Your Performance Doesn’t Really Matter

WHAT SUCCESSFUL ASSET MANAGERS DO DIFFERENTLY

October 2014

- **Investment performance alone does NOT drive asset flows.**

  The current industry-accepted wisdom is that if asset managers deliver strong investment performance, capital will simply flow their way. Our research shows that is not the case.

- **Assets flow best when investors trust the asset manager. Investor Relations builds that trust via investor education.**

  The traditional relationship-based sale is no longer effective. Investors today need to understand exactly what their asset manager is doing with their money, and why. In Chestnut’s proprietary survey of institutional investors, conducted for us by Rivel Research, the top factors driving investors’ decision to hire an asset manager are heavily influenced by effective IR education.

- **The best capital raisers outraised the best performers by more than 4 to 1.**

  A successful IR program builds investor trust and a strong brand for the asset manager. Trusted asset managers raise more assets, retain those assets longer, and end up with loyal clients who are easier to cross-sell.

- **Every contact between an asset manager and an investor either enhances or undermines trust.**

  In our survey, investors told us they want deep and relevant investment substance from their asset managers, delivered in a clear, concise and consistent manner. Meeting these expectations is a tall order without help.

- **An effective IR effort is now a required tool of winning asset managers; 92% of investors view IR as integral to an asset manager’s mission.**

  Our analysis shows that asset managers who don’t effectively build investor trust are losing market share to those who do. Asset managers who rely on investment performance to drive flows are living on borrowed time.

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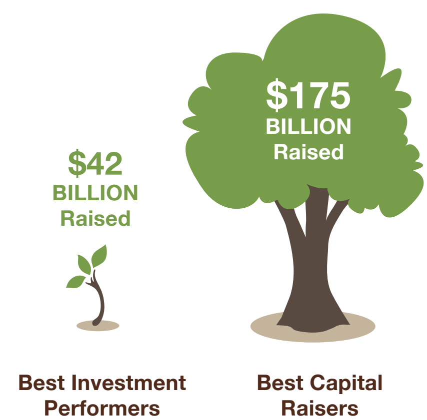
IN THIS PAPER

The biggest asset managers keep getting bigger, while smaller managers are finding it more and more difficult to attract and retain clients. We wanted to understand why. To answer this question, we reviewed investment performance and asset flow data for 931 asset managers over the past seven years, and conducted a survey of institutional investors controlling $429 billion of capital. The surprising answers to our question are detailed in this paper.

The Best Investment Performers Raised 4x Less Capital than the Best Capital Raisers



Source: eVestment and Chestnut Advisory Group. Total net capital flows of top quintile investment performers and top quintile asset gatherers, 2006-2013.

INTRODUCTION

STRONG INVESTOR RELATIONS DRIVES ASSET FLOWS

ASSET MANAGEMENT IR TODAY IS LIKE CORPORATE IR 40 YEARS AGO

We believe the asset management business view of IR today is very similar to public companies' attitudes toward IR 40 years ago. At that time, public companies simply issued dry, rote 10-Ks and did not cultivate any relationship with their investors. As larger public companies realized their underlying assets were undervalued they built a dedicated investor relations effort. Today, every public company either has a dedicated IR staff or hires an outsourced IR firm to provide this vital service. It is now common knowledge in the public equity markets that great IR, coupled with good performance, leads to higher equity valuations.

STRONG IR BUILDS TRUST AND TRUST DRIVES ASSET FLOWS

Chestnut believes this same IR adoption cycle is already underway in the asset management industry, led by the largest asset managers, who are early adopters of this new model. **In Chestnut's proprietary survey of institutional investors (conducted for us by Rivel Research) the top five factors driving investors' decision to hire an asset manager all come from the new educational approach to sales.** These same factors drive investors' trust of an asset manager. An outstanding IR effort provides investors with the understanding they need to build trust and to ultimately commit their capital to an asset manager. "Investment results" clocked in at a distant sixth.

> Legacy relationships were once the primary means of generating sales. Today, to attract and retain investors, asset managers must educate them about their strategy and products.

INVESTOR RELATIONS PERMEATES EVERY INVESTOR/MANAGER ENCOUNTER

Each interaction between an asset manager and an investor or consultant leaves an impression that either builds or reduces trust. These impressions are cumulative, happening everywhere from the initial pitch, a chance meeting at an investment conference, a finals presentation, a performance review, or a simple response to an incoming email. Asset managers with outstanding IR programs train and monitor all client-facing professionals to ensure their communications are always on point. These asset managers also conduct periodic market research to determine how their IR programs are being perceived, making adjustments as necessary.

INVESTORS WANT TO UNDERSTAND WHAT YOU'RE DOING WITH THEIR MONEY

Chestnut conducted extensive research to shed light on the current state of investors' appetite for understanding exactly what their asset managers are doing with their money and why. The market reality our research describes is very different from that which existed when most of today's portfolio managers started their careers, or even ten years ago. At that time, legacy relationships were the primary means of generating sales. Today, asset managers must educate investors deeply about their products and every key aspect of their own company to gain trust and build a strong brand. Our research shows that **assets flow only when investors trust the asset manager.**

ASSET MANAGERS WITH OUTSTANDING IR WILL CONTINUE TO TAKE SHARE

The largest asset managers have invested the most in their investor relations efforts over the last 10-15 years. For example, at the largest global asset managers, sales and marketing costs now make up 24% of the cost base, second only to the investment management function.[1] These same large asset managers are now perceived as the most trusted by institutional investors, as our survey shows. Unsurprisingly, these large asset managers have also meaningfully increased their market share. In the last decade, the top 10 global asset managers' market share has increased from 35% to 50%[1]. Last year, the

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largest hedge funds, those with $5bn or more of AUM, received 65% of all net asset flows[2].

For middle-market asset managers, the best way to reverse this trend is to maintain a strong investor relations program.

EVERY ASSET MANAGER CAN BENEFIT FROM ROBUST IR

Operating an asset management business is a difficult undertaking. Aside from delivering strong investment performance, asset managers have many other important duties, including establishing a strong firm culture, documenting and implementing impeccable compliance, recruiting, incenting and retaining talent, and much more. Each operational element provides the opportunity for an asset manager who excels at that piece to share this excellence with their clients and prospects. Over time, a consistent effort to educate the marketplace about a particular asset manager's strengths builds a strong brand and investor trust, making that asset manger less reliant on near-term investment performance to maintain and grow its business.

1 Source: McKinsey
2 Source: HFR

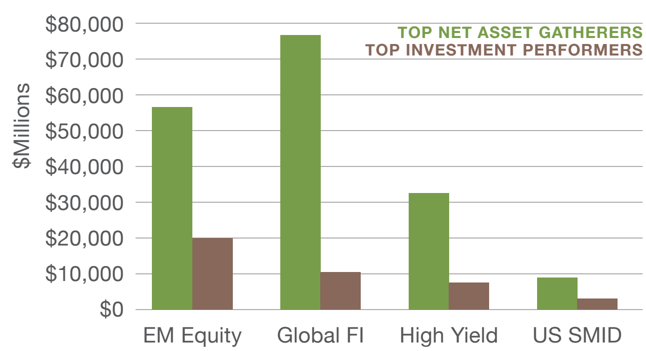
HISTORIC CAPITAL FLOW DATA ANALYSIS

INVESTMENT PERFORMANCE ALONE DOES NOT DRIVE ASSET FLOWS

To determine the veracity of the common assumption that capital simply follows investment performance, we analyzed eVestment data for 931 investment products for the period 2006-2013 across four different asset categories. We chose these asset categories to represent a broad swath of the current long-only product landscape: US Small/Mid-Cap Equities; Global Fixed Income; Emerging Markets Equities; and US High Yield (see Appendix on p. 11 for details of our analytical methodology). We examined the relationship between investment performance and net asset flows in a variety of ways—looking at correlations between these two variables and the characteristics of the most effective asset gatherers. Our analysis yielded the following results:

- **Asset managers who delivered the best investment performance did not raise the most capital.**
- **The top net capital flow gainers raised over four times more capital than the best investment performers did.**
- **Size doesn't really matter to investors, as both smaller and larger asset managers raised significantly more capital than the top performers did.**
- **The correlation between investment performance and capital flows, although positive, is unexpectedly low: between 0.04 and 0.24.**

BEST TOTAL NET ASSET FLOWS, 2006-2013



Source: eVestment and Chestnut Advisory Group. Average quarterly net capital flows of top quintile net asset gatherers, and of top quintile investment performers over the period 2006-2013.

TOP INVESTMENT PERFORMERS RAISED LESS THAN 25% OF THE CAPITAL OF TOP ASSET ACCUMULATORS

The top quintile funds ranked by trailing-three-year returns raised about $42 billion in capital for the six-year period. The top quintile funds ranked by net flows raised more than $175 billion for the period, over four times that accumulated by the top performers. This pattern held true within each of the four, widely varying, asset categories we examined. Since all these funds were competing against each other for the same basket

$133 BILLION MORE

Managers that got IR right brought in an additional $133bn AUM over a seven-year period.

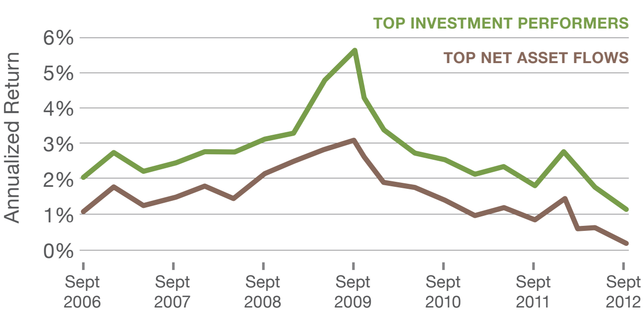
of investment dollars at the same time, and were executing similar investment strategies in the same product classes and geographies, we conclude that the top capital gatherers did something besides delivering excellent returns to facilitate their asset growth. We expect that 'something else' varies widely across these many successful asset managers, encompassing everything from compelling contrary investment insight to outstanding operational and investment risk management. Whatever it was that each manager excelled at, we believe the primary way investors learned to appreciate these outstanding traits was through the asset manager's educational IR efforts. **In terms of dollars, getting IR right brought in $133bn AUM additional over the period we studied.**

The order of magnitude of the excess capital flows raised by the net capital flow winners over top investment performers is large. For example, in Global Fixed Income, the top quintile of investment performers received only 24% of the total net asset flows into the entire category during the period, while the top quintile of net asset accumulators received 175% of that category's net asset flows. This pattern held true across categories experiencing net outflows during the period (US SMID) and those which grew substantially (Global Fixed Income, Emerging Markets Equities).

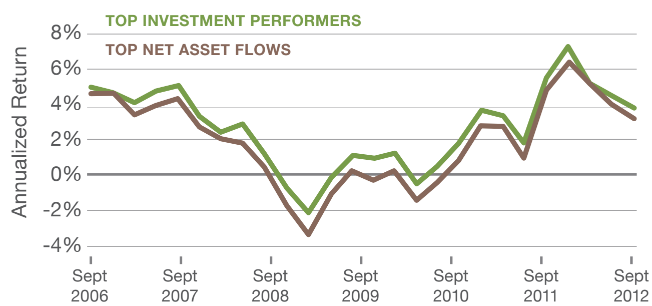
ASSET MANAGERS WHO RAISED THE MOST CAPITAL DID NOT DELIVER THE BEST INVESTMENT RETURNS

In fact, across all four categories, the top net capital flow gainers' average investment performance trailed the top investment performers by 86 basis points annualized. The most successful capital flow gainers' investment performance was about in-line with (trailing by only 7 basis points) the second quintile of investment performers overall.

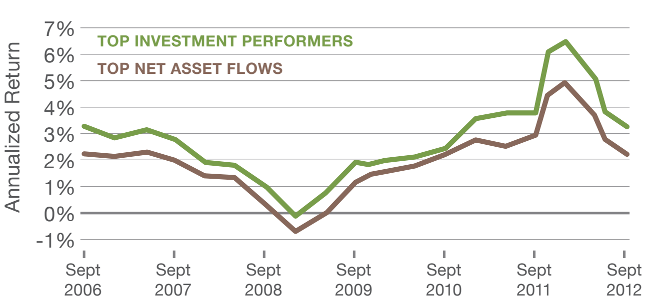
TRAILING THREE-YEAR RETURNS
GLOBAL FIXED INCOME



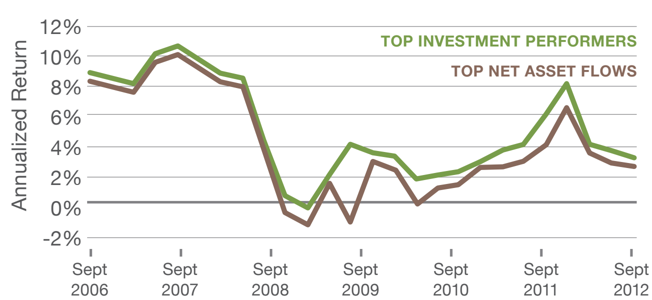
TRAILING THREE-YEAR RETURNS
US SMALL-MID CAP EQUITY



TRAILING THREE-YEAR RETURNS
US HIGH YIELD



TRAILING THREE-YEAR RETURNS
EMERGING MARKETS

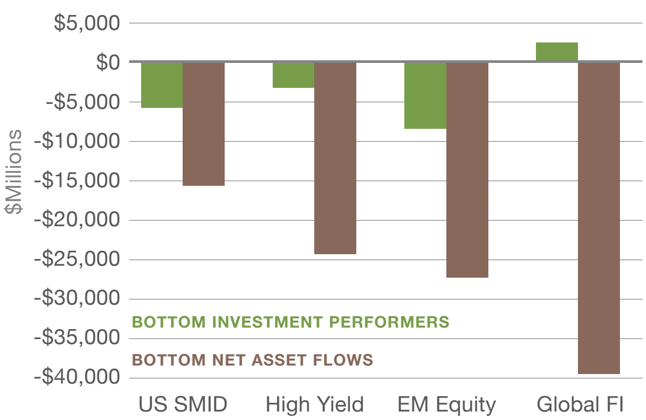


Source: eVestment and Chestnut Advisory Group. Trailing three-year investment performance of top quintile net asset gatherers, and of top quintile investment performers for each quarterly period from 2006-2012.

POOR IR SPELLS MASSIVE REDEMPTIONS

What is perhaps even more telling is the pummeling accorded those products that have lost investors' trust. The bottom quintile of funds ranked by net flows experienced over seven times more net outflows over the period than the bottom quintile of investment performers. The worst net asset flow firms lost over $106 billion of net assets over the period, while the worst investment performers lost only $14 billion over the period. And this occurred despite the fact that the investment performance of the biggest net asset losers was consistently **better** than the worst overall performers – by 81bps annually, on average.

WORST TOTAL NET ASSET FLOWS 2006-2013



Source: eVestment and Chestnut Advisory Group. Average quarterly net asset flows of the bottom quintile investment performers and of the bottom quintile net asset gatherers, over the period 2006-2013.

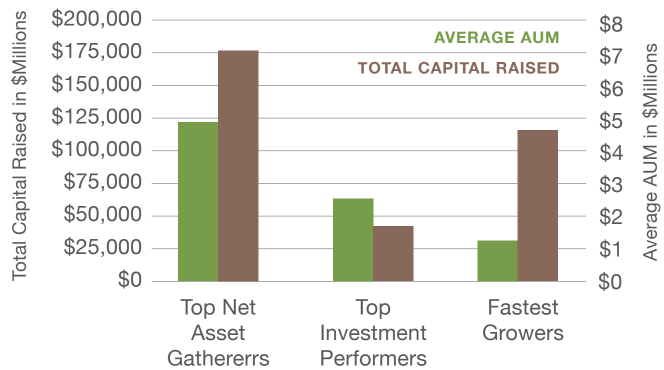
SIZE DOESN'T REALLY MATTER WHEN IT COMES TO ATTRACTING INVESTORS

We analyzed the size of the asset managers in this study, wanting to discover whether large size alone was an advantage in attracting investors. We found that bigger is not necessarily better, and in fact some of the most successful asset raisers were among the smallest firms.

The top investment performers in our study were slightly smaller than average; in our study the average AUM of the top performers was $2.5 billion, below the overall $3.5 billion average. These top performers grew at a healthy 49% rate over the period, although our study reveals that they had the potential to grow much more despite their size.

The top asset gatherers grew by 164% on average over the period, more than three times faster than the top investment performers. While the top asset gatherers

AVERAGE AUM SIZE AND TOTAL CAPITAL RAISED, 2006-2013



Source: eVestment and Chestnut Advisory Group. Average quarterly net capital flows of top quintile net asset gatherers, and of top quintile investment performers over the period 2006-2013.

were larger than the top performers ($4.9bn), their success in attracting dollars came from real market share gains, not from their size.

It would be logical to assume that larger asset managers have a natural advantage in brand-building and thus always grow faster than the market, but the data shows that is definitely not the case. The biggest asset losers, at $6 bn AUM on average, were even larger than the biggest asset winners.

The fastest growing asset managers were much smaller, averaging only $1.2 bn AUM. This small size could have been a hindrance to growth in two ways. First, the smaller resources could have limited these firms' ability to build their brand with investors. Second, their small size could have served as a limit to asset raising, as many investors will only commit capital representing a relatively small percentage of a manager's total AUM.

Smaller size proved no disadvantage to the fastest growers, as they grew by 237% on average, and raised $113 bn during the period, almost three times more dollars than the top performers. The fastest growers also delivered meaningfully worse investment performance than the top performers, underperforming by 78bps on average. Investors found something very attractive about these rapidly-growing asset managers, and we believe that 'something' was primarily relayed to them by the managers themselves via their IR efforts.

CORRELATIONS SUGGEST INVESTMENT RETURNS HELP DRIVE FLOWS, BUT NOT AS MUCH AS EXPECTED . . .

Intuition and the current industry accepted wisdom suggests that the primary driver of net asset flows is investment performance. We ran correlations between trailing three-year returns and subsequent one-year net capital flows to quantify just how critical investment performance is to garnering more assets. Our analysis shows that there is a clear relationship between the two factors, but the correlations were significantly lower than conventional wisdom might lead you to believe.

. . . AND MAY ACCOUNT FOR ONLY 15% OF THE REASON FOR PLACING MONEY WITH MANAGERS

Over the period we studied, small- and mid-cap equity investors applied more importance to prior three-year returns than investors in Emerging Markets, US High Yield, or Global Fixed Income products. Even then performance accounted for less than a quarter of the driver of asset flows. The correlation between three-year returns and subsequent one-year net flows were 0.24 among the small- and mid-cap group but tapered off to only 0.04 for Global Fixed Income products.

Investors are not as swayed by the last 12 months' results as they are by longer-term trends. In almost all cases, the correlations between the one-year trailing return and subsequent one-year net capital flows are weaker than that between the three-year trailing return. The only exception was Global Fixed Income, perhaps due to increased volatility.

Correlations Between Investment Returns and Net Asset Flows
2006-2013

Investment Category	3Yr Return and Subsequent 1Yr Net Flow	1Yr Return and Subsequent 1Yr Net Flow
EM Equity	0.16	0.11
High Yield	0.11	0.08
Global Fixed Income	0.04	0.10
SMID US Equity	0.24	0.16

Source: eVestment Data.

INVESTOR SURVEY RESULTS

WHAT DRIVES ASSET FLOWS? GREAT INVESTOR RELATIONS.

In order to answer the perennial question, "What do investors want?" we decided to ask the investors themselves. Rivel Research Group conducted an in-depth phone survey for us of 74 U.S. institutional investors and investment consultants. We spoke with investors who together manage $429 billion in assets, and with consultants who advise on over $10.5 trillion in assets. We spoke with decision makers at government funds, corporations, endowments and foundations, each in a proportion corresponding to the percentage of assets each sector represents in the U.S. Institutional market (see Appendix on p. 11 for details of our survey methodology).

Our survey results quantify the substantial benefits that accrue to asset managers with strong IR efforts.

Ninety-two percent of our respondents said that they view investor communication and support as integral to an asset manager's mission. Our survey shows that trusted asset managers raise more assets, are hired more quickly and are fired more slowly than the general population of asset managers. They also have an easier time cross-selling and up-selling their clients.

TRUSTED ASSET MANAGERS WIN MORE ASSETS

Institutional investors were extremely articulate on the importance of great IR in their hire decisions. **59% of our survey respondents said the quality of IR is a significant factor when deciding whether to hire or fire an asset manager.** As one consultant told us, when

Top Five Factors Driving the Decision to Hire an Asset Manager

		% of respondents rank as important
1	Strong understanding of the firm's investment process	95%
2	Asset manager credibility	89%
3	Strong understanding of the firm's risk management	82%
4	Clear and consistent communications	77%
5	Confidence in the firm's business structure and incentives	77%

recommending an asset manager, the quality of IR *"is a factor and it's an important factor. I don't think they get the job if they don't have good IR."* As the CIO of an $8bn corporate plan told us, *"We have specifically, on more than one occasion in the last couple of years, fired or not hired an asset manager because that manager could not communicate to us results or some other information effectively and in a timely manner."*

INVESTOR RELATIONS BUILDS TRUST VIA INVESTOR EDUCATION

Investors today need to understand exactly what their asset manager is doing with their money, and why. In our survey, the top five factors driving investors' decision to hire an asset manager (detailed in the table above) all come from the new educational approach to sales. These same factors drive investors' trust in an asset manager.

Average Time to Hire an Asset Manager

We asked investors to rank eleven different factors on a scale of 1 to 6, with 6 being extremely important and 1 being not important at all. The chart above shows the percentage of respondents ranking factors as a 5 or 6.

Consistent with our findings from our analysis of historical capital flows, investment performance was not cited by our survey respondents as a top factor in driving capital flow decisions. Performance ranked sixth, followed by consultant recommendation, ability to meet with the PM, recommendations from other investors, insightful thought pieces from the asset manager, and seeing the firm's portfolio managers quoted in the media.

TRUSTED ASSET MANAGERS GET HIRED MORE QUICKLY . . .

Fifty-nine percent of respondents said their hiring timeframe shortens when they are hiring an asset manager in whom they already have a high degree of confidence.

Among respondents who hire a trusted manager more quickly, investors estimate this trust saves 3-12 months in the hiring process. This translates into 3-12 months of additional income for a trusted asset manager, or $25,000-100,000 (based on a 1% average fee) for every $10mm in additional assets.

> Institutional investors say they hire asset managers 3–12 months more quickly when they trust them.

. . . AND GET FIRED MORE SLOWLY

Trusted asset managers are fired more slowly than the typical asset manager, according to our survey. We asked respondents how much time they give underperforming and trusted underperforming asset managers before taking steps to fire them. The average manager gets less than two years before investors move to terminate. Trusted managers, on average, are given about two and a half years before investors move to terminate. This can mean an additional $100,000 of annual income earned by trusted managers on every $10mm in retained assets (assuming a 1% fee).

INVESTOR SURVEY FEEDBACK

RESPONDENTS DESCRIBE GREAT IR: ROBUST CONTENT THAT'S EASILY DIGESTIBLE

Survey respondents were extremely articulate about what constitutes great IR. Our survey makes clear that great IR is difficult to deliver and does not consist of simply more communication. Investors' needs are specific and the bar is set very high.

Great IR Starts With Strong Content

Institutional investors expect to receive a steady diet of strong investment substance from their asset managers. This expectation begins in the investor recruitment process and *increases* after the investor has committed capital. Ironically, that's when most asset managers reduce their investor communications.

INVESTMENT CONTENT MUST BE CRISP DURING THE MARKETING PHASE . . .

The content must be sophisticated and on point from the very first meeting with a prospective investor. As we discussed previously, investors told us they won't invest without a deep understanding of the firm's investment process and risk management (see table on p. 7).

. . . AND IS CRUCIAL IN PERFORMANCE REPORTING . . .

When it comes to performance reporting, investors' content standards are equally high. Detailed performance attribution is key; it was rated as important by 76% of consultants, and about 60% overall. Investors want to quickly understand exactly what drove all the key elements of performance, along with relevant context where needed.

Respondents told us this detailed attribution is often lacking in performance reports they receive. When investors' expectations aren't met, their trust in the asset manager erodes. As one investor put it, minimal performance attribution tells him that the asset manager *"doesn't care what anybody thinks."*

One investor told us what makes a great performance report is: *"Full performance analytics, against the benchmark, up-down analysis, historically. Put risk statistics in it so you can see it over rolling periods. Then you need a qualitative review of how the portfolio's positioned. Then backup to support the qualitative position. You've got to show me the numbers behind your qualitative position if you're going to make the case that it's an [investment] opportunity."*

> A great performance report isn't just numbers. It also explains why your portfolio is positioned the way it is.

A great performance report isn't just numbers, however – it also explains why your portfolio is positioned the way it is. One investor also wants to understand *"Why they did what they did, and what will they be doing over the next few months. The last point, most of them don't do that. That's important."*

. . . AND IS *ESPECIALLY* CRUCIAL WHEN THE ASSET MANAGER HAS ISSUES

The performance review provides an outstanding opportunity for trust-building candor. An open discussion of any small hiccup in the portfolio will earn much more trust from investors than five detailed stories about winning investments. As one investor put it, he most wants to hear about *"what they've learned from their mistakes. You can blow smoke until you're blue in the face about how great you are but we want to hear how you've screwed up and what did you learn from it."* Another investor told us, *"I think the best [performance reviews] are when they lead off with what went wrong and there's an open discussion of mistakes or issues that worked against them. Far too many managers put up excuses and aren't very self-reflective."*

Great IR can make the difference between net asset inflows and outflows at a critical time for the asset manager. Many asset managers focus communications on their performance when performance is good, and get increasingly quiet when performance is poor, or when other issues arise. This approach is the opposite of that which builds trust with investors.

In our survey, 86% of respondents overall (and a whopping 94% of consultants) said the most important thing an asset manager can do to retain capital during a period of underperformance, aside from improving performance, is to communicate. As one investor put it, *"If they communicate incredibly effectively and we believe in the strategy and we still have faith in it, we will stay."* As another investor told us, *"We would prolong a relationship if we felt there were legitimate reasons for underperforming. In fact, we might give them more money. Unless we have good communications and customer service there would be no way that we could understand why they are underperforming. If they had poor communication that would also speed up our decision, in the opposite direction."*

> Investors say the most important thing an asset manager can do to retain capital during a period of underperformance is to communicate.

During a period of underperformance investors want informative and easily digestible content: credible explanations for the underperformance, as well as any steps being taken (or not, if the issue is that the investment style is not being rewarded by the current market) to address the problem.

THE IMPORTANCE OF HEADLINE NEWS COMMUNICATIONS HAS GROWN

We were surprised to learn from our survey that the way a firm communicates around headline market events is now extremely important to investors. **Sixty-nine percent of our respondents said the timeliness and quality of an asset manager's headline event communications is important when making a decision to hire or fire a manager.** The survey also revealed that **more institutional investors turn to their asset managers for insight about the potential impact of a headline event on their portfolio than to any other source,** including consultants, media and peers.

To us, this clearly demonstrates that the bar for IR has been raised across the industry.

A firm that communicates well and consistently around headline events has a major advantage over those firms that don't. As one investor said, "[headline event communication is] *very important because it colors your mindset about the manager over time. The manager that doesn't comment on it and just puts it in their quarterly reviews, you don't even know whether they took it into consideration. Somebody who communicates immediately shows that they are on top of the markets and they understand what's going on in the world, and they're willing to have a dialog with you."*

Asset managers who simply provide the minimum communications to their investors do so at their peril; as one investor told us, *"More than 50% [of asset managers] communicate only in quarterly reports. They're not proactive enough."*

The Three Cs of Great IR: Clear, Concise and CONSISTENT

Creating the detailed content described above requires a significant investment of time and energy. If the message isn't on point, the most brilliant analysis will never get across to today's harried investors.

CLEAR—RELATE TO YOUR AUDIENCE

Using investment jargon is the quickest way to lose an investor's attention. Although investors and consultants are quite sophisticated, they oversee dozens of different products, and must explain their portfolio to other stakeholders who are often not professional investors.

A government plan CIO with 26 years' experience described the type of communication he's looking for when hiring an asset manager: *"The asset manger must . . . get away from the technical terms and jargon to be able to talk to non-investment professionals and have them understand what they're saying."*

> Many asset managers communicate regularly when performance is good but go quiet when performance is weak. This erodes investor trust and is the exact opposite of investors want.

CONCISE—GET TO THE POINT

Perhaps the most difficult investor requirement is the demand for a brief synopsis of what is often a complex analysis. Brevity was the second-most cited element of an outstanding performance review in our survey (after performance attribution, as discussed above). As every writer or speaker knows, it takes much more time to write a short document than it does to write a longer one. Nonetheless, it is well worth the extra time to make investor communication as concise and purposeful as possible. As one investor said, *"I like something that starts with a synopsis, this is what we're trying to tell you in 3-4 sentences, to determine if you want to read it."*

Asset managers must ensure they have accurately identified who should receive each communication and must craft each communication so its purpose instantly comes across.

CONSISTENT—BUILD TRUST

Consistency of investor communication is crucial, because it builds trust and a strong brand over time. Consistency was the second-most cited action investors said underperforming asset managers should undertake to retain their investment (after overall communications). In order to deliver a consistent message, asset managers must operate an ongoing IR program that ensures that every client-facing professional is on the same page. A history of consistent messaging becomes particularly valuable during a period of underperformance. As one investor told us, *"Before their period of underperformance, they need to establish a reputation of absolute truthfulness so we will believe their story when the underperformance occurs. Integrity and credibility before the underperformance is critical."*

SUMMARY

After reviewing investment performance and asset flow data for 931 asset managers over the past seven years, and speaking with investors controlling $429 billion of capital and consultants advising on $10.5 trillion, we learned some important lessons.

1 INVESTOR RELATIONS BUILDS TRUST VIA INVESTOR EDUCATION

While it seems like great performance should be enough to attract and retain investors, the reality is that building trust via investor education is even more important than delivering great returns. Six out of 10 investors told us the quality of IR is a significant factor in whether they hire or fire a manager.

2 INVESTOR UNDERSTANDING AND TRUST DRIVES ASSET FLOWS

To drive asset flows and retain clients today, asset managers need strong investor relations. Performance used to be everything. Now, the bar has been raised and assets flow only when investors trust the manager and fully understand the investment philosophy, strategy and process.

3 TRUSTED ASSET MANAGERS WILL CONTINUE TO GAIN MARKET SHARE

Trusted asset managers are hired more quickly and fired more slowly. Those who don't build investor trust are losing share.

4 IR PERMEATES EVERY ENCOUNTER BETWEEN INVESTORS AND ASSET MANAGERS

Finally, in order to effectively build the necessary trust, investors told us they want deep and relevant investment substance from their asset managers, delivered in a clear, concise and consistent manner. Meeting these expectations requires identifying target investors' key concerns, along with a unique combination of deep investment knowledge and sophisticated communications skills. This is a tall order for most asset managers without some help.

APPENDIX

RESEARCH METHODOLOGY

HISTORIC INVESTMENT PERFORMANCE AND ASSET FLOW RESEARCH—METHODOLOGY

Our first task in undertaking this analysis was to find a source of high-quality data. We homed in on eVestment, as we found it to possess a highly reliable and extensive array of critical asset manager information. We wanted to focus our study on asset classes that would be broad enough to serve as a stand-in for the entire asset management industry. In so doing, we chose four long-only product categories from eVestment's database of over 175 long-only investment categories. In total, eVestment supplied us with quarterly data on 931 products, for the periods September 2006 to December 2013, covering four asset categories: Emerging Markets (382 funds), U.S. High Yield (204), Global Fixed Income (276) and U.S. Small & Mid Cap (69). The average AUM was $3.5 billion.

We analyzed characteristics of the top, middle and bottom investment performers and asset gatherers once we grouped them into quintiles in each asset class. Using the U.S. SMID universe as an example, first we ranked all the funds into quintiles based on three-year-trailing investment performance for each quarter from September 2006 to December 2013. Then, for each quintile in each quarter, we calculated the average subsequent-one-year net flows, average AUM, average age of fund, and average trailing-one-year performance. When looking at the seven-year period overall, we either summed the data (net flows) or examined the average or both. We repeated this exercise to rank the universe into quintiles based on net flows as a percentage of AUM, and then again based on subsequent-one-year forward net flows. In this case, the top quintile as ranked by investment return delivered a 3.10% average three-year trailing return over the six year period. In comparison, the top quintile as ranked by net asset flows delivered only a 2.2% average three-year trailing investment return over the same period. We included this 90 basis point difference in annualized average return between these two groups of asset managers in the SMID universe along with the same calculations for the other three universes, to derive an average 86bp annualized performance difference between the two groups overall.

We also calculated correlations between a variety of variables, such as assets under management, age of product, trailing one-year and three-year returns and net flows (in absolute dollars and relative to the asset base), in order to understand the drivers of the most and least successful asset gatherers within each product area. For this paper we focus on the correlations between the next 12 month net asset flows and the trailing three-year returns. This analysis generated the highest correlations of our study, and fits with the self-reported belief of investors and investment consultants that longer-term return trends carry more weight than the last year's returns.

INSTITUTIONAL INVESTOR SURVEY—METHODOLOGY

As we set out to answer our questions about investors' perceptions of asset managers, we decided to go straight to the people making the decisions about where to place their assets: institutional plan sponsors and their consultants. We asked Rivel Research Group to help us create a survey focused on identifying what institutional investors want from asset managers, helping us pinpoint the steps asset managers can take to increase their chances of attracting and retaining investors. We turned to Rivel for our survey due to their 20+ years' experience as the premier corporate IR perception study provider to leading public companies around the world. We surveyed CIO or equivalent professionals across the government, corporate, endowment/foundation and consultant sectors. We conducted 74 interviews with 57 plan sponsors and 17 consultants.

Among the plan sponsors we interviewed, 29 were in the government or public fund sector, 22 in the corporate sector and 6 in the endowment/foundation sector. This 51/39/11 percentage breakdown directly corresponds to the percentage of assets each sector represents in the US institutional universe. Seventy-five percent of the plan sponsors interviewed oversee assets greater than $1 billion.

We also interviewed investment consultants as they are important participants in every step of the process involved in hiring, firing and retaining asset managers. The consultants we spoke with included field and research consultants at firms that represented the largest number of assets under advisement. Throughout the survey, all of the participants were very engaged and highly experienced. The mean years of experience among all respondents was 16.

We were thrilled with the time that our respondents devoted to the survey. This topic is important to them and they were eager to engage in a dialog that helps asset managers understand what is most important to them.

CHESTNUT ADVISORY GROUP

ABOUT THE AUTHORS AND CONTRIBUTORS

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Amanda Tepper, CEO, Chestnut Advisory Group

Before founding Chestnut Advisory Group, Amanda held several significant roles in her over-25-year career across the capital markets, most recently as Global Director of the senior portfolio management team at AllianceBernstein. Amanda led the firm's product specialists as they marketed all of AB's investment products to institutional investors. Amanda has deep experience in sell-side equity research, with multiple recognitions as a member of *Institutional Investor's* "All-America" research team while at JPMorgan, and as Associate Director of Equity Research at Bank of America. She began her Wall Street career on a bond trading desk, moving on to bond sales and investment banking before becoming an equity analyst.

Amanda holds an MBA from The Wharton School and a BA from Brown University, Phi Beta Kappa. She currently serves as Chair of 100 Women in Hedge Funds' Connecticut/Westchester Committee, and is a member of the Phillips Academy's Andover Development Board.

Deborah Bronston-Culp, Senior Advisor, Chestnut Advisory Group

Deborah's career spans over twenty-five years on Wall Street. In addition to serving as a Senior Advisor at Chestnut, she is currently focused on investing in seed rounds of financing for start-up companies. She was previously a Managing Director of Morgan Stanley and Deputy Director of North American Equity Research. Prior to coming to Morgan Stanley, Deborah was Director of U.S. Equity Research at NatWest Securities and spent nearly 15 years at Prudential Securities where she was Associate Director of Global Equity Research, Director of Analytical Training and a top ranked textile and apparel analyst for each of the seven years she was an equity analyst.

Deborah earned her undergraduate degree in Economics from the University of California, San Diego and is a Chartered Financial Analyst (CFA). Deborah is also a Trustee of the University of California, San Diego Foundation and a member of its investment finance committee. Over the past several years she has served on the grant allocations committee of New York Women's Foundation and is a member of Medecins Sans Frontieres (Doctors Without Borders) Association.

Kelly Galvin, High and Low Consulting

Kelly has over 19 years of investment industry experience. She provides consulting services to asset managers and plan sponsors helping them with strategic planning, product positioning, client messaging and manager evaluations. Prior to starting High and Low, Kelly was a Managing Director at Allianz Global Investors, responsible for developing and maintaining key client relationships. Before that she was a Vice President, Relationship Manager of Institutional Marketing and Client Service with Credit Suisse Asset Management and a Senior Performance Analyst with Prudential Securities.

Kelly earned her MBA from NYU's Stern School of Business and her BA from Colgate University. She currently serves as Chair of the Town Pension Board for the town of Darien, CT.

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Investor Survey Conducted for Chestnut Advisory Group by Rivel Research Group

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Gathering, analyzing and interpreting investment community feedback is Rivel's core business. Art Rivel, Rivel Research Group's founder, invented the investor perception study nearly 40 years ago. Through proprietary methods of quantifying anecdotal survey responses, Rivel provides a laser-precision strategic marketing tool that serves as the cornerstone for a client marketing and communication strategy.

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Chestnut Advisory Group specializes in creating and implementing comprehensive investor relations programs for asset management companies. We excel at the four key components of IR for institutional investors: deep capital markets expertise, effective investor communications, real world understanding of the institutional investor marketplace, and sound counsel.