employee retirement health plans
- Life expectancy from age 65 was 14.4 years for males and 18.6 years for females

1 MOVE FROM ACCUMULATION TO INCOME AND RISK PROTECTION

Illustration of sources of retirement income

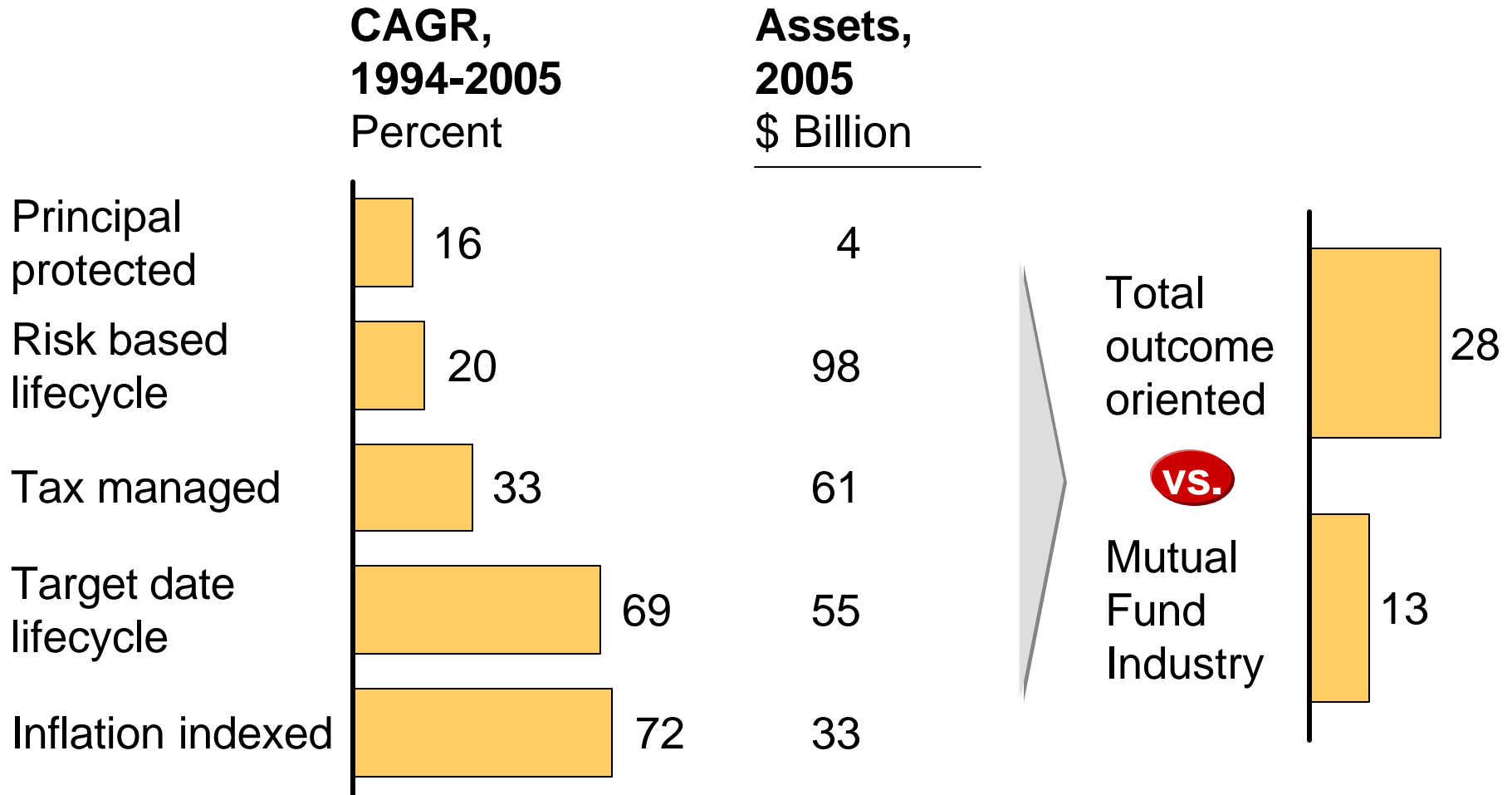


2006

- Social Security provides a maximum of \$25k per year
- DC plans cover majority of households – but savings rates are very low
- Increased proportion of health care costs borne by individuals – 2-3X CPI
- Couple turning 65 has >50% chance that one lives into their 90s

2 MOVE FROM RELATIVE INVESTMENT PERFORMANCE TO OUTCOME ORIENTATION

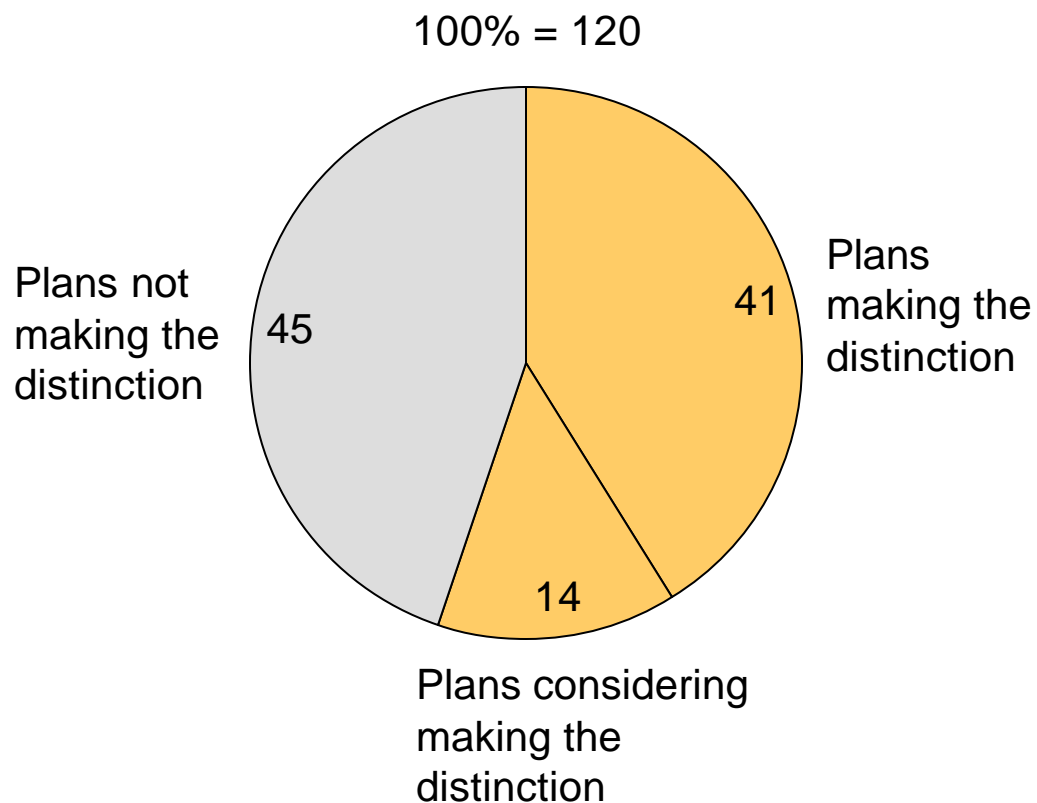
Growth rates of outcome oriented funds vs. industry



3 SEPARATION OF ALPHA AND BETA

DB plans distinguishing between alpha and beta

Percent



We are seeing a **more bifurcated industry**. People are buying beta through ETFs and complementing that with alpha-adding managers.

– CEO, Investment Company

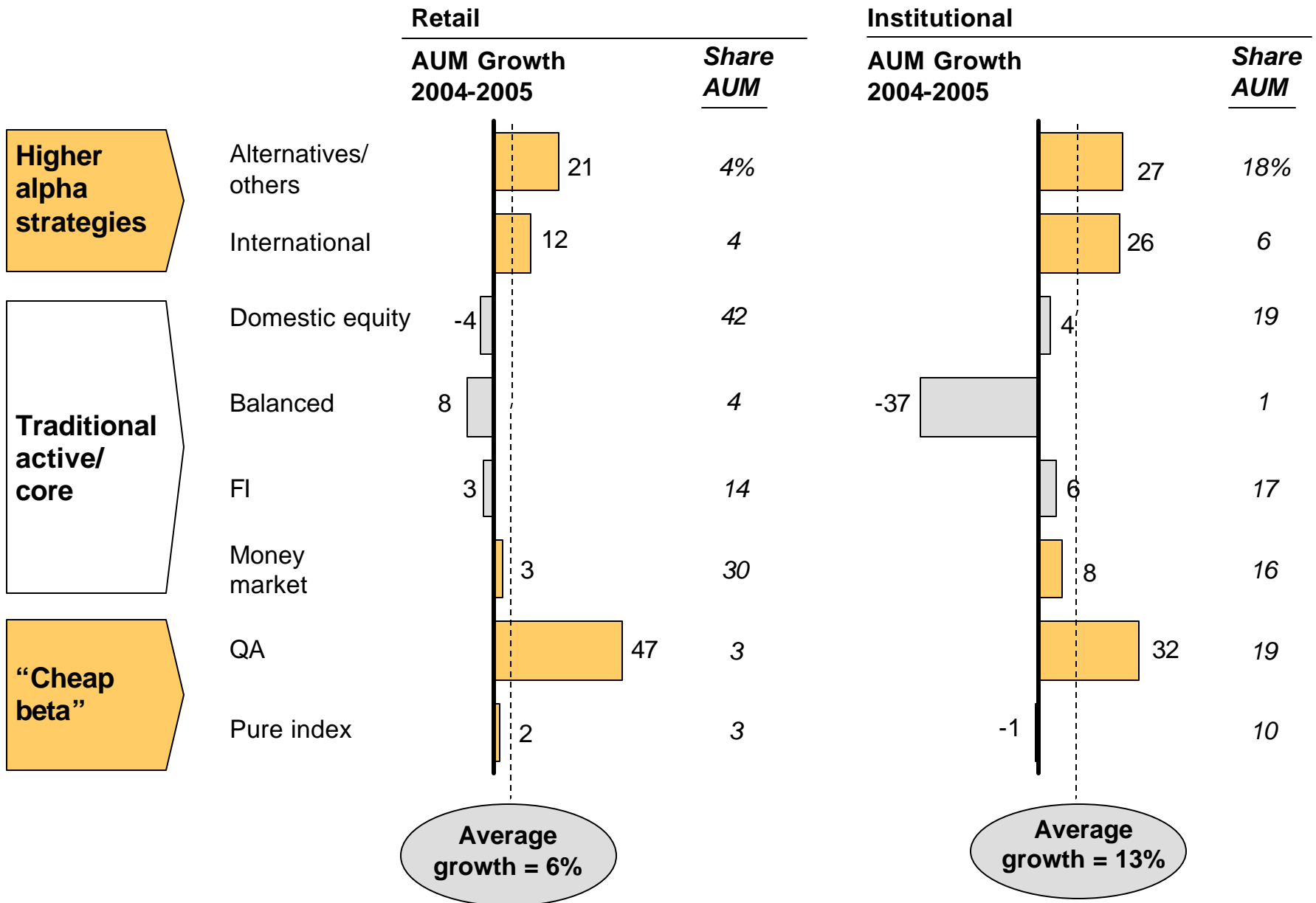
The smart funds-of-funds guys are **trying to isolate alpha**. The stuff that's hard to hedge out is what people will pay for.

– Co-founder, Hedge Fund

3 SEPARATION OF ALPHA AND BETA



3 SEPARATION OF ALPHA AND BETA



4 PENSION RESTRUCTURING

89% of S&P 500
DB plans are
under-funded
(vs. 32% in 2000)

Plan freezing
frequency is increasing
(71 out of top 1,000
froze in 2004 vs. only
31 in 2001)

Solutions

- **Asset/liability management strategies**
- **Moving DB participants into DC plans**
- **Structured products to immunize frozen plans**

Plans' **expected return on assets** decreased to 8.4% in 2004 from 9.3% in 2000

Plan liabilities
discount rate
dropped to
5.75% from 7.5%
in 2000

5 INSTITUTIONALIZATION OF RETAIL

Historical practices

Wholesaling focused at the individual advisor level; emerging home office relationships

Efforts largely product-driven

Social relationships key (driven by “schmoozing” – lunches, conferences, golf outings, etc.)

Frequency of visits driven by schedule/regularity rather than opportunities to add value

Emerging challenges

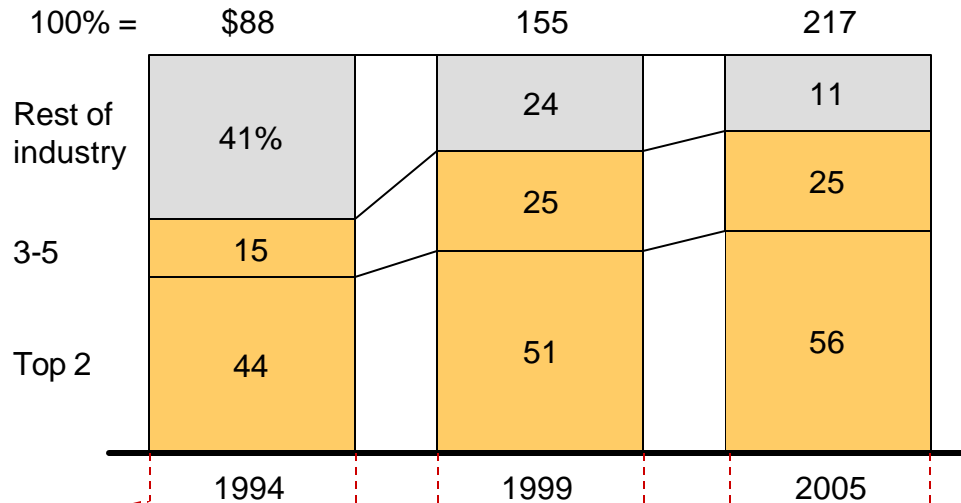
- Wirehouse home offices playing an even stronger role, packaging products, and looking for strategic partnership
- Scale required to cover full range of advisors, home office, and wirehouse regional infrastructure daunting in an environment of compressing economics
- Product characteristics increasingly commoditized (at least in perception even not if in reality)
- Performance no longer enough – just a ticket to play
- Product-led sales demonstrate less staying power during times of underperformance
- Personal relationships still critically important, but increasingly “table stakes” for other sources of value add
- Non-value add visits increasingly lost in the clutter
- Frequency of visits still important to maintain mindshare, but advisors demonstrating lower tolerance for “regular” wholesaler meetings
- However, wholesalers lack skills/confidence to consistently find topics to generate meaningful interactions

5

INSTITUTIONALIZATION OF RETAIL – DISTRIBUTORS PLAYING A CENTRAL ROLE

Net flows by fund family

\$ Billion, percent



Percent of net flows

- 1. Fidelity 34%
- 2. American Funds 11
- 3. Merrill Lynch 5
- 4. Putnam 5
- 5. AIM 5

Top 5 share

59

- 1. Vanguard 28%
- 2. Janus 24
- 3. Fidelity 11
- 4. Alliance Bernstein 7
- 5. PIMCO 6

Top 5 share

76

- 1. American Funds 37%
- 2. Vanguard 19
- 3. PIMCO 11
- 4. Dodge & Cox 8
- 5. Franklin Templeton 7

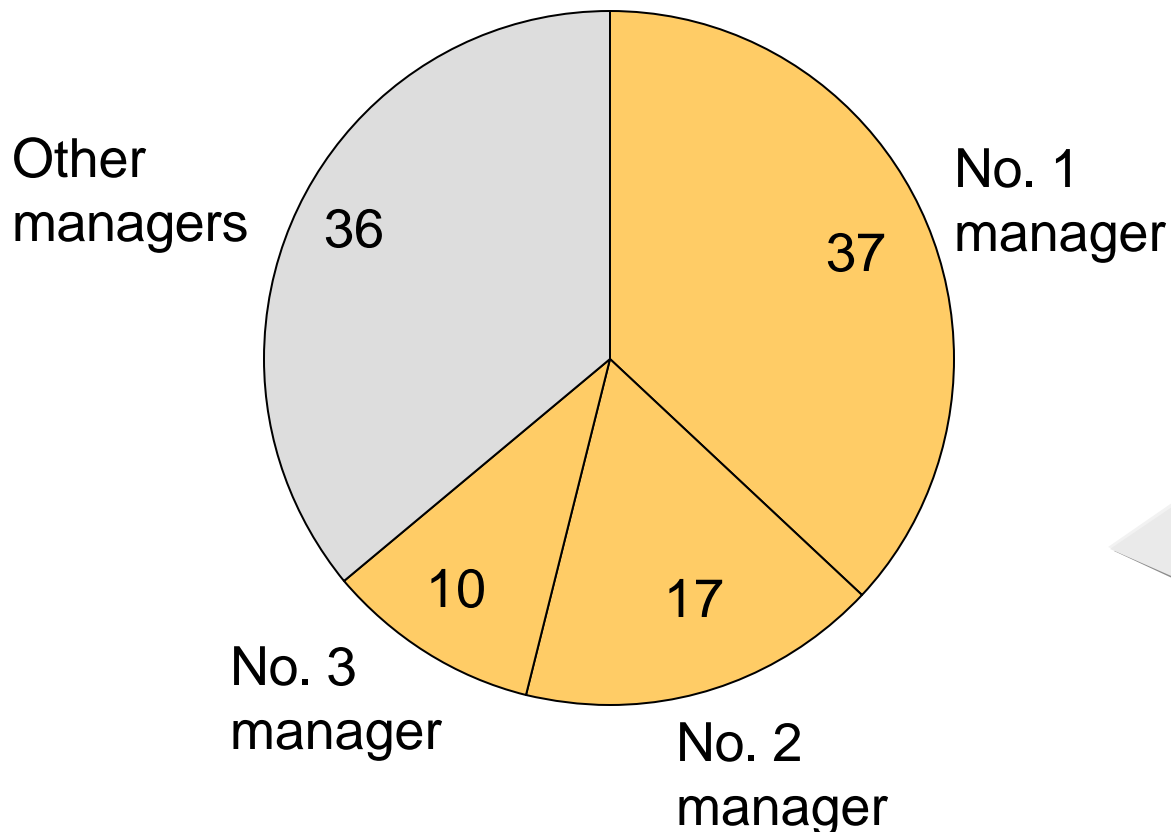
Top 5 share

81

5 INSTITUTIONALIZATION OF RETAIL – IMPLICATIONS AT THE ADVISOR LEVEL

Advisors' allocation of mutual fund assets

Percent



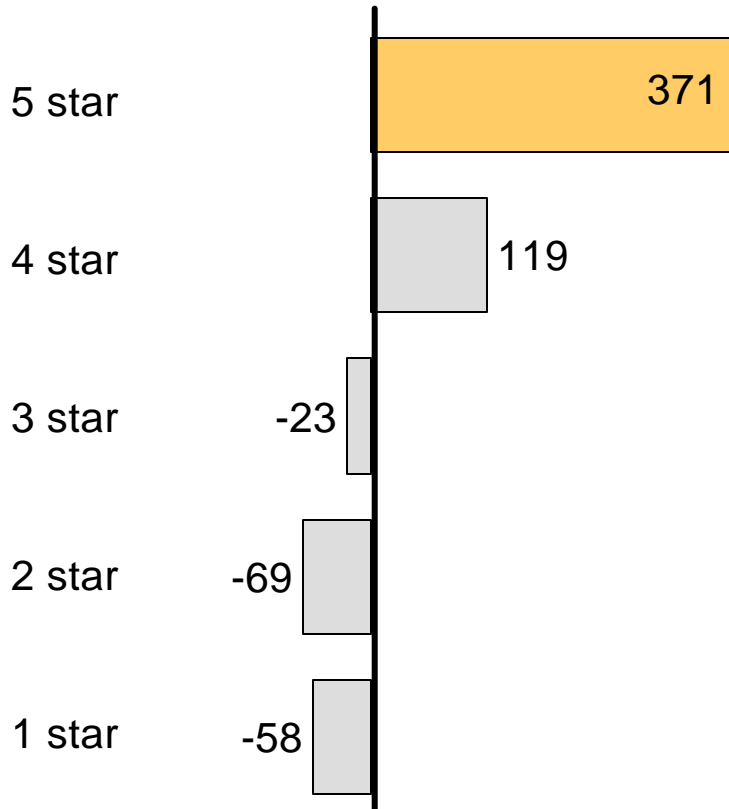
I don't want to keep track of more than five or six products. I call this 'simplification and focus'.

– Financial advisor

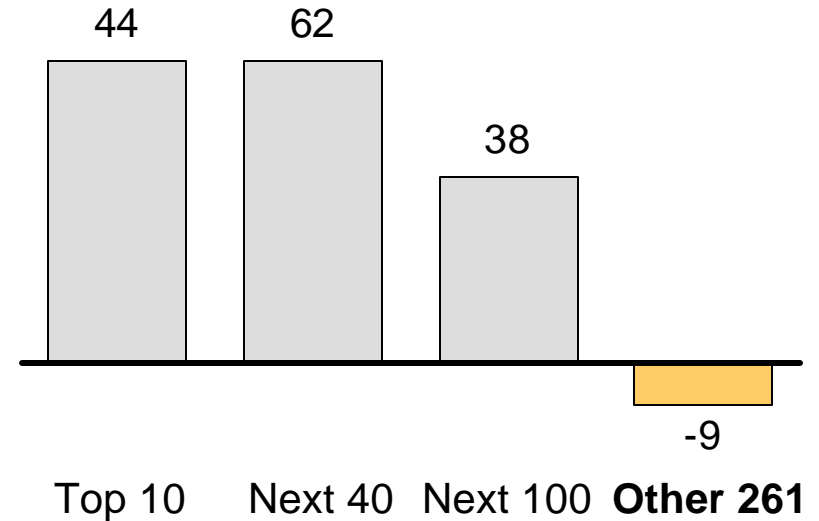
6 ROLE OF MARKETING AND CLIENT SERVICE

Average net flow per fund in 2005
USD m

Morningstar rating




Net flows of 5-star rated funds in 2005
USD bn



Over 100 5-star funds had negative outflows

7

CONVERGENCE AND EVOLUTION OF ALTERNATIVES

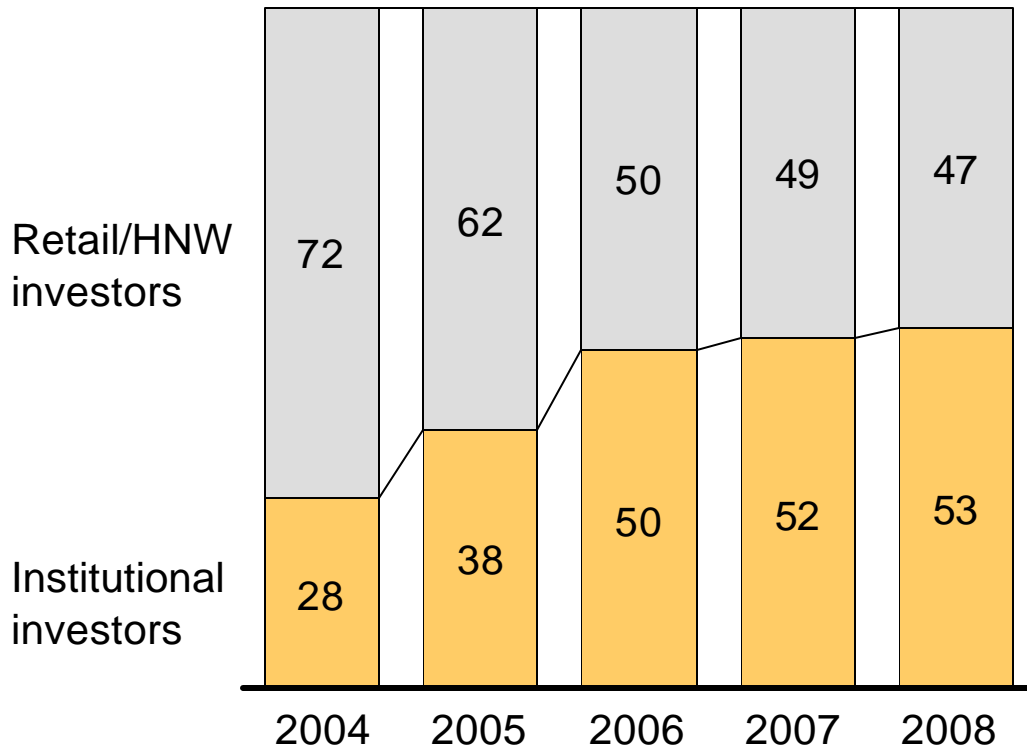
 Institutional share

Increasing institutional flows...

... driving greater professionalism

Hedge fund flows by source

Percent



Right now, **running a hedge fund is like running a nightclub**. But we'll begin to see **more professionalism** – process and branding will become more of an issue.

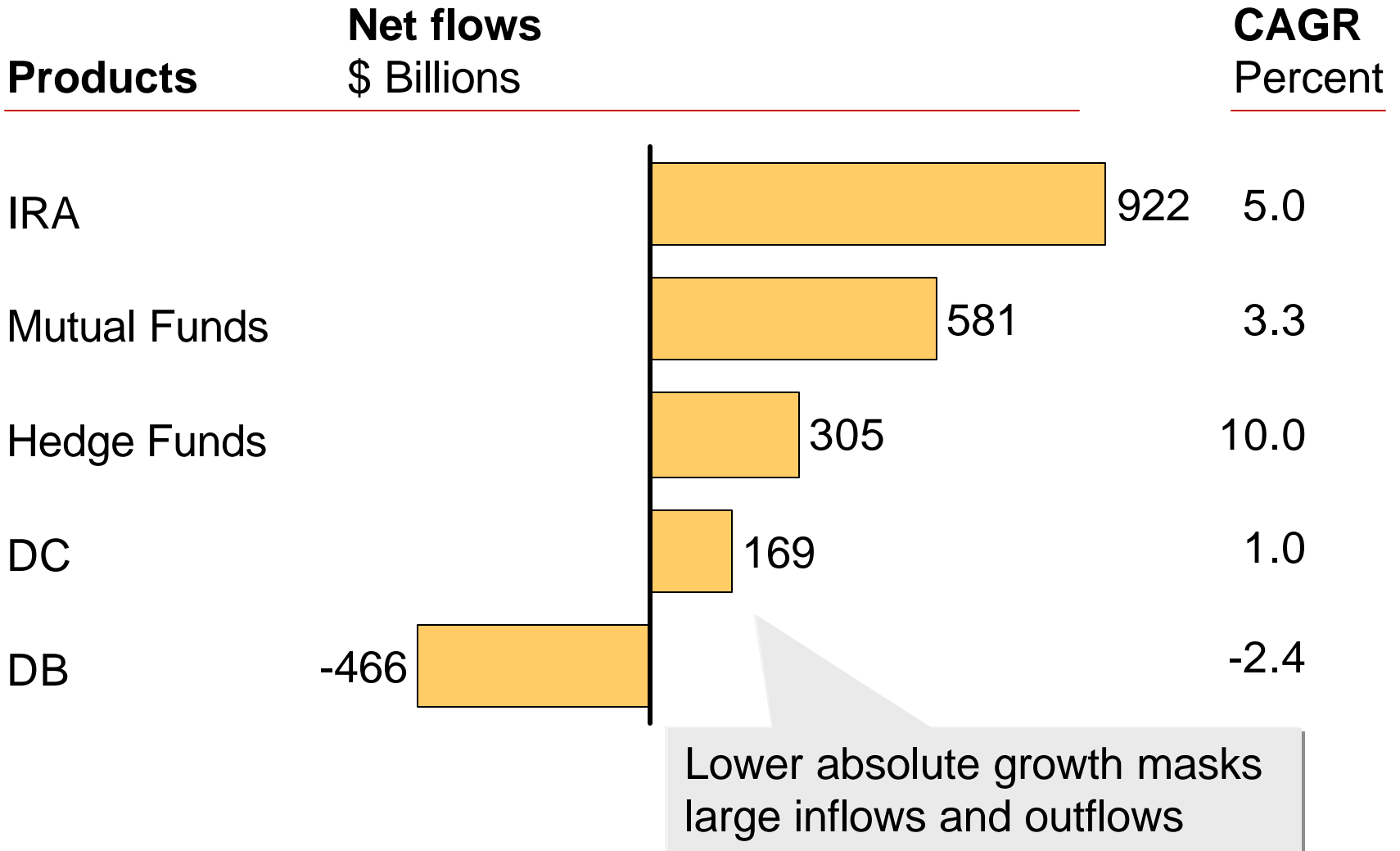
– Co-Founder, Hedge fund

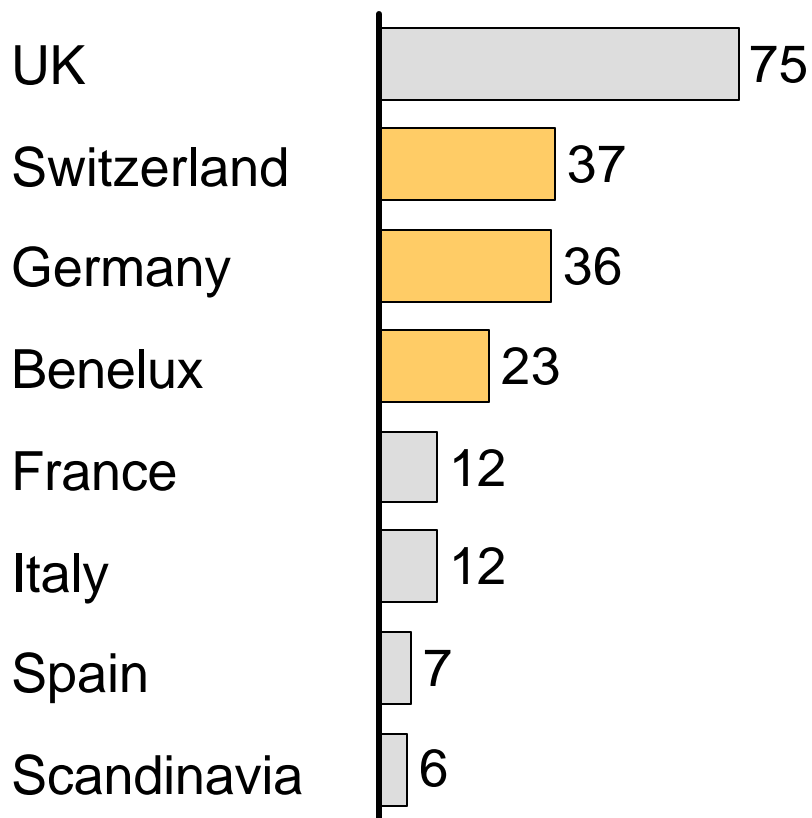
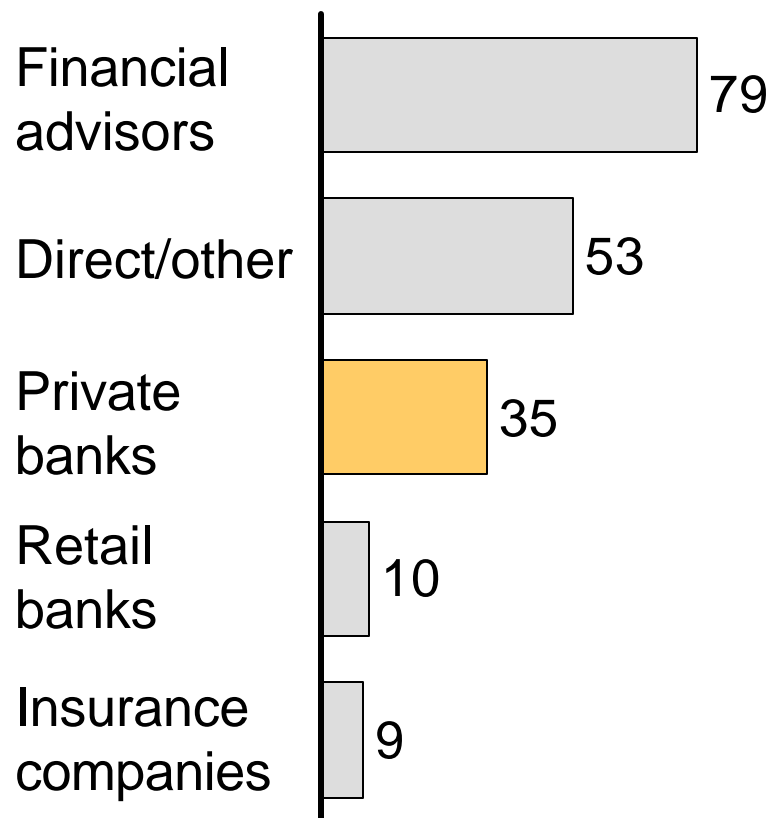
The smaller guys will go away – it's just too hard to make the economics work.

– Portfolio Manager, Hedge fund

8 RETAIL AND INTERNATIONAL GROWTH

Forecasted retail net flows, 2004–09



Penetration of third-party products, percent of retail inflows 2004E**Country****Channel**

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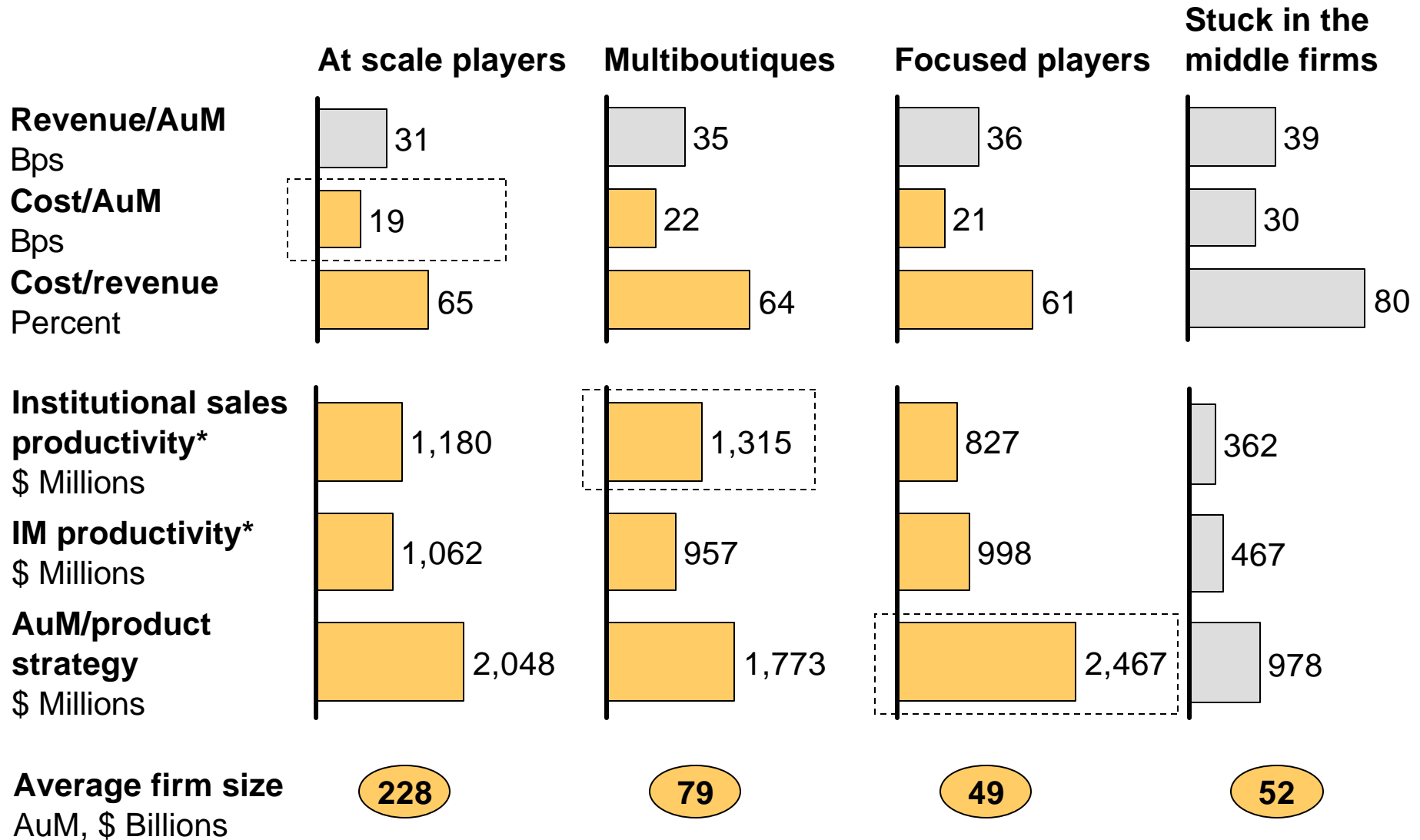


**The asset management industry in 2010 –
Wide-ranging changes in industry structure
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The path ahead – Key questions for asset managers to address

LEADING PLAYERS WILL USE SCALE IN DIFFERENT WAYS

Competitive advantage
 Across winning strategies
 Specific to strategy



* Assets per IM and sales/sales professional

BY 2010, GENERATING 30 PERCENT+ OF EARNINGS FROM NEW PRODUCTS

Current earnings profile	
Strategy/product	Percent of earnings
Equities	40
<ul style="list-style-type: none"> • Large cap • Core • Small cap 	
Fixed income	30
<ul style="list-style-type: none"> • Core/core plus • High yield • Municipals 	
International	15
Alternatives/ real assets	8
Other	7



Sample future earnings profile	
Strategy/product	Percent of earnings
Equities	35
<ul style="list-style-type: none"> • Traditional • Beta products 	
Fixed income	25
<ul style="list-style-type: none"> • Traditional • Beta products 	
Alpha engines	15
<ul style="list-style-type: none"> • Equity-driven • Fixed income-driven 	
Outcome-oriented funds	15
<ul style="list-style-type: none"> • Income generators • Risk protection 	
Other	10

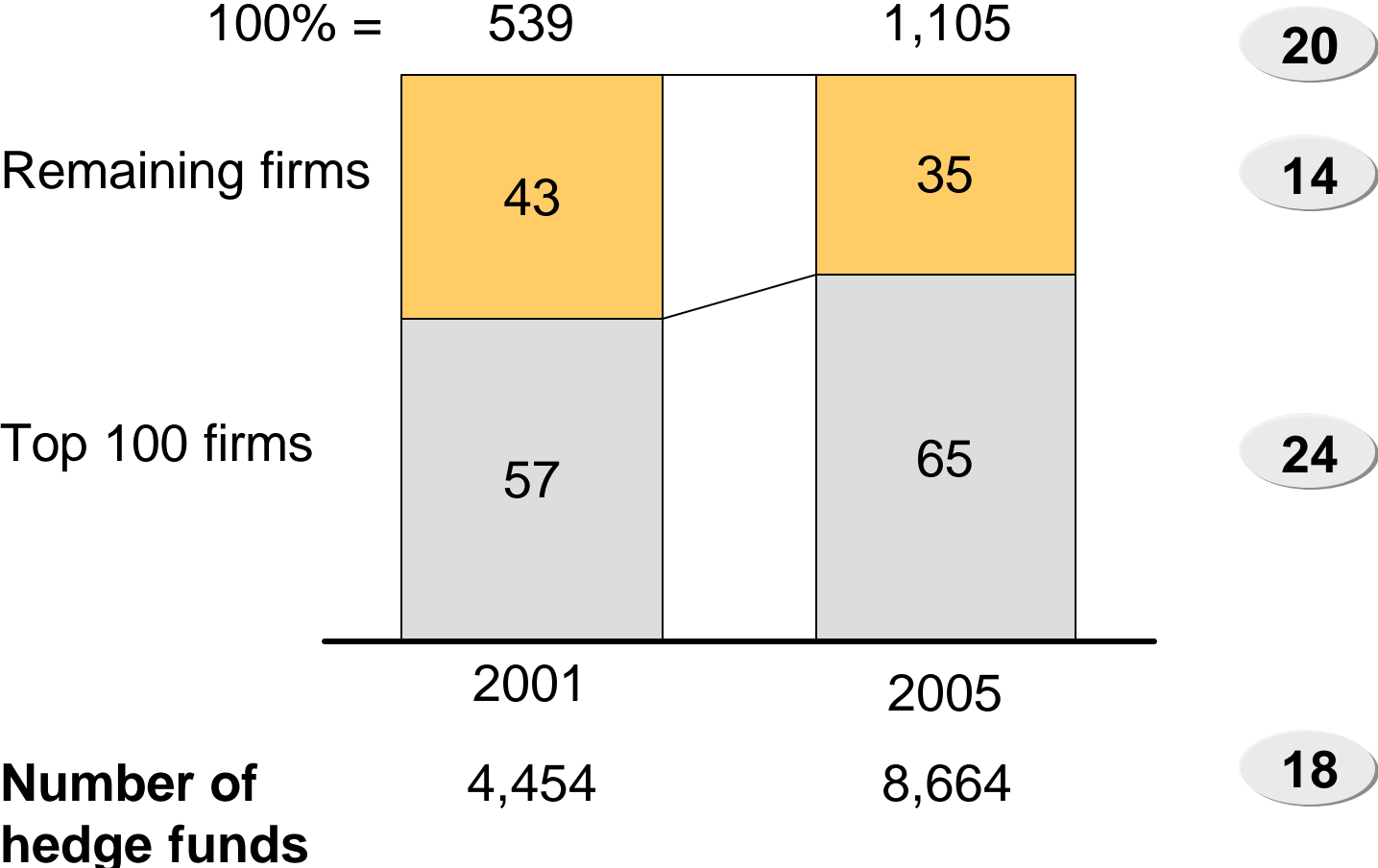
EMERGENCE OF A NEW WHOLESALING MODEL

- 1 Emergence of true strategic partnerships with home offices**
 - Help build packaged solutions/modify products to fit platforms
 - Integrate processes (e.g., reporting, sales management); gain access to critical data to enable better advisor targeting
 - Develop new institutional-like processes, marketing, and metrics
- 2 More targeted advisor targeting/prioritization**
 - Greater scrutiny of highest potential advisors based on product suite
 - More thoughtful geographic deployment of wholesalers based on results and potential
- 3 Greater involvement in advisors' books of business**
 - More tools and resources to help advisors prioritize their own books
 - Consultative approach to developing strategies to serve subsegments of their client base
- 4 Solution- and context-oriented advisor wholesaling**
 - Ability to explain important context shifts (e.g., retirement) and how products fit into broader solutions (e.g., risk protection strategies)
 - New forums for distributing knowledge (e.g., multi-advisor workshops)
- 5 Ability to train advisors on specific skills, rather than products**
 - Capability-specific training (e.g., tax, income generation strategies, risk/protection), perhaps delivered through central resource centers
 - Greater use of investment specialists

SHAKEOUT IN THE ALTERNATIVES DRIVING A BARBELLED INDUSTRY

Market share of top 100 hedge fund providers
 Percent of AuM, \$ Billions

CAGR
2001–2005
 Percent



A CHANGED LANDSCAPE – “ASSET MANAGEMENT” REDEFINED

Example – pension restructuring

Offering

Insurance companies

- Sell annuities to plans that intend to exit

Investment banks

- Structured products for immunizing frozen pension plans

Asset managers

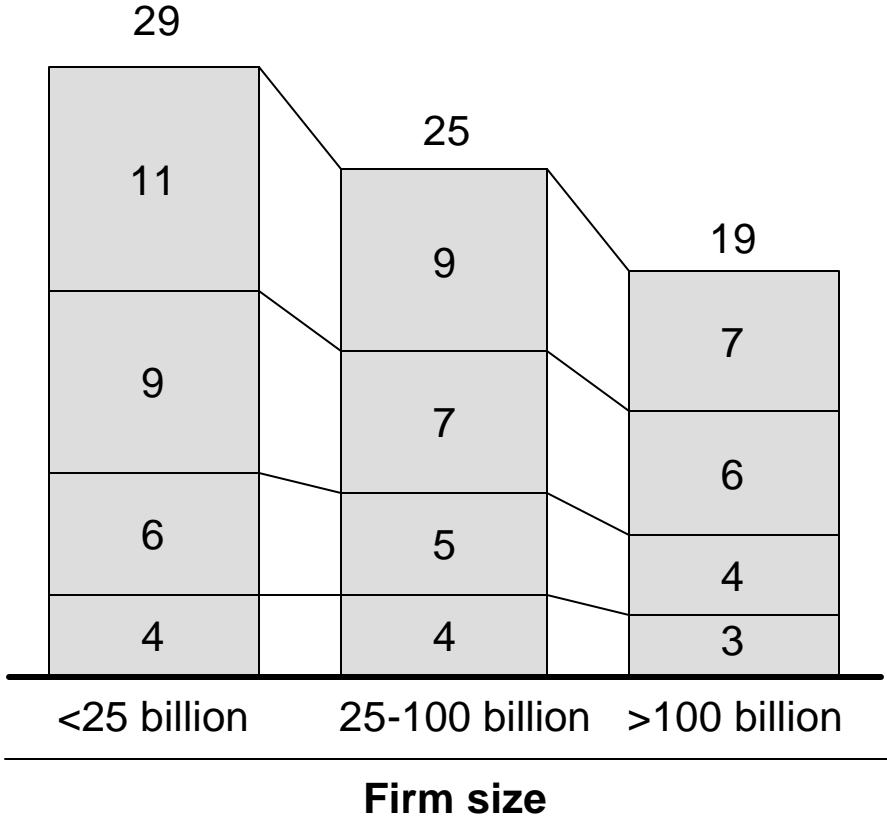
- New AM strategies focusing on predictability more than investment return
- Pooled vehicles using swaps to hedge inflation risk (UK)

Pension consultants

- More sophisticated actuarial modeling to provide total balance sheet solutions

SCALE AS ONE DRIVER OF A MEASURED PACE OF CONSOLIDATION

Cost per asset
Bps



	<u>Scale benefits</u>		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Investment management	4	7	6
Management, administration, and other	3	5	5
Sales and marketing	2	3	4
Technology and operations	1	3	2
	11	18	17

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LOOKING TO THE FUTURE: HOW ARE WE...

1

Seizing the retirement agenda?

- Next generation products – income, risk, and DB-like features
 - IRA rollover processes and value-added services for advice channels
 - Innovative liability-driven solutions for institutional clients
-

2

Retooling the investment management process?

- Retail “overlays” for existing products
 - More fundamental changes to “separate” alpha and beta
 - Willingness and ability to assume risk on behalf of clients
-

3

Reinventing the wholesaling/distribution process?

- Strategic alliances with gatekeepers; institutional processes
- Consultative approaches to working with frontline advisors
- Better alignment of compensation

LOOKING TO THE FUTURE: HOW ARE WE...

4

Developing new businesses to capture next wave of growth?

- IRA and DC (particularly IO DC) strategies
 - European and Asian expansion – channels, products, partners
 - Alternatives strategy, both offensive and defensive
-

5

Driving scale and generating operating leverage?

- Exiting/rationalizing sub-scale areas, non-core products, low-share channels
- Building on areas of strength, including through M&A where necessary

PLEASE CONTACT US WITH QUESTIONS AND COMMENTS



Alok Kshirsagar, Partner

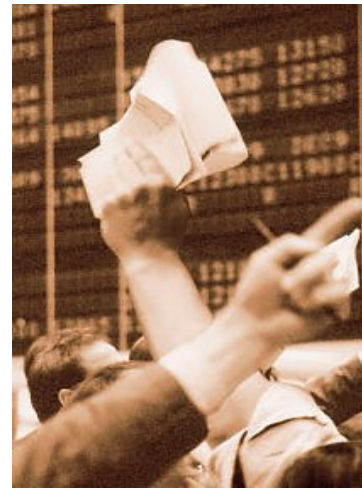
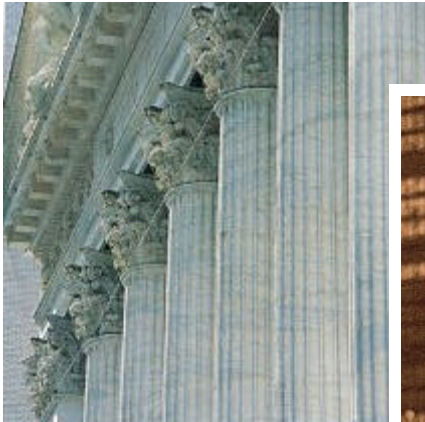
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